

■ PROGRAM ON ESCAPING THE MIDDLE - INCOME TRAP: CHAINS FOR CHANGE

Islamic Finance in the Bangsamoro Autonomous Region of Muslim Mindanao

Opportunities, Challenges, and Paths Forward

*Annette Balaoing-Pelkmans, Jane Lynn D. Capacio,
and Roberto R. Calingo*

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UP CIDS Monograph Series

is published by the

University of the Philippines**Center for Integrative and Development Studies**

Lower Ground Floor, Ang Bahay ng Alumni
Magsaysay Avenue, University of the Philippines
Diliman, Quezon City 1101

Telephone: (02) 8981-8500 loc. 4266 to 4268 / (02) 8426-0955

Email: cidspublications@up.edu.ph

Website: cids.up.edu.ph



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ISSN 2719-0722 (Print)

ISSN 2719-0730 (Online)

Cover image credit

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Abbreviations

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ASEAN	Association of Southeast Asian Nation
BARMM	Bangsamoro Autonomous Region in Muslim Mindanao
BSP	Bangko Sentral ng Pilipinas (Central Bank of the Philippines)
BTA	Bangsamoro Transition Authority
CARD MRI	CARD Mutually Reinforcing Institutions
EMIT C4C	Escaping the Middle-Income Trap Chains-for-Change
ISF	Islamic Social Finance
MSME	Micro, Small, and Medium Enterprises
NWM	North Western Mindanao Front of the Moro Islamic Liberation Front
PAB	Philippine Amanah Bank
PEF	Peace and Equity Foundation
SDG	Sustainable Development Goals
SME	Small and Medium-sized Enterprises
SSB	Shari'ah Supervisory Board
UP CIDS	University of the Philippines Center for Integrative and Development Studies

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Acknowledgement

Funding for this action research on Islamic Financing was provided by the UP CIDS and the Peace and Equity Foundation. The authors thank the members of the action research impact team namely Maria Pia Villapando and Danica Marra Soliman of the Peace and Equity Foundation and Rio Marie Delgado, Shalom Floro, and Omairah Usman of EMIT C4C for their insights and assistance.

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UP CIDSS
UNIVERSITY OF THE PHILIPPINES
CENTER FOR INTEGRATIVE AND DEVELOPMENTAL STUDIES

ISSN 2619-7278 (Print)
ISSN 2619-7286 (Online)

Policy Brief
2025-09

PROGRAM ON ESCAPING THE MIDDLE-INCOME TRAP: CHAINS FOR CHANGE
PROGRAM ON DATA SCIENCE FOR PUBLIC POLICY

Islamic Finance: Needed, Wanted, but Unavailable

How Can Government Promote Islamic Finance in the Philippines?

Jane Lynn D. Capacio¹ and Juan Carlos Rodriguez²

Abstract

We overlaid sentiment analysis onto our ongoing project on Islamic finance and discovered that the sentiments toward Islamic finance are generally positive. However, there are a number of negative sentiments, such as concerns about “risks,” which suggest that the literature perceives risks either in the design or implementation of Islamic financing. The preliminary findings of our project, combined with the results of the sentiment analysis, underscore the important role of government agencies in disseminating information and enhancing public knowledge on Islamic finance. Successful models of Islamic finance could be supported to scale up or expand. More importantly, the government, particularly the Bangsamoro Autonomous Region for Muslim Mindanao (BARMM), is encouraged to take a proactive role in developing industry plans and promoting investments and entrepreneurship. This would help attract Islamic financial institutions to set up operations in the region. With these measures in place, Islamic finance, which is much needed and highly sought after, may become more available and accessible.

¹ The sentiment analysis of this policy brief is an output of the Webinar on Spatial and Text Data Mining Analytics organized by the UP Center for Integrative and Developmental Studies (UP CIDSS) Data Science for Public Policy (DSPP) held on 29-31 July 2024. Prior to the conduct of sentiment analysis, the data review of literature, and analysis on Islamic finance were outputs of the Islamic Finance Project of the UP CIDSS Escaping the Middle-Income Trap: Chains for Change (EMT-C4C) Program and the Peace and Equity Foundation (PEF). This policy brief is part of a more comprehensive forthcoming publication of EMT-C4C and PEF. Funding for the Islamic Financing Project came from PEF and UP CIDSS.

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The cover of the proceedings features a blue background with a photograph of a mosque. The title 'Proceedings on the Stakeholders' Meeting on Islamic Financing' is written in large, bold, white text. Below the title, it specifies the date and location: '6 September 2024 at the Peace and Equity Foundation'. It also credits the documentation by Julliano Yzabelle Viota and editing by Jane Lynn D. Capacio. At the bottom, there are logos for UP CIDSS and the Center for Integrative and Developmental Studies.

Proceedings 2025-05

Proceedings on the Stakeholders' Meeting on Islamic Financing

6 September 2024 at the Peace and Equity Foundation
Documented by Julliano Yzabelle Viota
Edited by Jane Lynn D. Capacio

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ISLAMIC FINANCE IN THE BANGSAMORO AUTONOMOUS REGION OF MUSLIM MINDANAO

Opportunities, Challenges, and Paths Forward

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ABSTRACT

This monograph is a product of action research on Islamic finance involving academics, policymakers, financing institutions, civil society, and Sharia scholars. It contains a literature review and the results of discussions with key stakeholders resulting in a comprehensive scoping of the history, policies, and initiatives on Islamic finance. The recommendations and paths forward for pursuing Islamic finance in the Bangsamoro Autonomous Region for Muslim Mindanao (BARMM) lies in the combination of fast-tracking institutionalization of Islamic finance through policies and the gradual community-based development of Islamic finance models at the grassroots level. There is a need to continue the capacity building of policymakers, regulators, financial institutions and communities on Islamic finance and to equip grassroots players on financial literacy and in the development and documentation of models of Islamic finance.

Research Objectives and Scope

Each time there is renewed focus on advancing Muslim Mindanao, attention inevitably shifts to the significance of enhancing Islamic finance. Such was the case in 1973 with the establishment of Amanah Bank, and it is once again evident during the period leading up to the creation of the Bangsamoro Autonomous Region in Muslim Mindanao (BARMM). This recurring emphasis arises because Islamic finance is intricately tied to the cultural and religious fabric of the region's predominantly Muslim population, making it a crucial element of any comprehensive strategy for economic and social progress.

Islamic finance is uniquely suited to meet the specific financial needs of Muslim communities by offering services that adhere to Sharia principles and promote social justice, ethical investments, and inclusive growth. The consistent return to Islamic finance in development initiatives highlights its potential to improve financial inclusion, particularly in a region where conventional financial systems may lack accessibility or cultural relevance. Its principles of risk-sharing, the prohibition of interest (*riba*), and the emphasis on real economic activities align with local values, encouraging broader participation in economic endeavors.

Moreover, Islamic finance is seen as a vital tool for addressing social and economic inequalities, which are often underlying causes of conflict and instability in the region. By fostering equitable financial practices, Islamic finance supports the broader goals of peacebuilding and sustainable development in Muslim Mindanao.

However, despite the recognized importance of Islamic finance, its establishment and growth within the Philippines have faced significant challenges. Amanah Bank, the country's pioneering Islamic financial institution, has struggled with various operational difficulties over the years, including periods of near default and ongoing issues related to governance, capitalization, and market penetration. These challenges have hindered the widespread adoption and deep-rooted establishment of Islamic finance in the region. The scarcity of Islamic banking and financing services through the years underscores the inherent difficulties in promoting this financial model in the Philippines, especially in the BARMM. The limited availability of such services not only reflects the operational hurdles faced

by existing players but also highlights the broader societal and economic barriers that must be addressed to create an environment conducive to the growth of Islamic finance in the region.

This monograph provides an overview of the key issues surrounding Islamic finance critically examines the evolving landscape of Islamic finance in the Philippines, focusing on both its strategic role in the development of BARMM and the challenges it faces in becoming a deeply rooted component of the region's financial system.

This research aims to achieve the following objectives:

1. Analyze the current landscape of Islamic finance in the Philippines, especially in the BARMM;
2. Identify specific challenges and deficiencies that hinder the broad adoption and effective implementation of Islamic finance principles in the BARMM;
3. Understand community needs, perceptions, and preferences regarding Islamic finance; and
4. Propose actionable strategies and policy recommendations that will establish Islamic finance as a viable and effective vehicle for the development of the BARMM.

The paper is structured as follows. The following section provides a brief overview of Islamic, its principles, and its global significance. Section 3 examines the landscape of Islamic Finance in the Philippines and the BARMM; Section 4 looks at the challenges and opportunities, as well as the needs and preferences of interviewed communities in reference to Islamic Finance. The paper ends with policy recommendations for various stakeholders, including government agencies, financial institutions, and community leaders, to promote Islamic finance in the BARMM.

Brief Review of Literature on Islamic Financing

The body of literature on Islamic financing has notably expanded, particularly over the past five to six years. This growth is likely a reflection of the increasing global awareness of the viability and success of Islamic finance models. As more countries and financial institutions around the world experience the benefits of these models, there has been a heightened interest in exploring and documenting their potential for broader application.

This literature review aims to highlight the key principles of Islamic finance, explore the various financial instruments and practices associated with it, and identify the remaining challenges as documented in the existing literature. The purpose of this review is to help us contextualize the current state of Islamic financing in the Philippines, particularly within the BARMM, and to better understand how these global insights can be applied to the unique context of the region.

WHAT IS ISLAMIC FINANCE?

Islamic finance, being rooted in Islamic law or Sharia, is inherently founded on moral and ethical principles. As a consequence of this ethical foundation, Islamic finance is characterized by equity in financial transactions, ethical behavior in business practices, and environmental and social responsibility in investments and financial decisions. The moral underpinnings of Sharia law thus shape Islamic finance into a system that prioritizes fairness, ethics, and sustainability alongside financial considerations.

