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SENATE

S.B. No. 2105

REC.

Introduced by SEN. WIN GATCHALIAN

AN ACT
PROVIDING FOR THE REGULATION AND ORGANIZATION OF
ISLAMIC BANKS

EXPLANATORY NOTE

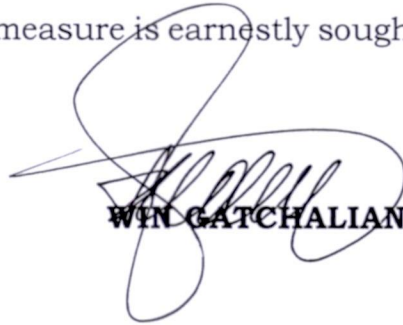
Islamic banking and finance are characterized by risk-sharing and equitable distribution of wealth in the conduct of banking and finance operations consistent with the principles of Shariáh or Islamic law, where undertaking or financing anti-social and unethical businesses and setting of interest or a fixed pre-determined rate of return are prohibited.

Providing a framework where our Filipino Muslim entrepreneurs, especially micro, small and medium enterprises, can effectively access responsive banking and financial services that are compliant with the principles of Shariáh or Islamic law, will further help the government's efforts to develop the Bangsamoro Region as a complement to the Bangsamoro Organic Law. It will likewise enable the country to tap into the growing pool of Islamic investors across the Middle East and Southeast Asia.

With the end view of promoting greater financial inclusion, this bill seeks to establish the legal and regulatory framework for the development of

Islamic financing in the country. It also authorizes the Bangko Sentral ng Pilipinas and its Monetary Board to exercise supervision and regulatory powers over the operations of Islamic banks with the hope of promoting the development of critical inclusive finance reforms and innovations. It also provides for a mechanism to allow tax neutrality in Islamic banking transactions to support the growth of this industry.

In view of the foregoing, the passage of this measure is earnestly sought.



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*Be it enacted by the Senate and the House of Representatives of
the Philippines in Congress assembled:*

1 **SEC. 1. Declaration of Policy.** – The State recognizes the vital
2 role of Islamic banking and finance in creating opportunities for greater
3 financial inclusion especially for the underserved Muslim population,
4 in expanding the funding base for small and medium-sized enterprises
5 as well as large government infrastructure through financial
6 arrangements with risk-sharing as their core element, and in
7 contributing to financial stability through the use of financial contracts
8 and services that are founded on risk sharing rather than speculation
9 in compliance with Shariáh principles.

10
11 **SEC. 2. Definition of Terms.** – For the purposes of this Act, the
12 following definition of terms is hereby adopted:
13

- 1 (a) “Shariáh” refers to the practical divine law deduced from
2 its legitimate sources: the Qur’an, Sunnah, consensus of
3 Muslim scholars, analogical deduction and other
4 approved sources of Islamic law;
- 5 (b) “Current account” refers to the total deposits at an
6 Islamic bank which are repayable on demand and
7 compliant with Shariáh principles;
- 8 (c) “Investment account” refers to the total funds placed by
9 an investor with an Islamic bank for a fixed period of time
10 under an agreement to share the profits and losses on
11 the investment of such funds in accordance with the
12 principles of Shari'ah;
- 13 (d) “Islamic banking business” refers to a banking business
14 with objectives and operations that do not involve interest
15 (*riba*) which is prohibited by the Shari'ah and which
16 conducts its business transactions in accordance with
17 Shari'ah principles;
- 18 (e) “Islamic banking unit” refers to a division, department,
19 office or branch of a conventional bank that conducts
20 business in accordance with the principles of the
21 Shari'ah;
- 22 (f) “Participation” refers to any agreement or arrangement
23 under which the mode of joint investments or specific
24 transactions shall not involve the element of interest
25 charge other than as percentage share in profits and
26 losses of business and which is conducted in accordance
27 with the principles of the Shari'ah;
- 28 (g) “*Riba*” has the meaning assigned to it by Islamic law and
29 jurisprudence as expounded by authoritative sources; in

1 the context of banking business, the term refers to the
2 receipt and payment of interest, including in the various
3 types of lending and borrowing and in the exchange of
4 currencies on forward basis;

5 (h) "Savings account" refers to an account reflecting the total
6 deposits at an Islamic bank which normally require the
7 presentation of passbooks or in lieu thereof, such other
8 legally acceptable documents approved by the Bangko
9 Sentral ng Pilipinas ("Bangko Sentral") for deposit or
10 withdrawal of money;

11 The Monetary Board may, by regulation, further define or clarify
12 the terms used in this Act or commonly used in Islamic banking
13 transactions, consistent with the declared state policy and taking into
14 consideration the peculiar characteristics of Islamic banking.

