



BANGKO SENTRAL NG PILIPINAS

OFFICE OF THE GOVERNOR

CIRCULAR NO. 1070

Series of 2019

Subject: Shari'ah Governance Framework for Islamic Banks (IB) and Islamic Banking Units (IBU)

The Monetary Board, in its Resolution No. 1945 dated 13 December 2019, approved the Shari'ah Governance Framework (SGF) for Islamic banks (IBs) and Islamic banking units (IBUs). This is aligned with the strategic policy of the Bangko Sentral to strengthen corporate governance in its supervised institutions being central to sustaining resilience and stability of the financial system. The guidelines also aim to protect consumers and other stakeholders by requiring that an IB or an IBU of a conventional bank complies with the SGF.

Section 1. Section 139 of the Manual of Regulations of Banks (MORB) is hereby added to the MORB covering the SGF of an IB or IBU relevant to the promotion of Islamic banking and aligned with existing laws and regulations, to read as follows:

139 SHARI'AH GOVERNANCE FRAMEWORK (SGF) FOR ISLAMIC BANKS (IBs) AND ISLAMIC BANKING UNITS (IBUs)

The SGF is 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 complements the existing regulatory corporate governance framework.

As part of the corporate governance framework, the following are the minimum expectations of the Bangko Sentral on the SGF required for an IB or IBU:

a. The SGF shall be commensurate with the size, complexity and risk profile of an IB or IBU. The SGF shall ensure an effective independent oversight of Shari'ah compliance over various structures and processes within the IB or IBU.

b. The essential components of the SGF are the following:

(1) *Effective Board of Directors (BOD) and management oversight over Shari'ah compliance.* The BOD, or its equivalent in case of a foreign Islamic bank branch, shall be ultimately responsible and accountable for ensuring full conformity of the IB or IBU with the Shari'ah principles. The BOD needs to be fully cognizant of the risk of Shari'ah non-compliance and its potential implications on the reputation and business of the IB or IBU. The BOD shall introduce an effective mechanism and oversight on the SGF. The IB or IBU shall ensure continuous enhancement of the competency of the Board, management and all personnel on Islamic banking.

The senior management of the IB or IBU shall be responsible for implementation of the SGF. The relevant policies and procedures on Islamic banking products and services, at a minimum, shall be made available to units concerned and shall

constantly be reviewed and updated to reflect current market practices and developments.

The functions and responsibilities of members of the BOD and the Shari'ah Advisory Council (SAC) shall be embedded in the bank's policies and processes covering its SGF. The terms of reference adopted by the BOD in appointing member to the SAC shall include, at a minimum, the SAC's objective, duties and responsibilities, qualification requirements and the authorities required by the SAC to effectively implement its Shari'ah rulings. All rulings of the SAC on Shari'ah matters shall be final.

- (2) *An independent and effective SAC.* The SAC shall be appointed by the majority stockholders in their annual stockholders meeting upon the recommendation of the BOD pursuant to the IB or IBU's qualification requirements and the minimum prudential expectation set by the Banko Sentral. The BOD shall have a vetting process to ensure the fitness and propriety of the members of the SAC before endorsing their appointment for approval by the stockholders.

The SAC shall discharge its duties independently and objectively. The SAC shall be empowered to consider, decide and oversee all Shari'ah related matters of the IB or IBU. The BOD shall ensure that the SAC is not subject to any undue influence or pressure from the management and/or its own members in the performance of the following minimum functions:

- (i) Approval and certification for the product structures and all the documentation thereon;
- (ii) Rendering opinions or clarifications on Shari'ah compliance matters; and
- (iii) 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.

A dismissal of a member of the SAC shall require recommendation from the BOD and approval by the stockholders. Generally, a member of the SAC may be disqualified if he/she acted in a manner which may cast doubt on his/her fitness as a member of the SAC.

In vetting the fitness and propriety of the members of the SAC, the IB or IBU shall carry out a background check and ensure that a person to be appointed as a member of the SAC shall have the relevant academic qualifications, experience/exposure, and track record indicating the person's general competence on Shari'ah compliance. The IB or IBU, in consultation with the SAC, may also engage lawyers, accountants, economists and such other professionals to assist and advise the SAC on banking, legal, financial, economic and other relevant matters.

To sustain best practices of corporate governance, there shall be a periodic formal assessment of the effectiveness of the SAC and its members by the BOD or the

Head of the IBU. The BOD and the SAC shall meet on a periodic basis to discuss matters of mutual interest. In case of IBU, the SAC shall hold this periodic meeting with at least the Head of the IBU.


An IB or IBU may engage a competent Shari'ah adviser or consultant during the three (3) year period from BSP's approval of its application in lieu of an SAC. The Shari'ah adviser or consultant shall have the same functions and responsibilities of an SAC as prescribed in this Section.

- (3) *Independent and effective compliance and internal audit functions.* The compliance function shall, at a minimum, ensure that the rulings of the SAC when adopted by the BOD, are properly implemented. The internal audit must undertake a review of the Shari'ah compliance at least annually in support of the SAC's annual Shari'ah Compliance Statement. Such statement should be considered in the preparation of the Annual Report of the IB or the conventional bank, in the case of IBU.

The IB or IBU may outsource the Shari'ah compliance and audit functions during the first 3 years of Islamic banking business upon approval thereon by the BOD and with prior notice to the appropriate supervising department of the Bangko Sentral.

Section 2. Effectivity. This Circular shall take effect fifteen (15) calendar days following its publication either in the Official Gazette or in a newspaper of general circulation.

FOR THE MONETARY BOARD:


CHUCHI G. FONACIER
Officer-in-Charge

27 December 2019