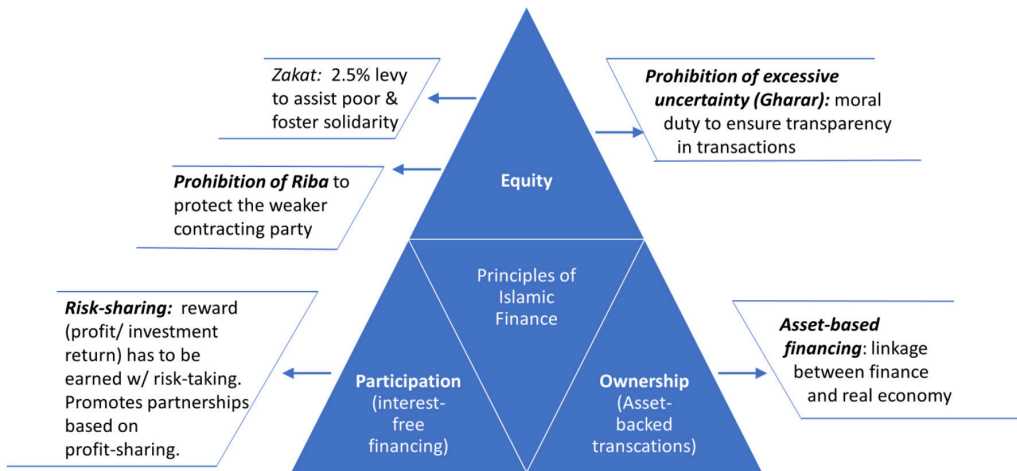
For many, Islamic finance is not merely a financial system but a way of life, closely linked to the broader concept of Halal, which governs not only what is permissible in food and commerce but also in all aspects of ethical living.

Islamic finance is governed by three core principles: equity, participation, and ownership (Hussain, Shahmoradi, Turk 2015). The principle of equity prohibits predetermined payments (*riba*) and excessive uncertainty (*gharar*) or ambiguity in contracts, ensuring a fair distribution of wealth, transparency, and protection of

the weaker party in financial transactions (usually the borrower). The principle of participation emphasizes the importance of risk-taking and productivity, meaning investment returns must be linked to asset performance rather than the mere passage of time. Lastly, the principle of ownership requires that one can only sell what they own, ensuring that transactions are tied to real assets and fostering a strong link between finance and the real economy.

While Islamic finance is fundamentally rooted in moral principles of equity and solidarity, its operational framework is significantly shaped by the Sharia's unique perspective view on money. This view of money forms the basis of several key principles in Islamic finance (Hussain, Shahmoradi, Turk 2015):

1. In Islamic finance, money is seen primarily as a medium of exchange rather than a commodity that can be traded for profit. This perspective prohibits the earning of interest on money lending, as it is considered an unjustified increase in wealth without productive activity.
2. The Sharia's view of money encourages risk-sharing in financial transactions. This is reflected in the principle that "reward (profit) comes with risk-taking." As a result, Islamic finance favors equity-based financing over debt-based financing, promoting partnerships where both parties share in profits and losses.
3. The Islamic view of money and wealth encourages the use of ethical filters in financial activities. This means avoiding investments in industries considered harmful or unethical, such as alcohol, tobacco, gambling, or weapons.



■ **Figure 1.** Principles of Islamic Finance. Source: Authors' illustration based on IMF (2015)

One of the misconceptions about Islamic finance is the view on profits. It is not that profits are forbidden, but rather that they must be based on productivity and risk-taking. This principle ensures that wealth is shared and not merely accumulated, promoting social solidarity and equity.⁴

Islamic finance therefore differs from conventional financing in three main aspects: (1) imposition of interest; (2) risk-sharing; (3) penalties for late payments. While commercial finance earn interest from capital, Islamic finance does not consider capital as more important or as separate factor of production as labor and land.

4 There are several Christian principles that can be likened to or share similarities with the principles of Islamic Finance. While the specific implementations may differ, both religious traditions emphasize ethical and moral approaches to financial dealings. Both Christian and Islamic traditions emphasize the concept of stewardship - the idea that wealth and resources are entrusted to individuals by God, and should be managed responsibly. Many Christian denominations, historically, have discouraged or prohibited usury (charging excessive interest). This aligns with Islamic Finance's prohibition of riba. Christian principles often encourage avoiding investments in industries considered unethical (e.g., weapons, tobacco, gambling), similar to Islamic Finance's avoidance of forbidden (haram) industries. Both traditions emphasize the importance of using wealth for the betterment of society, including charity and supporting the less fortunate. Christian teachings stress honesty and fairness in business transactions, which aligns with Islamic Finance's emphasis on transparent and equitable financial practices. Both traditions discourage excessive accumulation of wealth and promote moderation in financial matters. Some Christian financial principles, like those found in Catholic Social Teaching, emphasize the importance of linking finance to the real economy, similar to Islamic Finance's focus on asset-backed transactions. Some Christian approaches to finance, particularly in earlier times, favored risk-sharing arrangements over pure debt, which is similar to Islamic Finance's preference for profit-and-loss sharing structures. Both traditions increasingly emphasize the importance of environmental responsibility in financial decisions. While these similarities exist, it is important to note that Christian finance is not as codified or universally applied as Islamic Finance, and practices can vary widely among different Christian denominations and individuals. However, the underlying ethical principles often share common ground.

This stems from the way money is valued in Islamic finance. Since money has no intrinsic value and is only a medium of exchange, earning interest on a medium of exchange without bearing risks is not consistent with the principles of Islamic finance (Rahman N.D.).

Moreover, everyone who contributes capital or money to a business or enterprise should assume the risk of losing their capital. In the same way, the contributor of capital should also be entitled to a proportional share in the actual profit (Siddiqi 1983, 99). Islamic financing is deemed “fair” to entrepreneurs who usually bear the risk of the business by carrying the management of the enterprise. Where the capitalist or commercial economic system seems to favor the provider of capital by giving them secure returns regardless of the enterprise’s earnings, Islamic financing shares the risks between the entrepreneur and capital provider. Instead of fixed returns on capital (interest), earnings should be proportionally divided based on net profit, which is earned only after rent, wages, and other costs are paid. Risks must be involved otherwise the gains from the enterprise are not seen as profit but as interest and thus, haram (illegal).

ISLAMIC FINANCE INSTRUMENTS

Thaker et al. (2020) provide a valuable overview of the theoretical and practical aspects of Islamic banking and finance, particularly focusing on the needs of small businesses. Figure 2, based on their work, presents a modified and simplified version of the various types of instruments used in Islamic finance and banking.

The most common type of Islamic financing instrument is the so-called *Murabahah*, which is a form of buy and sell financing wherein the finance provider buys an asset specified by the consumer and then sells it back to the client (usually in installments) at a higher price. The main benefits are its transparency, fixed financing, and absence of required collateral.

Ideally, most of the benefits of Islamic financing, especially for entrepreneurs, stem from more equity-based instruments, which emphasize profit and loss sharing (Thaker et. al. 2020). The two key instruments are: *Mudharabah*, and *Musharakah*, which are both partnership models similar to joint venture agreements. While profits are both shared according to pre-agreed ratios, the difference is that in the *mudharabah*, losses are borne only by the capital provider, while in *musharakah*, losses are borne proportionately to each partner’s capital contribution.

All these three major instruments are asset-based, but *murabahah* is also defined as debt-based, due to the possibility of paying in installments.

For enterprises, one of the more useful instruments is *Ijarah*, which is a leasing agreement, where the lessor buys the asset and leases it to the client for a fixed period in exchange for rental payments. This ensures that the lessor retains the ownership of the asset and assumes the risks linked to the asset throughout the lease period. The typical assumption is that the ownership can eventually be transferred to the lessee.

Another enterprise-friendly instrument is *Salam financing*, especially for those in a stable value-chain partnerships with end buyers. *Salam* provides upfront capital to producers to fund their production activities, and help solve the typical problem of sourcing seed capital. Risks are mitigated in a value-chain context where there is explicit coordination with end buyers who can build stable relationships with suppliers and finance providers.

One of the key elements to ensure the success of the risk-sharing model is the provision of insurance mechanisms and instruments to mitigate risks. *Takaful*, which means “mutual guarantee or solidarity,” refers to Islamic insurance where parties or policyholders pool their money into a system to guarantee each other against loss or damage. Each contribution is based on the type of coverage they need and their personal circumstances. The *takaful* contract specifies the nature of the risk and the length of the coverage, akin to a conventional insurance policy but *takaful*, which is increasingly being combined with principles of *mudaraba*, incorporates profit-and-loss sharing where policyholders become partners in the insurance company (Warde 2000 p. 148).

If the need for liquidity is the problem, then *Ar-Rahn* and *Tawaruq* provide Sharia-compliant channels to acquire immediate cash. *Ar-Rahn* is an Islamic pawn broking system where a valuable object is used as collateral for a loan. If the borrower fails to repay the debt, the collateral can be sold to satisfy the debt. *Ar-Rahn* is considered permissible under Islamic law, as it avoids interest (*riba*) and provides a transparent and fair transaction. *Tawaruq* is a method of obtaining cash by buying a commodity on a deferred payment basis and sells it to a third party for immediate cash.

