

LEGAL  
ALERT

Philippines  
5 February 2020

**Author****Felix Sy**

Managing Partner  
Insights Philippines  
Legal Advisors (IPLA)  
felix.sy@insights-law.com

**Reeneth B. Santos**

Associate  
Insights Philippines  
Legal Advisors (IPLA)  
reeneth.santos@insights-law.com

## Philippine Central Bank passes Shari'ah Governance Framework

On 13 December 2019, the Monetary Board of the *Bangko Sentral ng Pilipinas* (“**BSP**”) approved the *Shari'ah* Governance Framework (“**SGF**”), which it codified in BSP Circular No. 1070. The release of the SGF is seen as a logical supplement to the passage of Republic Act No. 11439 (“**Islamic Banking Act**”) in August 2019 and the *Guidelines on the Establishment of Islamic Banks and Islamic Banking Units* (“**BSP Circular No. 1069**”) in December 2019, both of which set out the rules governing the organisation, regulation and powers of Islamic banks that will be established in the Philippines.

### Implications for business in the Philippines

Investors and existing banks seeking to establish Islamic banks (“**IB**”) or Islamic banking units (“**IBU**”) are required to comply with the SGF, and make sure that the SGF is already in place on the first day of their operations. In doing this undertaking, those who want to enter the Islamic banking system should recognise BSP’s mandate and supervisory powers over every aspect of their Islamic banking operations, keeping in mind the implications on their reputation and business should they risk not to observe and comply with BSP’s regulations, including the creation of their SGF.

### Significant provisions of the Circular

BSP Circular No. 1070 defines SGF as a comprehensive system that defines a set of appropriate institutional measures, arrangements, requirements, structure and policies of an IB or IBU to ensure that there is effective and independent oversight of *Shari'ah* compliance of its Islamic banking business. The SGF enhances the already existing corporate governance framework applicable to conventional banks, and it is worth noting that BSP Circular No. 1070 sets out only the minimum expectations on the SGF within the IB or IBU.

In general, the implemented SGF should be commensurate with the size, complexity and risk profile of an IB or IBU, with the *Shari'ah* compliance encompassing the various structures and processes within the IB or IBU. Ultimately, the responsibility and accountability for ensuring full compliance with *Shari'ah* principles rest with the Board of Directors, or its equivalent in case of a foreign Islamic bank branch, but the implementation of the SGF itself is the responsibility of the senior management.

### [Shari'ah Advisory Council](#)

Pursuant to the Islamic Banking Act, and in order to ensure that their banking arrangements are *Shari'ah* compliant, IBs and conventional banks with IBUs are required to organise their respective *Shari'ah* Advisory Councils (“**SAC**”) whose function is to render advice and to review how *Shari'ah* principles are being applied to the operations of IBs or IBUs.

The Board of Directors is tasked with drawing up the objectives, duties and responsibilities, and qualification requirements of the members of the SACs, and the authorities required by the SAC to effectively implement its *Shari'ah* rulings, which are considered final under BSP Circular No. 1070.



The SAC likewise has the following minimum responsibilities:

- approval and certification for the product structures and all the documentation thereon;
- rendering opinions or clarifications on *Shari'ah* compliance matters; and
- leading the *Shari'ah* compliance verification of IB or IBU's transactions and operations through an effective internal and/or external *Shari'ah* audit and issuing an annual *Shari'ah* Compliance Statement thereon.

In discharging the above-mentioned duties and other duties that may be given to it by the Board of Directors, the SAC must work objectively and independently. For this purpose, the Board of Directors shall make sure that the SAC is not unduly influenced or pressured by the management and/or its own members. However, the Board of Directors (or the Head of the IBU) is empowered to conduct a periodic formal assessment of the effectiveness of the SAC and its members.

#### Members of the SAC

In accordance with the Islamic Banking Act, the SAC, at the minimum, shall be composed of persons who are qualified in *Shari'ah* or who have knowledge or experience in *Shari'ah* and in banking, finance, law or such other related disciplines. BSP Circular No. 1070 adds that members of the SAC shall also have relevant academic qualifications and experience or exposure on *Shari'ah* compliance. These guidelines give the Board of Directors a wide latitude in doing its duty of coming up with its own criteria.

The appointment of the members of the SAC shall be subject to two phases: endorsement by the Board of Directors after the candidates have passed the vetting process of the Board, and approval of the endorsement by the majority of the stockholders in their annual stockholders' meeting. Since the installation of the members to the SAC is endorsed and approved by the Board of Directors and stockholders, respectively, their dismissal shall likewise undergo the same process.

In case an IB or IBU prefers not to constitute an SAC, BSP Circular No. 1070 allows them to engage the services of a competent *Shari'ah* adviser or consultant whose engagement shall be for a period of three years from BSP's approval of the IB or IBU's application. The *Shari'ah* adviser or consultant shall exercise the same responsibilities and functions given to the SAC.

#### **Conclusion**

The regulatory framework of the BSP which helps to create a resilient and stable financial system will encourage more investors and businesses to invest in Islamic banking operations. Specifically, with the implementation of the SGF guidelines, the BSP is continuing with its indicated initiative of ensuring financial literacy, financial inclusiveness and protection of consumers, investors and other stakeholders.

If you have any questions or require any additional information, please contact [Felix Sy](#) or [Reeneth B. Santos](#) of Insights Philippines Legal Advisors (a member of ZICO Law).

---

*This alert is for general information only and is not a substitute for legal advice.*