15
16 **SEC. . Establishment of Islamic Banks.** – The Monetary Board
17 of the Bangko Sentral ng Pilipinas ("Monetary Board") may authorize
18 the establishment of Islamic banks. It may also authorize conventional
19 banks to engage in Islamic banking arrangements, including structures
20 and transactions, through a designated Islamic banking unit within the
21 bank provided that the bank shall have a system for segregating the
22 transactions of the Islamic banking unit from its conventional banking
23 business.

24 The Monetary Board may, under such rules and regulations as it
25 may prescribe, authorize foreign Islamic banks to establish Islamic
26 banking operations in the Philippines under any of the modes of entry
27 provided for under Republic Act No. 7721, as amended. The Monetary
28 Board may regulate the number of participants in the Islamic banking
29 system, taking into account the requirements of the economy, the

1 preservation of the stability of the system, and the maintenance of
2 healthy competition.

3 For purposes of this Act, the Al-Amanah Islamic Investment Bank
4 of the Philippines, other Islamic banks, designated Islamic banking
5 units of conventional banks and foreign banks that are authorized to
6 conduct business in accordance with the principles of Shari'ah shall be
7 referred collectively to as "Islamic Banks" or "Islamic banking system".
8

9 **SEC. 4. Supervision and Regulation by the Bangko Sentral**
10 **ng Pilipinas.** – The Bangko Sentral ng Pilipinas ("Bangko Sentral")
11 shall have regulatory powers and exercise supervision over the
12 operations of Islamic banks. The Bangko Sentral shall issue the
13 implementing rules and regulations on Islamic banking.
14

15 **SEC. 5. Shari'ah Advisory Councils.** – It shall be the
16 responsibility of an Islamic bank to ensure its compliance with Shari'ah
17 principles. For this purpose, it shall constitute its Shari'ah advisory
18 council composed of persons who are qualified in the Shari'ah or who
19 have knowledge or experience in Shari'ah and in banking, finance, law
20 or such other related disciplines. The council shall render advice and
21 review applications of Shari'ah principles, but it shall not involve itself
22 directly in the operations of the Islamic bank or engage in any activity
23 which may give rise to conflict of interest. Nothing contained herein
24 precludes the establishment of a centralized Shari'ah Supervisory
25 Board to ensure that the Islamic banking transactions and products
26 comply with Shari'ah principles.
27

28 **SEC. 6. Powers of Islamic Banks.** – a. In addition to the general
29 powers granted to corporations, Islamic banks shall have such powers

1 as shall be necessary and prudent to carry out the business of a bank
2 in accordance with Shari'ah principles.

3 b. Islamic banks may perform the following banking services:

4 1. accept or create current accounts;

5 2. accept saving accounts for safekeeping or custody with no
6 participation in profit and loss except unless otherwise
7 authorized by the account holders to be invested;

8 3. accept investment accounts;

9 4. accept foreign currency deposits;

10 5. act as correspondent of banks and institutions to handle
11 remittances or any fund transfers;

12 6. accept drafts and issue letters of credit or letters of
13 guarantee, negotiate notes and bills of exchange and other
14 evidence of indebtedness, Provided that, such financial
15 instruments are in accordance with the principles of Shari'ah;

16 7. act as collection agent insofar as payment orders, bills of
17 exchange or other commercial documents covering Shari'ah
18 compliant transactions and do not impose or collect ribah or
19 interest;

20 8. provide Shari'ah compliant financing contracts and
21 structures;

22 9. handle storage operations for goods or commodity financing
23 secured by warehouse receipts presented to the Islamic bank;

24 10. issue shares for the account of institutions and companies
25 assisted by the Islamic Bank in meeting subscription calls or
26 augmenting their capital and/or fund requirements as may be
27 allowed by law;

28 11. undertake various investments in all transactions allowed
29 by Shari'ah principles; and

1 12. such other banking services as may be authorized by the
2 Monetary Board.

3 c. With prior Monetary Board approval, Islamic banks may issue
4 investment participation certificates, *sukuk*, and other Shari'ah
5 compliant funding instruments to be used by the Islamic banks in its
6 operations or capital needs.