Table 1. Islamic vs Conventional Finance

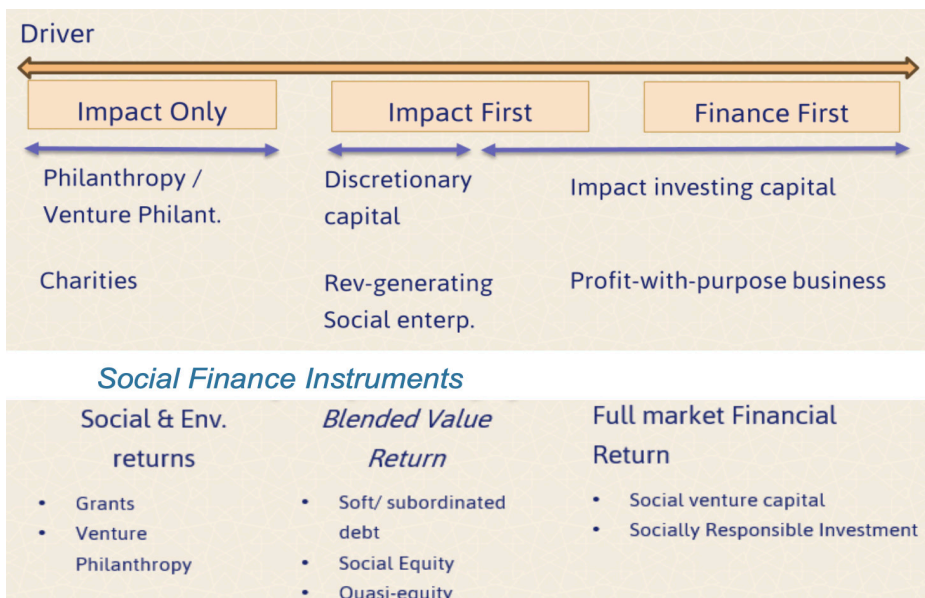
ISLAMIC FINANCE	CONVENTIONAL FINANCE
Murabahah: seller and buyer agree to the cost and markup of an asset; cost-plus financing	Consumer loans; short-term trade financing
Mudharabah: capital provider assumes the financial risks while participating in a profit-sharing agreement. Bank depositors take on the role of investors, entrusting their capital to the bank, who then acts as a fund manager, deploying the capital in various investments.	Profit-sharing investment; joint venture; bank functions as a fund manager; equity investments; venture capital. Investors provide capital and share in the profits or losses generated by the fund manager's investment decisions .
Musharakah: Profit and loss sharing agreement between capital provider and borrower.	General partnerships, joint venture, cooperative business, limited partnerships.
Ijarah: lease financing whereby the legal title of the leased asset passes at the end of the ijarah (or lease term), provided that all ijarah installments are settled (Hanif, 2016)	Finance lease receivable: recorded at the fair value of the leased asset (Hanif 2016); interest is charged once the contract is signed, irrespective of whether the asset is actually available for use or not
<i>Al-Bai Bitthaman Ajil</i> : deferred payment sale where ownership is transferred upon contract signing; price paid in installements. The bank earns profit from the markup charged to the consumer.	Installment sale agreement; hire purchase; personal loans for purchase; retail financing; lease-purchase agreements
Salam: forward sale contract; buyer pays in advance for goods delivered at a future date.	Value-chain financing (interest/credit-based)
Takaful: cooperative insurance; pooling of funds based on principal of ta'awun or mutual aid	Insurance (prohibited under Sharia as it constitutes a major uncertainty [Hanif 2016])
<i>Al-Qard Al-Hassan</i> : no-interest bearing, collateral-free loan on the basis of benevolence (ihsan).	Zero-interest personal loans provided out of goodwill
<i>Wadiah</i> : safekeeping deposit; bank keeps the depositor's money and returns it on demand, with no fixed return to the depositor, though the bank may at its discretion give a gift, or hibah, to the depositor.	Time-deposit
<i>Qard hassan</i> : benevolent loans, flexible repayment based on capacity to pay	Interest-free loan; collateral-free, requiring repayment of the face value of the loan within a specified period.

■ Source: Modified version from De Castro (2022)

Islamic Social Finance

Islamic Social Finance (ISF) encompasses traditional Islamic institutions such as *zakāt* (almsgiving), *ṣadaqah* (charity), and *waqf* (endowments), alongside mutual cooperation mechanisms like *qard* (loans) and *kafālah* (guarantees), and modern Islamic microfinance institutions. The primary goals of ISF are to alleviate poverty, promote economic justice, and foster inclusive participation and shared prosperity, aligning with the values of Islamic philanthropy. Despite its potential, actual *zakāt* collections fall short due to perceived incompetence and a lack of trust in *zakāt*-related institutions. Enhancing the professionalism, integrity, transparency, and governance of these institutions could make *zakāt* collections more sustainable and impactful.

Islamic microfinance is considered superior to conventional microfinance as it integrates elements of philanthropy and cooperation, avoiding the profit-seeking nature that can lead to debt spirals. Social finance, which ISF is a part of, prioritizes social and environmental returns alongside financial returns, often termed "blended value investing." This approach contrasts with conventional finance by focusing on total blended outcomes for multiple stakeholders, addressing issues such as market failures, social inequality, and environmental degradation. By fostering credibility and efficiency, ISF has the potential to significantly alleviate poverty and promote social inclusion (Azman and Ali 2019).



■ **Figure 2.** Spectrum of Social Finance and Instruments. Source: Authors' illustration based on Azman and Ali (2019)

Social finance instruments cover three primary themes: "social and environmental return," "blended value return," and "full market financial return." These instruments include grants, venture philanthropy, subordinated debt, equity, quasi-equity, social venture capital, and Socially Responsible Investment (SRI). Their placement on this spectrum depends on the stakeholder's goals for social and financial outcomes. For instance, instruments like zakāt and waqf are geared towards social and environmental returns, while SRI şukūk are oriented towards full market financial returns.

Diniyya (2019) examines how a waqf-based microfinance model can offer Sharia-compliant financial services aimed at poverty alleviation, effectively addressing issues related to capital, human resources, and project financing while mitigating risks such as credit risk and moral hazard.

Waqf-based microfinance models tackle challenges like credit risk and moral hazard through various strategies. By employing social collateral via group-based microfinancing, these models reduce credit risk by leveraging peer pressure to ensure repayments. This approach is practical for the poor, allowing them to make small weekly instalments rather than a lump sum payment.

Box 1. Indonesia's Dompfet Dhuafa Model

In Indonesia, the National Sharia Council was established by the Indonesia Council of Ulama or MUI. The National Sharia Council was mandated to treat all issues regarding activities and operations of Islamic financial institutions. It issues fatwa (a ruling on a point of Islamic law). A Sharia Supervisory Body (SSB) is established in every financial institution to ensure that the institution operates in conformity with Sharia law. In Indonesia, the National Sharia Council is not under the government (as compared to Malaysia) but the government endorses fatwas and supervises SSBs. Fatwas are non-binding unless endorsed by the government.

To get the National Sharia Council to issue a fatwa, a financial institution may first appeal for a possible fatwa from the National Sharia Council that will study the matter. Five to six members will draft the fatwa. It will be approved or disapproved by the National Sharia Council. A disapproved fatwa may be considered through additional studies. All fatwas must be compliant with the standards issued by the International Financial Services Board.

Domfet Duafa gives numerous lessons that could be considered in developing Islamic financing in the Philippines. DD's formula for reducing poverty is to intervene in five aspects: economic, health, education, culture, and religion.

DD provides a host of social and financial products and services akin to what Iqbal (2007) refers to as "financial products superhighway" (p.10). It manages waqf and zakāt. It has DD Travel especially used for pilgrimage (hajj). It has a CSR Fokus that handles donations from private companies. DD tracks the donations and keeps donors updated on where the money goes (either charity or soft loans). It is engaged in trading (DD Niaga). The products from the Economic Empowerment Program are sold in the Daya Mart, a store in one of DD's offices. The organization also has a construction company, a pharmacy, and a publishing firm. It has an asset management firm (Wasila Nusantara) that manages waqf. It has schools and hospitals. Schools include Smart Eklesensia for poor families, semi-commercial schools, a business school, and a corporate university. In the DD hospital, 50 percent of the patients are paid by zakāt (charity) and 50 percent by government.

To get out of the cycle of poverty, DD's explicit aim is to scale up. If only a small capital is awarded to entrepreneurs, it would be difficult to guarantee that they could scale up. Noticeable were DD's eventual shifts from integrated farming programs to industrial level of production. There is a very deliberate aim to scale by levelling up its empowerment program for farmers.

DD's efforts imply that it is not enough to have a financing structure, there is a need for a DD-like organization that stimulates the creation of trust through revealed practice of values and virtues.

- Source: Documentation of the Technology Learning Exchange (TLE) Partnership: Successful Solutions in Poverty Alleviation Initiatives through Islamic Microfinance. April 23-29, 2018 at Dompfet Dhuafa Office, Jakarta, Indonesia.

ISSUES AND CHALLENGES

Although the Islamic finance industry has made significant progress, it still grapples with substantial challenges, including the necessity for standardized regulatory frameworks, a broader array of product offerings, effective risk management practices, and enhanced stakeholder trust. Addressing these issues is crucial for cultivating a more robust and compliant Islamic finance sector that truly reflects Islamic values while adequately meeting the financial needs of diverse communities.

Regulatory Frameworks and Product Diversity

A significant obstacle in Islamic finance is the absence of standardized regulatory frameworks across different regions, coupled with high transaction costs. These factors restrict the effective utilization of Islamic finance products, particularly for small and medium-sized enterprises (SMEs). SMEs tend to favor Islamic financing options like *murabahah* and *bai bithaman ajil* due to their stability and risk-sharing features. However, the prevailing tendency towards debt-based financing limits product diversity, emphasizing the necessity for a strategic transition towards equity-based solutions such as *mudharabah* and *musharakah* to promote financial inclusivity and resilience (Haron and Ibrahim 2016).

In terms of implementation, the absence of standardized practices complicates implementation, as fatwas issued by Sharia boards can vary significantly. This discrepancy leads to differences in the application of Islamic finance by institutions with their respective Sharia Supervisory Boards (SSBs). As a result, reaching a consensus on internationally accepted products, services, and procedures is difficult (Banaga, Ray, and Tomkins 1994). Warde (2000) advocates for collaborative discussions to address these challenges and find common ground regarding global practices in Islamic finance.

Takaful and Insurance

The role of Takaful (Islamic insurance) is crucial for safeguarding investments. Nevertheless, current insurance frameworks within the Islamic finance sector often fall short of aligning with Sharia principles (Adekoya 2022). This misalignment highlights the urgent need for effective Takaful systems that not only protect investments but also adhere to Islamic law. This need is particularly pronounced in regions like the Philippines, where Islamic banking encounters additional

limitations arising from a small Muslim demographic and challenging market conditions (Ali 2022).

Understanding Social Impact

There is a notable gap in understanding how Islamic social finance impacts society. Specifically, it remains ambiguous how investments conform to the *Maqāṣid al-Sharī'ah* (objectives of Islamic law) and contribute to the Sustainable Development Goals (SDGs). The absence of comprehensive guidelines for measuring social impact has garnered criticism, particularly regarding the industry's emphasis on legal compliance with Sharia principles at the expense of broader ethical and social objectives. Additionally, perceived incompetence and a lack of trust in Islamic social finance institutions impede their potential to generate meaningful social impact (Azman and Ali 2019).

Formalist Deadlock and Compliance Issues

Despite advancements in the Islamic finance sector, a contentious issue persists: the excessive focus on legalistic and mechanistic aspects of Sharia compliance and financial returns. This predicament, termed the "formalist deadlock" by Balz (2010), suggests that Islamic finance practices often prioritize adherence to Islamic legal norms while overlooking their fundamental objectives. As a result, many Islamic finance institutions tend to replicate conventional financing structures, placing greater importance on regulatory compliance rather than genuinely reflecting Islamic principles. Chapra reinforces this perspective, noting that the development of the Islamic financial system has only partially aligned with Islamic ideals and remains constrained by traditional financial frameworks (Azman and Ali 2019).

Unique Risks in Islamic Banking

Islamic banks encounter distinct challenges that set them apart from conventional financial institutions. These challenges comprise Sharia compliance risk, resulting from diverse scholarly interpretations of product legitimacy, as well as displaced commercial risk, where banks are compelled to provide competitive returns, potentially jeopardizing shareholder profits (Hussain et al. 2016). Furthermore, Islamic banks face increased equity risk through profit-and-loss-sharing arrangements, relying on business risks instead of traditional interest-based contracts. To mitigate these challenges, Islamic banks could benefit from

developing standardized international regulations to enhance Sharia compliance, as well as establishing prudential reserves, such as the Profit Equalization Reserve and Investment Risk Reserve, to stabilize profits and manage potential losses.

Reducing Moral Hazard and Enhancing Governance

To effectively manage equity risks in mudharabah and musharakah contracts, Islamic banks must strengthen their risk management frameworks. This can be achieved by integrating conventional risk management tools that align with Sharia principles, such as internal rating systems and maturity matching. Moreover, implementing a comprehensive liquidity risk management framework – including Sharia-compliant lender-of-last-resort facilities – can address liquidity challenges effectively. Improving transparency and governance regarding prudential reserves will further mitigate moral hazard risks and ensure that stakeholders, particularly investment account holders, remain well-informed (Hussain et al. 2016).

Perceptions of Islamic Banking

Research conducted by Islam et al. (2024) reveals discrepancies between managers and clients regarding the implementation of Islamic marketing by conventional banks with Islamic banking windows in Bangladesh. Clients frequently express scepticism regarding the Shari'ah compliance of these windows. Concerns center around the integration of interest-bearing and non-interest-bearing operations, raising doubts about the separation of funds and management practices. This skepticism underscores discussions surrounding the principles of halal (permissible) and haram (forbidden) transactions, emphasizing the need for strict adherence to Islamic norms.

Challenges in Islamic Finance Markets

The Islamic finance industry in Asia encounters unique challenges, such as the lack of liquid and active Sukuk markets, which restrict investor trading opportunities. Presently, only Malaysia and Iran possess fully established Islamic money markets capable of effectively managing domestic liquidity. Furthermore, the shortage of Sharia-compliant high-quality liquid assets hinders Islamic banks' ability to fulfil the requirements set by the Basel III liquidity coverage ratio, thus revealing critical gaps that need to be addressed.

Taxation Issues

Tax considerations also pose a challenge within the Islamic finance landscape. Interest, as a cost of doing business, is typically tax-exempt. However, the markup from lenders is considered part of the overall profit and thus subject to taxation. It is imperative to address this concern and pursue appropriate measures with relevant authorities, such as the Bureau of Internal Revenue (BIR), to clarify and potentially reform these tax implications.

Areas for Improvement

Further improvements on a global scale include developing well-functioning secondary markets and introducing liquidity-enhancing and risk-sharing products (Iqbal 2007). Currently, Islamic banks predominantly operate with a limited array of short-term traditional instruments, resulting in a shortage of products for medium- to long-term maturities. This limitation prevents the securitization of dormant assets and their removal from balance sheets. For Islamic finance portfolios to flourish, establishing robust secondary markets is essential; without them, the system cannot operate at its full potential (Iqbal 2007). The need for innovative financial engineering to manage risks, liquidity, and investment challenges is paramount.

OPPORTUNITIES

If implemented effectively, Islamic banking has the potential to offer more affordable, interest-free financing alternatives, presenting significant advantages over conventional banking practices (Bananuka et al. 2020). Such financing mechanisms could help promote financial inclusivity, benefitting both Muslims and individuals from other faiths seeking accessible banking solutions. These opportunities are available to mainstream Islamic finance in the Philippines. However, these require partnerships to consolidate action.

Growth and “Standardization” of Islamic Banking

Key global institutions and regulatory bodies are pivotal in fostering the growth and standardization of Islamic banking practices (Ali 2022). In Bahrain, for instance, the Bahrain Monetary Agency has significantly contributed to the Islamic banking sector by promoting academic and intellectual initiatives alongside regulatory frameworks. The presence of organizations such as the Accounting and Auditing Organization for

Islamic Financial Institutions (AAOIFI) and the Islamic International Rating Agency (IIRA) in Bahrain bolsters the credibility and standardization of Islamic financial practices. Collectively, these initiatives demonstrate how regulatory bodies and key institutions play a crucial role in nurturing the Islamic banking sector across various regions (Ali 2022).

Islamic Finance and Financial Inclusion

Islamic financing has expanded opportunities for individuals to adhere to Islamic principles while becoming financially viable. It provides alternative banking mechanisms that promote inclusion, thereby enabling broader access to financial services. The rapid growth of Islamic finance is evident as it gains traction worldwide in both Muslim-majority and non-Muslim countries. Major banks, including Citigroup, HSBC, J.P. Morgan, and Standard Chartered, are among the market leaders offering Islamic financing products through their Islamic windows (Day 2003).

SUMMARY

Islamic finance presents a compelling alternative and inclusive economic system with considerable potential for growth. Essential to its successful implementation are robust regulatory frameworks, strong governmental support, heightened public awareness, and the development of innovative financial products. The experiences of countries such as Malaysia and Indonesia offer insightful lessons that other regions can learn from, particularly in the context of the Philippines. By harnessing these insights and addressing existing infrastructural and societal challenges, the growth and impact of Islamic finance can be significantly enhanced, ultimately fostering greater financial inclusion and socio-economic development.

At its core, Islamic finance should encompass a wide-ranging ecosystem of financial instruments that enable clients to adhere to their values as Muslims. When evaluating the effectiveness of Islamic finance, it is pertinent to consider several key questions: Do individuals have access to invest, even minimally, through savings (e.g. waqf) and shared ownership of small enterprises? Are they able to contribute to charitable causes (zakāt) and support the poorest members of society, thereby investing in their spiritual well-being, regardless of the amount? Can they benefit from cooperative insurance systems (takaful) that enable them to be both donors and beneficiaries in times of crisis, such as illness or loss?

These inquiries underscore critical insights from the literature. First, Islamic finance extends beyond conventional notions of banking, borrowing, and lending; it must also facilitate avenues for charitable giving and savings, catering to both productive endeavours and periods of hardship. Second, there is a pressing need to expand the range of Sharia-compliant financial services, as many essential options — such as money markets and interbank facilities for short-term liquidity — are currently unavailable. Consequently, institutions offering Islamic financial services may need to function as "supermarkets of financial products," providing a one-stop shop where clients can access both banking and non-banking services (Iqbal 2007). Adopting this "all-in" service model could be a strategic direction for current and aspiring providers in the Islamic finance sector.

Landscape of Islamic Finance in the Philippines

HISTORICAL OVERVIEW AND CURRENT DEVELOPMENTS

The Philippines has a long history with Islamic finance, being home to the oldest Islamic financial institution in the world. Islamic banking in the country began in the early 1970s with the establishment of the Philippine Amanah Bank (PAB) through Presidential Decree No. 264 by President Ferdinand Marcos in 1973. This initiative aimed to implement Islamic banking principles, such as profit-loss sharing and interest-free transactions, specifically to cater to the financial needs of the Muslim population in the country. Despite this early start, Islamic finance in the Philippines has largely languished due to various challenges, limiting its growth and impact over the decades (World Bank 2016).

Among the factors contributing to the underdevelopment of Islamic finance in the Philippines is the lack of regulatory support that has historically hindered the integration of Islamic banking principles within the country's predominantly conventional banking system. The absence of a robust regulatory framework made it difficult for Islamic banks to operate efficiently and competitively. Additionally, when the Development Bank of the Philippines (DBP) assumed control of Al-Amanah, which evolved from PAB, the institution encountered significant constraints stemming from a lack of specialized knowledge and resources essential for the effective management of an Islamic financial entity. This gap in expertise further stymied the bank's development and ability to adapt to Islamic banking standards.