7 d. Islamic banks may carry out financing and joint investment
8 operations by way of *mudarabah* partnership, *musharakah* joint
9 venture or by decreasing participation, *murabahah* purchasing on a
10 cost-plus financing arrangement, lease (*ijara*) arrangements,
11 construction and manufacture (*istisna'a*) arrangements, and other
12 Shari'ah compliant contracts and structures, and to invest funds
13 directly in various projects or through the use of funds whose owners
14 desire to invest jointly with other resources available to the Islamic
15 bank on a joint *mudarabah* basis in accordance with the foregoing
16 arrangements, contract and structures.

17 e. With prior Monetary Board approval, Islamic banks may invest
18 in equities of Shari'ah compliant undertakings that directly support the
19 delivery of Islamic banking and financing services.

20 f. Islamic banks may exercise the general powers of a universal
21 bank that are consistent with the principles of Shari'ah.

22
23 **SEC. 7. Ownership and Legal Existence.** – Islamic banks to be
24 created under this Act shall comply with pertinent laws, rules and
25 regulations applicable to a private corporation engaged in banking,
26 such as the Corporation Code of the Philippines, as amended, and the
27 requirements of the respective regulatory agencies. Islamic banking
28 units shall be operated and managed pursuant to a management and
29 organizational structure which should be properly disclosed and

1 segregated from the operations of the parent bank.

2 The capitalization requirements of an Islamic bank shall be equal
3 to that prescribed by the Bangko Sentral for a universal bank. Islamic
4 banks may take the necessary steps to have their shares listed in any
5 duly registered stock exchange.

6
7 **SEC. 8. *Transfer and Acquisition of Substantial***
8 ***Shareholdings.*** – No person shall acquire shares in an Islamic bank
9 that will result in ownership or control, directly or indirectly, of more
10 than ten per cent (10%) of the voting stock of such Islamic bank,
11 without obtaining the prior approval of the Monetary Board. Prior to
12 Monetary Board approval, no such transfer or acquisition of shares
13 shall have legal effect nor shall the same be recognized in the stock and
14 transfer books of the Islamic bank or in the records of any government
15 agency.

16
17 **SEC. 9. *Fit and Proper Rule.*** – In order to maintain the quality
18 of bank management and afford better protection to depositors,
19 investors and the public in general, the Monetary Board shall prescribe,
20 pass upon and review the qualifications of persons who are elected or
21 appointed as directors or officers of Islamic banks and disqualify those
22 found unfit. The Monetary Board shall prescribe the qualifications of
23 bank directors and officers for purposes of this Act.

24
25 **SEC. 10. *Regulatory Standards.*** – Islamic banks shall be
26 licensed and regulated in the same manner as a universal bank. The
27 Bangko Sentral shall prescribe prudential regulations and standards of
28 conduct to promote the sound financial position of Islamic banks and
29 to ensure integrity, professionalism and expertise in the conduct of their

1 business, affairs and activities. These standards shall take into
2 consideration international best practices and principles relating to,
3 but not limited to:

- 4 1. capital adequacy;
- 5 2. liquidity;
- 6 3. corporate governance;
- 7 4. risk management;
- 8 5. related party transactions;
- 9 6. maintenance of reserve funds;
- 10 7. prudential reporting;
- 11 8. investment ceilings and limitations;
- 12 9. prevention of an institution from being used, intentionally or
13 unintentionally, for unlawful activities; and
- 14 10. consumer protection.

15
16 **SEC. 11. *Current Accounts of Islamic Banks.*** – The Bangko
17 Sentral is authorized to open current accounts for Islamic banks for
18 settlement and other purposes under such rules and regulations as the
19 Monetary Board may prescribe. The Bangko Sentral may charge
20 administrative and other fees for the maintenance of such facilities as
21 may be allowed under Shari'ah principles.

22
23 **SEC. 12. *Financial Facilities for Islamic Banks.*** – The Bangko
24 Sentral may, taking into consideration the peculiar characteristics of
25 Islamic banking, formulate rules and regulations for the extension of
26 financial facilities to Islamic banks for purposes provided under
27 Chapter IV, Articles IV and V of Republic Act No. 7653, as amended,
28 otherwise known as the New Central Bank Act.