Geographically and demographically, Al-Amanah's was initially mandated to serve the Autonomous Region of Muslim Mindanao, which curtailed its growth potential and limited its customer base. Compounding these challenges, the relatively small size of the Muslim population in the Philippines, which represents a minority, created less favorable market dynamics for Islamic banking to thrive (Ali 2022). Moreover, competition from well-established conventional banking sector posed strong competition, making it difficult for an Islamic bank to gain significant market share.

Amanah was re-chartered in 1990 as the Al-Amanah Islamic Investment Bank of the Philippines (AAIIBP) with a capital of Php 1 billion. It aimed to expand Islamic banking but continued to struggle due to high operating expenses and non-performing loans. The bank continued to rely on the support from the Bureau of Treasury to manage its operation, which suggests that the bank continued to face financial and operational difficulties. It eventually came under the control of the Development Bank of the Philippines in 2008 to stabilize its operations, and in 2009, the Monetary Board of the Bangko Sentral ng Pilipinas (BSP) approved a five-year rehabilitation plan indicating the need for significant restructuring.

THE 2019 ISLAMIC FINANCING LAW: A MILESTONE

The passage of Republic Act No. 11439 in 2019 marked a significant milestone in the development of Islamic finance in the Philippines. This law, which provides for the regulation and organization of Islamic banks, opened the Islamic finance space to new players beyond the longstanding Al-Amanah Islamic Investment Bank. The BSP now has the authority to license additional Islamic banks and allow conventional banks to set up Islamic banking units, thus broadening the reach and accessibility of Islamic financial services in the country. Additionally, Islamic financing instruments are now made available to Muslims and non-Muslim clients alike.

R.A. No. 11439 triggered a more focused approach to Islamic Banking by the BSP, which issued several circulars and memoranda to support the implementation of the Act. Initially, Islamic banking was guided and monitored by a task force within the Central Bank, today, a dedicated unit is established under Assistant Governor Atty. Arifa Ala, that is proactively driving new initiatives.

In January 2024, CARD Philippines made history by becoming the first conventional bank in the Philippines to open an Islamic banking window. Building on this momentum, Maybank Philippines followed suit in August 2024 by submitting an application to operate its own Islamic banking window.

To advance the development of Islamic banking and finance and diversify its funding sources, the Bangko Sentral ng Pilipinas recently issued its inaugural sukuk, successfully raising USD 1 billion from the global Islamic financial market.⁵ The sukuk issuance was significantly oversubscribed, with demand nearly five times the amount offered, highlighting strong investor interest. This enthusiasm reflects a desire among investors to diversify beyond Saudi Arabia, coupled with confidence in the Philippine government's financial stability and the promising potential of Islamic finance in the country. The sukuk was structured using *ijarah* (lease), *wakalah* (agency), and commodity *murabahah* (cost-plus-profit margin sale) arrangements.

REGULATORY FRAMEWORK

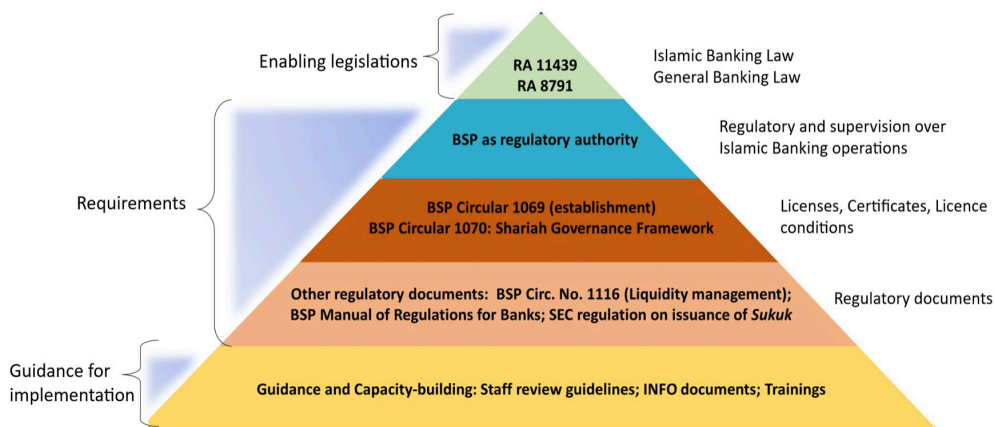
As illustrated in Figure 4, the regulatory framework for Islamic finance in the Philippines is built on several key component. It is primarily governed by the Islamic Banking Law or R.A. No. 11439, which provides the legislative foundation for Islamic banking and finance in the country, as well as the General Banking Law R.A. No. 8791, which establishes the general regulatory environment within which all banking institutions, including Islamic banks, operate. The BSP, the central bank of the Philippines, plays a crucial role in regulating both conventional and Islamic banks under a unified framework, requiring Islamic banks or windows to comply with the same set of regulations as conventional banks, with additional guidelines to address the unique aspects of Islamic banking operations. Moreover, the BSP aims to enhance its Shariah governance framework through ongoing reviews so supplemental guidelines are tailored-fitted to Islamic finance including revised rules on capital requirements, reporting standards, and liquidity management for Islamic banks and banking units.⁶

The next essential component involves the set of requirements such as licenses, certificates, along with clearly defined licensing conditions outlined in key BSP

5 In 2015, there were two applications for Sukuk issuance (by National Home Mortgage Finance Corporation and the First Metro Investment Corp. (in partnership with Malaysia's CIMB Bank). But these did not push through due to the absence of a regulatory framework for Islamic Finance. See: Paolo G. Montecillo, "Lack of rules delays 'sukuk' bonds issuance," *Inquirer*, 19 October, 2015, <https://business.inquirer.net/200932/lack-of-rules-delays-sukuk-bonds-issuance>.

6 https://www.bsp.gov.ph/Pages/FinancialStability/Islamic%20Banking/docs/Summary%20Guide%20for%20Islamic%20Bank%20License%20Applicants_updated%20as%20of%2017%20June%202025.pdf

circulars and other regulatory documents. Another vital element of the framework is the Sharia governance structure, which ensures that Islamic banks operate in compliance with Islamic principles, particularly the prohibition of interest and the avoidance of using capital for haram activities such as gambling and alcohol.⁷ Finally, effective implementation guidance is necessary, alongside capacity-building to enhance the capacity of both regulators and market participants in delivering Islamic financial services, including specialized training.



■ **Figure 3.** Elements of Islamic Finance Regulatory Framework. Source: Authors’ own illustration

CHALLENGES FACING ISLAMIC FINANCE IN THE PHILIPPINES

Despite the progress made, several urgent gaps in the regulatory framework need to be addressed to fully support the growth of Islamic finance in the Philippines. One significant challenge is the absence of a comprehensive legislative framework for

7 The Shari’ah Supervisory Board (SSB), as established under RA No. 11054, plays a crucial role in promoting Islamic banking and finance in the BARMM. It also complements the Bangko Sentral ng Pilipinas (BSP)’s Shari’ah Governance Framework for Islamic banks and banking units. The SSB represents a convergence of expertise in Islamic jurisprudence and contemporary finance, strengthening Shari’ah oversight while aligning with conventional governance frameworks. Its mandate includes issuing opinions on Islamic banking transactions and products within the BARMM. Additionally, the BSP, financial institutions, and other stakeholders may request the SSB’s opinion on matters related to Islamic banking and finance. The following is its composition: Chair: Muhammad Nadzir S. Ebil (dean of graduate studies and College of Shari’ah at Jamiat Cotabato and Institute of Tech); Dep. Chair Ashraf Bin Md Hashim (Chairman of Shari’ah Advisory Council of Bank Negara Malaysia; Salih Musa (Phil rep to world assembly of Muslim youth); Abdulwahid A. Inju (from Tawi-tawi); DOF usec Bayani Agabin; Mohammad S. Yacob; Dr. Rusni Binti Hassan (Dean of Institute of Islamic Banking and Finance at International Islamic University Malaysia and Chairperson of Shari’ah Committees of various Islamic financial institutions in Malaysia); Natl Comm on Muslim Filipinos (NCMF) Div chief Aleah S. Marabur.

Islamic finance. Although the BSP has some flexibility to promote Islamic finance, a more robust legislative foundation is necessary to strengthen the industry.

A comprehensive legislative framework for Islamic finance refers to a well-defined and cohesive set of laws, regulations, and guidelines that govern all aspects of Islamic finance within a country. Such a framework would address the unique requirements and principles of Islamic finance, ensuring that financial products, services, and institutions operate in full compliance with Sharia law. The absence of this framework means that the regulatory environment may lack the specificity, clarity, and legal support needed to sustain the growth and development of the Islamic finance industry.

For example, a comprehensive framework might include specific laws that regulate Islamic financial products like sukuk, takaful, and murabahah. These laws would clearly define how these products are issued, traded, and supervised, distinguishing them from conventional financial instruments. Additionally, the framework would mandate that all Islamic financial institutions establish a Sharia board, composed of qualified Sharia scholars, to oversee and approve their operations, thereby ensuring consistency and credibility.

Furthermore, such a framework could include tax provisions that address the unique nature of Islamic finance transactions, preventing issues like double taxation that could arise from multiple sales or leases of assets. It would also incorporate accounting standards tailored to Islamic finance, ensuring that financial transactions are transparently reported and audited. Moreover, the framework might establish specialized courts or tribunals for resolving disputes related to Islamic finance, where judges or arbitrators with expertise in both Sharia law and conventional legal systems can ensure fair rulings. Finally, it would likely include measures to promote awareness and understanding of Islamic finance among consumers and businesses, along with educational programs and certifications to build a knowledgeable workforce. Overall, a comprehensive legislative framework would provide the legal and regulatory foundation necessary to support the distinct needs of the Islamic finance industry, promote its growth, and ensure it operates within both national law and Sharia principles.

Another critical area is the development of Sharia expertise within the country. Establishing a core group of Sharia scholars who can validate transactions as compliant with Islamic principles would help ensure uniformity and credibility in Islamic finance operations.

Furthermore, there is a pressing need to increase market development and awareness of Islamic finance products among potential consumers and investors. This includes enhancing financial literacy and educating the public on the benefits and principles of Islamic finance. Lastly, the development of supporting infrastructure, such as legal, regulatory, and supervisory frameworks, is essential to facilitate the growth of Islamic finance. This effort would benefit from adopting best practices from international standard-setting bodies like the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

SUMMARY

The Philippines has a long history with Islamic finance. Islamic banking in the country began in the early 1970s, but it was only in the last five years that Islamic finance started thriving. Moving forward, the next essential component involves the set of requirements including licenses, certificates, along with clearly defined licensing conditions outlined in key BSP circulars and other regulatory documents. An important element of the framework is the Sharia governance structure, which ensures that Islamic banks operate in compliance with Islamic principles, particularly the prohibition of interest and the avoidance of using capital for haram activities.

At the supply side, effective implementation guidance is necessary, alongside capacity-building to enhance the capacity of both regulators and market participants in delivering Islamic financial services. At the demand side, financial literacy is important to ensure that borrowers know how to use the money. This latter point is elaborated in the next chapter.

The Landscape of Islamic Finance in the BARMM

Islamic finance in the Philippines is still in its formative stages, despite recent legal and policy efforts aimed at fostering its growth. Nowhere is this more evident than in the Bangsamoro Autonomous Region in Muslim Mindanao, where the challenges and opportunities for Islamic finance are uniquely pronounced.

One of the most critical issues facing BARMM is its alarmingly low level of financial inclusion. The region, which has the highest concentration of Muslims in the Philippines, is also the most underserved in terms of financial services. It has only a total of 43 branches (out of a total of 13,066 nationwide), two-thirds of which are in the Maguindanao province (BSP, 2024).⁸ That constitutes to around 1.6 banks (and 4.4 ATMs) per 100,000 adults, and 0.35 banks per square kilometer. This is considerably lower than the national average and other regions, such as the National Capital Region (NCR), which have a much higher density of bank branches and ATMs.⁹ The financial exclusion in BARMM is therefore, more pronounced than in other parts of the country.

Debuque-Gonzales and Corpus (2024) analyzed the main barriers to financial inclusion in the BARMM. These include: distance from financial institutions, high banking costs, lack of documentation, and lack of trust in financial providers. In their survey a significant proportion of individuals in the region cite "too far away" (41.4 percent) and "too expensive" (54.1 percent) as reasons for not having a formal account, highlighting the prevalence of involuntary exclusion due to these factors. Additionally, approximately 69.7 percent of the financially excluded attribute their lack of access to financial services to a lack of money, further compounding the challenges in this area.

8 This consists of 36 regular banks, 2, thrift banks, 1 Islamic Banking window, and 4 so-called Branch-lite units. See: Philippine Deposit Insurance Corporation, "Philippine Banking System Distribution of Deposits," PDIC, https://www.pdic.gov.ph/files/BSStats/DDD_PBS_ProvinceMunicipality.htm; <https://www.bsp.gov.ph/SitePages/Statistics/BSPhysicalNetwork.aspx>

9 Bangko Sentral ng Pilipinas, "Report on the State of Financial Inclusion in the Philippines," Bangko Sentral ng Pilipinas, 2018, https://www.bsp.gov.ph/Media_And_Research/Year-end%20Reports%20on%20BSP%20Financial%20Inclusion%20Initiatives/2018/Financial_Inclusion_2018.pdf

In a predominantly Muslim region, the lack of Sharia-compliant financial products can deter people from using conventional banking services. This cultural mismatch is a barrier to financial inclusion, as many residents prefer financial products that align with their religious beliefs

The legislative and regulatory environment for Islamic finance in BARMM has been shaped by several key developments. The Charter of the Amanah Islamic Bank, established by R.A. No. 6846, clearly states that the bank's purpose is to promote and accelerate the socio-economic development of the region through Islamic banking, financing, and investment operations. This mandate was further reinforced by the 2019 Bangsamoro Organic Law (R.A. No. 11054), which specifies the BARMM government's participation in the governance of the Amanah Bank. The renewed push for Islamic banking, exemplified by R.A. No. 11439, illustrates the growing recognition of the importance of Islamic finance in the region's development. This law, signed by President Rodrigo Duterte, aims to unlock the full potential of Islamic financing and promote financial inclusion, particularly for Muslim Filipinos in BARMM.

In addition to these legislative efforts, the BARMM government is taking concrete steps to enhance its financial infrastructure. For instance, the Bangsamoro Transition Authority (BTA) has called for the acquisition of the Al-Amanah Islamic Investment Bank, either through cession from the national government or by purchasing shares.

Moreover, the introduction of the Bangsamoro Revenue Code marks a significant milestone as the first law in the Association of Southeast Asian Nation (ASEAN) to integrate Islamic finance into a regional tax system. The code aims to enhance Islamic banking by including provisions for various Islamic financial instruments, while also addressing concerns about potential taxation overlaps and their implications for educational institutions. Public consultations are currently underway to gather feedback and assess the impact on taxpayers.

Other ongoing efforts to improve financial inclusion in BARMM include Parliament Bill 164, also known as the Bangsamoro Microfinancing Act of 2021. This bill aims to establish an affordable and accessible micro-financing program specifically designed to support micro-enterprises in BARMM, particularly targeting the poorest populations. This initiative is crucial for enhancing economic opportunities and supporting local businesses in the Bangsamoro area.

GRADUAL PROGRESS OF ISLAMIC FINANCE IN THE BARMM

The pressing need for financial access in the BARMM has driven non-profit organizations to establish a presence in the region. Among the most notable is ASA Philippines Foundation, a leading microfinance institution that has been actively involved in Islamic financing. The foundation initiated its Islamic finance program on July 4, 2014, in Taguig City, with a focus on Muslim women who often avoid conventional financial institutions due to religious beliefs. The program started modestly, offering *ard Hassan* (interest-free loans) to twelve clients.¹⁰

Encouraged by the success of this pilot initiative, ASA Philippines expanded its operations to the BARMM in late 2016, after carefully studying Islamic finance practices in countries like Malaysia, Indonesia, and Bangladesh. By 2018, the program had broadened its reach to support Muslim women throughout the Philippines, offering financial products such as *murabahah* and *ijarah*. These products were designed to empower women economically, enabling them to grow their businesses and improve their socioeconomic status.

As of June 2024, ASA Philippines has established 37 branches in the BARMM, staffed by 269 employees and serving 38,112 clients. The foundation's total financing portfolio in the region has surged to Php 15 billion, a significant increase from Php 541 million in 2021. The repayment rate in the BARMM has also improved, reaching 89.27 percent in 2024, up from 87.13 percent in 2021. This high repayment rate challenges the notion that Islamic microfinance in the BARMM is risky, underscoring the model's viability and sustainability. Additionally, the portfolio risk has decreased from 6.23 percent in 2021 to just 3.49 percent in 2024, further highlighting the program's success.

ASA Philippines' approach in the BARMM emphasizes community empowerment, with 50 percent of its portfolio in the region sourced from borrowers' savings. This strategy allows the branches to operate with a degree of financial independence. Moreover, when additional funding is needed, ASA provides cash advances rather than loans, ensuring that its operations remain Sharia-compliant.

10 <https://www.asaphil.org/history-of-islamic-financing-program/> (temporarily unavailable due to system maintenance)

Four years after the landmark signing of the Islamic Banking Act, a second provider of Islamic finance formally commenced operations in BARMM. On January 22, 2024, CARD Bank Inc., a microfinance-focused bank under the CARD Mutually Reinforcing Institutions (CARD MRI), inaugurated its first Islamic banking branch in Cotabato City. This branch was established under the provisions for Islamic banking windows, marking a significant step in offering Sharia-compliant financial services to the local community. According to CARD-MRI's founder, Aristotle Alip, the model they are using is based on the Dompét Dhuafa Shariah financing model of Indonesia.¹¹

CARD's entry into the BARMM began in 2018 with the launch of the Paglambo Project, a Sharia-inspired microfinancing program. Initially, the program operated through two offices serving 56 Muslim families in Marawi, Lanao del Sur, and Shariff Aguak, Maguindanao. Within just one year, it expanded to serve over 4,000 families. By June 2022, the Paglambo Project had grown significantly, with 54 units operating in Lanao del Sur, Maguindanao, Zamboanga City, Basilan, and Tawi-Tawi, and more than 76,000 clients. The project achieved a capital build-up exceeding 164 million pesos and maintained an impressive loan repayment rate of 99.35 percent. Notably, the unit in Kapatagan, Maguindanao, achieved a 100 percent repayment rate in 2021, even amidst the challenges posed by the COVID-19 pandemic.

The success of the Paglambo Project is largely attributed to its Sharia-compliant financial products and services. For example, the project includes an education loan program based on the Islamic concept of Murabahah. In this system, the borrower uses funds from the lender to purchase goods for their business, with both parties agreeing on a fixed mark-up. This structure allows the lender to earn a profit without charging interest. Additionally, the project introduced a Kafalah Islamic contract to the existing financing options to address the financial needs of families for their children's education.

Beyond offering tailored financial products, the program emphasized cultural sensitivity in its operations. All staff received training to respect local customs, and the program's introduction included courtesy calls to Muslim elders and coordination with village leaders and local organizations. Effective communication

11 Dompét Dhuafa is a non-profit organization that received the Ramon Magsaysay Award of 2016 for "its example of incorruptibility, diligence, vision and leadership of the highest ethical standards in public service."

was crucial, as demonstrated by the success of the Kapatagan unit, where the manager's ability to explain that the Paglambo financial products were halal, or in accordance with Islamic principles, contributed to the program's growth.