29 Subject to availability of budgetary support and other funding

1 sources, the Philippine Deposit Insurance Corporation (PDIC) may
2 extend financial assistance to an Islamic bank determined to be in
3 danger of closing in order to prevent such closing or when it is
4 determined by the Monetary Board and the PDIC Board of Directors
5 that the continued operation of such Islamic bank is essential to
6 maintain financial stability in the economy.

7
8 **SEC. 13. *Monetary Stabilization Policy and Tools.*** – The
9 Bangko Sentral, pursuant to the authority of the Monetary Board under
10 Section 61 of Republic Act No. 7653 to constantly assess price
11 developments and outlook, and based on its analysis and evaluation of
12 inflationary pressures, and its policy instruments to attain and
13 maintain price stability, and taking into consideration the peculiar
14 characteristics of Islamic banking, may require Islamic banks to
15 maintain reserves against their deposit accounts and funds held in
16 trust or under investment accounts. The Monetary Board may further
17 identify and authorize the issuance by the Bangko Sentral of other
18 appropriate instruments and measures necessary to implement its
19 monetary policy, including instances of abnormal movements in the
20 price level, taking into account the peculiar characteristics of Islamic
21 banking.

22
23 **SEC. 14. *Tax Neutrality.*** – The Government shall endeavor to
24 achieve neutral tax treatment between Islamic banking transactions
25 and equivalent conventional banking transactions. The Secretary of
26 Finance, upon the recommendation of the Commissioner of the Bureau
27 of Internal Revenue (BIR), pursuant to its rule-making power, shall
28 issue policies and guidelines including rules and regulations to
29 implement tax neutrality conducive to the growth of Islamic banking

1 and finance in the country.

2
3 **SEC. 15. *Sanctions.*** – Any director, officer, employee, auditor,
4 or agent of an Islamic bank who is found guilty of acts or omissions in
5 violation of any provision of this Act and its implementing rules and
6 regulations shall be subject to the sanctions and penalties under
7 Sections 34, 35, 36 and 37 of Republic Act No. 7653, and shall be
8 punished by a fine not exceeding One million pesos (P1,000,000.00) or
9 by imprisonment of not more than five (5) years, or both at the
10 discretion of the court, without prejudice to administrative and criminal
11 sanctions that may be imposed pursuant to existing banking laws and
12 regulations.

13
14 **SEC. 16. *Consumer Protection and Capacity Building***
15 ***Program.*** – The Government shall provide programs for increased
16 consumer awareness and capacity building required by the expanded
17 Islamic banking system.

18
19 **SEC. 17. *Non-Applicability of Selected Acts.*** – In order to
20 achieve the international and domestic objectives of Islamic banking
21 business, the provisions of the following acts and laws shall not apply
22 to Islamic Banks to the extent as herein rendered inoperative:

23 1. the provisions of Republic Act No. 7653, and Republic Act
24 No. 8791, otherwise known as The General Banking Law of 2000,
25 with particular reference to the determination of bank interest
26 rates, loans and discounts, and interest-bearing instruments or
27 charge: Provided that, nothing contained herein shall be
28 construed to impair the powers of the Bangko Sentral to
29 supervise and regulate the activities of Islamic Banks and the

1 Islamic banking system;

2 2. the provisions of Presidential Decree 1445, otherwise
3 known as "The General Auditing Act" and any other enactments
4 thereon inconsistent with this Act; Provided, however, that,
5 nothing contained herein shall preclude the development of an
6 appropriate framework for the auditing of Islamic banks and the
7 Islamic banking system; and

8 3. the provision of Republic Act No. 3591, as amended,
9 otherwise known as the "PDIC Charter" and all laws, regulating
10 insurance companies: Provided, however, that nothing contained
11 herein shall preclude Islamic Banks from the establishment of
12 contemporary Islamic *takaful* (solidarity services) free of *riba*,
13 premiums or interests.

14
15 **SEC. 18. Separability Clause.** – If any provision or section of
16 this Act or the application thereof to any person, association or
17 circumstances is held invalid, the other provisions or sections of this
18 Act and their application to such person, association or circumstances
19 shall not be affected thereby.

20
21 **SEC. 19. Repealing Clause.** – All laws, orders, issuances, rules
22 and regulations or parts thereof inconsistent with this Act are hereby
23 repealed or modified accordingly.

24
25 **SEC. 20. Effectivity Clause.** – This Act shall take effect fifteen
26 (15) days following its publication in the Official Gazette or in two (2)
27 newspapers of general circulation.

28 ***Approved,***