The Paglambo Project illustrates that financial inclusion in Muslim areas can be successfully achieved through Islamic microfinance.¹² Government support for community-based organizations providing Sharia-compliant products is vital, particularly by investing in infrastructure to improve access to remote areas. In addition to increasing funding for financial services aimed at the poor and vulnerable, the government could allocate Islamic financing to support micro, small, and medium enterprises (MSMEs) offering halal products and services. Encouraging partnerships between public and private providers would further extend the reach of these services to more Muslim communities.

In August 2024, Maybank Philippines inaugurated its first Islamic banking unit in Zamboanga. It offers Shariah-compliant products that align with Islamic principles.

CASE STUDIES FROM THE FIELD

The engagement of the Peace and Equity Foundation (PEF) in Islamic financing initiatives within the Bangsamoro Autonomous Region in Muslim Mindanao (BARMM) represents a strategic move to further its mission of promoting social enterprises and development in rural communities.¹³ This decision aligns seamlessly with PEF's overarching goal of supporting sustainable economic growth in underserved areas, particularly in the culturally and religiously diverse region of BARMM. This section aims to delve into PEF's experiences in Islamic financing

12 See: <https://www.cardmri.com/cardinc/?p=750>

13 The Peace and Equity Foundation (PEF), a non-profit organization established in October 2001 in Quezon City, Philippines, is dedicated to fostering social enterprises and advancing development initiatives, particularly in rural communities. With a vision to create self-sustaining and resilient households, PEF focuses on promoting socio-economic solutions, building capacities, and fostering collaboration to achieve a collective impact. For over two decades, PEF has implemented an area development approach, encouraging synergy across social enterprises and providing interventions that lead to sustainable economic and non-economic growth. The foundation works closely with people's organizations, public and private institutions, and like-minded partners to develop models and best practices for scaling up social enterprises. Guided by values such as service to the poor, seeking better solutions, constructive stakeholder participation, prudent stewardship of resources, and openness to knowledge sharing, PEF aims to drive positive change in poor Filipino communities by supporting social enterprises that provide viable livelihoods and improve access to basic services.

within BARMM, offering insights into the challenges and opportunities of a community-based approach to Islamic finance.

The action research project conducted fieldwork to supplement the online interviews and the review of secondary documents. The fieldwork was designed to cover three areas in Mindanao which are populated by Muslims to provide depth of analysis through case studies.

These case studies are important because within the Bangsamoro region's cultural richness and diversity, the merger of religious influences to local culture can vary between tribes. There are 16 major ethnolinguistic groups, all of whom are considered "lumad," and they include: Maranao, Maguindanaon, Tausug, Kalagan, Iranun, Palibugan, Yakan, Sama, Badjao, Jumamapun, Palawan, and Molbog. Between these tribes exist cultural differences that carry a mild prejudice for another who is not of their own, especially within the business sector. The integration of Islamic principles with the local customs and behavioral dynamics significantly contribute to the complex cultural mosaic in the economic sector.

For instance, Maranaos and Maguindanaons, residing in mainland Mindanao, exhibit a very strong adherence to Islamic laws and customs, which are evident in their legal systems, educational practices, and even community rituals. Both are enterprising within the agriculture and trade sectors, engaging more closely to non-Muslim communities, with more middle-class children pursuing studies in various universities outside of the main regions. The Tausugs and Yakans are deeply intertwined with Islamic teachings, influencing their social hierarchy, conflict resolution methods, and even their artforms. Since intermarriage between Tausugs and Yakans are more prevalent, with both tribes establishing dominance over the inter-island regions of the Bangsamoro, trade and enterprise between both tribes are considered equitable by both. Badjao and Sama communities, while predominantly Islamic as well, are more fluid with their beliefs blending traditions from their deeply maritime lifestyle. They have the least adaptation to conventional ways of living and earning, due to the limited exposure of most community members.

These differences reflect their appreciation of enterprise, money, and credit. These are highlighted in this section. Select members of the impact team went on fieldwork to the following areas:

1. Lanao del Norte and Lanao del Sur to interview key partners of EMIT C4C who were former combatants under the Northwestern Mindanao Front of the Moro Islamic Liberation Front (NWMF). The fieldwork occurred intermittently from May 15 to June 15, 2024. Among those who were also interviewed were Aleem Anwar Radiamoda, Ph.D., of Mindanao State University who is an expert in Islamic financing;
2. Basilan Province to interview key stakeholders from the island provinces. The fieldwork was held on May 27-29, 2024 and the interviews included Mayor Hanie Bud of Maluso, Basilan and Dusib Durapan, former General Manager of the Basilan Electric Cooperative; and
3. Cotabato City and General Santos City to cover the partners of PEF on Islamic financing particularly Kadtabanga Foundation, Katiyakap Inc., and the Bangsamoro Women Commission / Federation. These organizations received funds from PEF to pilot test Islamic microfinancing. The fieldwork was held on August 3-6, 2024.

The fieldwork resulted in case studies which are discussed in this section. The case study research method (Cresswell 2007; Yin 2018) investigates a contemporary phenomenon – Islamic financing – in-depth and within its real-world context (Yin 2018). The three case studies will cover contextual conditions to understand explanations on where people access credit (if they could access credit) and why.

Lanao del Norte and Lanao del Sur

It was believed that during the Marawi Siege in 2017, a crucial need for Islamic financing could have prevented victims of the siege to fall into debt traps. The lack of formal and accessible financial institutions resulted in an increase of informal borrowing with 54 percent of adults turning to informal and unregulated lenders for emergency cash and capital according to a report done under the National Strategy for Financial Inclusions 2022-2028. Previously in 2017, only 39 percent of the population of adults in Marawi City incurred debt with lenders. This practice of borrowing and lending, particularly among microentrepreneurs, lacks the formal financing options which continuously contributes to the prevalence of informal lending with high interest rates.

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of formal and accessible financial institutions resulted in an increase of informal borrowing with 54 percent of adults turning to informal and unregulated lenders for emergency cash and capital according to a report done under the National Strategy for Financial Inclusions 2022-2028. Previously in 2017, only 39 percent of the population of adults in Marawi City incurred debt with lenders. This practice of borrowing and lending, particularly among microentrepreneurs, lacks the formal financing options which continuously contributes to the prevalence of informal lending with high interest rates.

EMIT C4C has been partners with base camp leaders and members of NWMF since the former has conducted action research on business-for-peace in abaca and banana in their area. EMIT C4C gathered a team of academics, civil society, public and private sector in training the headquarters and base camp leaders in project planning, management, finance, monitoring, and evaluation from 2020 to 2021. The training culminated in the provision of seed fund per camp to undertake livelihood projects. The projects were dressmaking, abaca production and processing, a sari-sari (variety) store, and two printing services. Most of the camps were able to establish or renew their cooperative which they now tap for providing access to credit to members, establishment of mutual aid benefits, and distribution of dividends.

These enterprises faced challenges including lack of access to formal and Islamic credit or microfinance that could meet the expansion or growth requirements of their enterprises. While they needed funds to increase their capital, the cooperatives /base camps did not borrow from microfinance institutions even if these were available. The following were their reasons:

1. Risk aversion - The cooperatives are wary of not being able to pay the loan amount and leaders and members having to personally use their own funds to meet the obligation. Hesitation is especially felt when they feel a slump in economic activities. While formal financial institutions are available including ASA Microfinance, some of the cooperative members have had negative experiences from formal financial institutions or have heard of negative experiences making them hesitate to borrow.
2. Strict loan condition - The stringent requirements, transaction cost to fulfill the requirements, and strict loan tenor make borrowing unattractive to cooperatives.

3. High interest rates - Since *riba* is present in usual loan agreements, including that of ASA microfinance, then it is considered as haram in Islam. Unfortunately, in most cases, the interest is deemed to be high. In these situations, borrowing does not suit their cultural, religious, and economic beliefs.
4. Focus on self-reliance - Given the limitations and risks of borrowing from formal sources, cooperatives from the base camps would rather rely on their own resources and contributions from members rather than borrow.

This study found out that labor service as payment for credit is practiced in BARMM especially in Lanao del Norte and Lanao del Sur. When a borrower is financially constrained and cannot pay for the loan, s/he agrees to provide labor services as repayment. This is prevalent among relatives.¹⁴

Basilan and Zamboanga City

In Basilan, the average rate of interest established by registered lenders is between 10 to 12 percent interest per month. Reports of other informal lenders register up to 30 percent interest rates, which are deemed unscrupulous.

Within the communities of the Tausug is a traditional financial tool unique to their tribe called a *Pagsanda*, which is an informal method of credit where they lend and borrow money without formal interest rates or collateral. This system is fully based on trust and social relationships within their communities, and borrowers and lenders are often related by consanguinity or affinity, which helps to ensure repayments. In and within the family of the borrower, it is made known that a debt is owed, and when repayments are needed, the terms can vary. With *Pagsanda*, the terms for repayment are very flexible and adaptable, as this is deeply rooted in Tausug culture and where formal financing institutions are scarce. To this day, *Pagsanda* helps maintain social relationships and community cohesion and it serves as a very foundational aspect in Tausug culture and their trade economy, allowing opportunity for underserved communities.

14 Grateful to Assad Baunto for discussing this during the stakeholder meeting on September 6, 2024 at the PEF office.

Cotabato City and General Santos City

Kadtabanga Foundation, Katiyakap Inc, and the Bangsamoro Women Commission/Federation were three of the four partners of PEF that were provided with funds so they can implement Islamic microfinance among their members and other stakeholders. They were also part of the study visit in Indonesia so they and PEF could learn about Islamic financing through the experiences of Domfet Duafa. The experiences of the three organizations provide valuable lessons on screening borrowers, business/financing model, mechanisms for implementing Islamic financing, and implementation challenges.

Kadtabanga Foundation implemented mudarabah and musharakah among women, farmers, and local community cooperatives. Kadtabanga provided loan and capacity building to local organization partners who are mostly farmers groups and directly to individuals who needed support for their enterprises. They set up a Sharia Advisory Council who monitored and approved the loan mechanisms. Before they released loans, they conducted orientation for the borrowers. They found that many of their partners and borrowers had difficulty understanding the concept of halal income. Part of the mechanisms of Kadtabanga Foundation was to require that a witness and co-maker be secured prior to the granting of loan. These were important in making sure that there was a social cost to borrowing.

Katiyakap Inc. implemented mudarabah, musharakah, and ijara to members of their local community. Particularly with mudarabah where clients request for funding to purchase assets like motorcycles, Katiyakap partnered with those who have regular sales or income but could not afford paying for the asset. Prior to the rollout of Sharia-compliant financing, Katiyakap Inc. knew that they face challenges like the long period of repayment which is an exposure to risk that problems would be experienced by the borrower leading to inability to pay the loan. There is also the challenge of the majority of Muslims not following payment agreements. Like Kadtabanga Foundation, Katiyakap set up a Sharia Advisory Board that emphasized to borrowers the importance of following agreements and providing advice on loan and assistance mechanisms. In some cases, the Sharia Advisory Board allowed the repossession of motorcycle units, which they sold, and after getting their payment from the sale, they provided the excess to the borrower. Katiyakap Inc. was strict in implementation and repayment terms. They also performed background checking and investigation of loan applicants. They also asked borrowers to look for loan guarantor and witness.

The Bangsamoro Women Commission/Federation loaned to women with small enterprises and farmers whom they taught to make beauty soap (Palamanis Whitening Soap). They did not yet obtain a Food and Drug permit but sales were good with repeat customers coming from Mindanao, Cebu, Metro Manila and even outside of the Philippines. They had plans to also sell online via Shoppee and Lazada but they faced multiple challenges like having to source their raw materials including chemicals from Manila. Their supply chain was severely hit by the pandemic. In 2023 when their customers started coming back, Typhoon Paeng caused devastation to the borrowers.

ISLAMIC FINANCE: HELPED ADDRESS THE CHALLENGES TYPICAL TO BUSINESS AND FINANCING MODELS

The major challenges of Kadtabanga Foundation, Katiyakap Inc., and Bangsamoro Women Commission/Federation were on running a business and financing model than on implementing an Islamic financing model. Their main concerns were on screening the right borrowers (those with capacity and willingness to pay), having the right business/financing model (e.g., soap making which was severely tested during the pandemic and the subsequent typhoon), and enforcement of loan agreements.

It could be even argued that Islamic financing mechanisms helped address the problems given the huge help of the religious leaders who were in the Sharia Advisory Council/Board of both Kadtabanga Foundation and Katiyakap Inc. Katiyakap was able to implement a successful mudarabah scheme because they correctly used reputation and social ties not only in policymaking but in motivating borrowers to pay. They also used guarantors, witnesses, co-makers and written contracts to enable repayment.

Key challenges in BARMM¹⁵

There are a number of challenges to undertaking and mainstreaming Islamic finance in the BARMM. Some of the major challenges concern not Islamic finance per se but its ecosystem in the region.

¹⁵ EMIT C4C and PEF are grateful to the attendees of the stakeholder meeting who increased our understanding of BARMM and Islamic finance through a discussion of opportunities and challenges.

Islamic finance could thrive in the BARMM if there would be a demand for it from the private sector and other potential users in the region. The cost of setting up banking and financial service operations is high but would be palatable if industries thrive. There is a need for the BARMM government to set up the business environment so market players could undertake business and require Islamic financing. The regional government needs to undertake a clear roadmap for the development of key industries and how these could be supported by the public and private sectors.

Key to the mainstreaming of Islamic finance, as noted earlier in this chapter, is financial literacy because Islamic finance requires that both creditor and lender understand contracts. It is important for borrowers to fully comprehend “what would I use the money for?” because the tangible asset behind it would be the core of the contracting agreement. It is also important to address property rights in the region because Islamic finance rely on assets. If there are uncertainties about who owns and has access over properties like land then these could not be used in Islamic finance.

Finally, there are also concerns that government and non-government programs which provide financing and other programs and services free of charge crowd out formal finance providers. The dole out of various kinds of goods could be a deterrent for the thriving of formal finance including Islamic finance in the region.

One of the ways that the challenges could be addressed is by setting up a Ministry of Religious Affairs or a similar institution in the region that will protect and oversee religious matters. This bureau would not only serve the Muslim population but also provide a broader mandate to ensure the protection of life and religion for all people within the Bangsamoro region. This ministry could also monitor and regulate Islamic financial activities, including zakah (obligatory charity), to ensure compliance with Islamic principles.

SUMMARY

Islamic finance is needed and wanted especially in the BARMM but for it to thrive in the region, the challenges on industry development, financial literacy, and settling of property rights should also be addressed concomitantly. The efforts at mainstreaming Islamic finance have been relatively fast-paced in the past three

years as evidenced by the CARD Bank and Maybank setting up Islamic banking in Cotabato City and Zamboanga City, respectively.

The case studies from fieldwork are inspiring for these showed that local models or mechanisms, which are culturally-sensitive and religiously-accepted. More importantly, the formal usage of Islamic finance among PEF partners showed that Islamic finance work and it has become an effective means for addressing conventional challenges in business and financing models.

Aside from murabahah, mudaraba, and rahn, which were predominantly used by the MFIs and cooperatives, Salam could also be considered for financing agricultural investments.¹⁶

¹⁶ Grateful to Mahartika Alonto for discussing her thoughts on Salam, Rahn, Sukuk, Tawaruq, and other Islamic finance mechanisms.

Challenges, Opportunities, Strategies, and Recommendations

CHALLENGES

The introduction and expansion of Islamic financing in the Bangsamoro Autonomous Region in Muslim Mindanao represent significant strides in aligning the region's financial services with its cultural and religious contexts. Much has already been accomplished, particularly in establishing the necessary regulatory framework. The enactment of the Islamic Banking Law stands as a crucial milestone, allowing conventional banks to offer Islamic banking services through dedicated windows. The proactive role of the BSP has further strengthened this institutionalization, issuing key circulars and regulations to support the growth of Islamic finance in the Philippines.

However, the journey towards a fully integrated Islamic financial system in BARMM is fraught with challenges. One of the most pressing issues is the need to raise awareness among the general population about the accessibility and benefits of Islamic banking. Despite its potential, there remains a widespread perception that Islamic banking is complex and costly, which may hinder its broader acceptance and utilization.

Another significant challenge is assessing and developing a sustainable market demand for Islamic financing within BARMM. The region's private sector is still in its nascent stages, with many enterprises yet to be established, making it difficult to cultivate the critical mass necessary for robust Islamic financial services.

While there are already existing frameworks for Sharia governance within the banking sector, the certification of non-bank Islamic financing as Sharia-compliant remains an unresolved issue. The development and expansion of microfinance, social financing, and other financial products tailored to the unique context of BARMM are essential. These products must address the region's high poverty rates, post-conflict recovery status, and low levels of investment and enterprise development.

Balancing the autonomy of the BARMM with its integration into the national Islamic finance framework is another complex challenge. This balance must be carefully managed to ensure that regional initiatives align with national standards without compromising local needs and autonomy. Additionally, land ownership issues, which are particularly sensitive in post-conflict areas, may impact the structuring of Islamic financing, further complicating its implementation.

Strengthening the trust infrastructure is critical, given the decades of vertical and horizontal conflicts that have plagued the region. Islamic finance, with its principles of risk-sharing and asset-backed financing, offers a unique approach, but its implementation in perceived high-risk areas like BARMM could be deterred by the high default risks associated with the region.

Finally, addressing issues with the civil registry system is essential, as this system is crucial for establishing the credentials of potential borrowers in Islamic finance. Without a robust and accurate civil registry, the integrity of Islamic financing operations could be compromised, limiting its effectiveness and reach in the BARMM.

OPPORTUNITIES

The future of Islamic financing in the BARMM is laden with promising opportunities, particularly as the region continues to stabilize and socio-political and economic confidence grows. As peace and governance take firmer root, the demand for financial intermediation is expected to rise, driven by the region's evolving needs for capital, investment, and economic development.

The success of institutions like ASA Philippines and CARD provides compelling evidence of a significant latent demand for financing in BARMM. These institutions have not only managed to meet the financial needs of the local population but have also achieved high repayment rates. This success challenges the perception that providing financing in the region is inherently risky, proving that with the right approach, the financial sector can thrive even in post-conflict areas.

As the practice of Islamic banking gains traction, the demonstration effect of early movers such as ASA Philippines and CARD could catalyze a bandwagon effect. This could lead to an influx of both Islamic and conventional banks into the sector, each eager to tap into the growing market. The entry of more players would not only

expand the availability of financial services but also enhance competition, driving innovation and improving service delivery.

This momentum could create a virtuous cycle: as confidence in the financial sector grows, so too would the mobilization of savings and other Islamic financial resources, such as zakat. The increased flow of these resources into the formal financial system would further bolster confidence, fostering a self-reinforcing loop of growth and development.

The codification of Islamic contracts, particularly through the anticipated Bangsamoro Revenue Code, holds significant potential for further institutionalizing Islamic financing in the region. By providing clear guidelines and minimizing the need for constant clarification on Shariah compliance, such codification would streamline financial transactions and boost investor confidence, making the region more attractive to both domestic and international investors.

Furthermore, as demand for Islamic banking and financing grows, there will be a market-driven push for more widespread capacity training. This would benefit Islamic financial institutions, regulators, and staff, equipping them with the necessary skills and knowledge to effectively manage and scale their operations. The enhanced capacity would ensure that the Islamic finance sector in BARMM is robust, resilient, and capable of meeting the region's unique needs.

STRATEGIES

To effectively expand Islamic financing in the BARMM, a strategic approach is essential. The phased implementation strategy adopted by the BSP could prove to be the right choice, offering a flexible framework that allows for gradual adaptation and refinement. This approach ensures that Islamic finance principles and products can be introduced and scaled up in a way that is responsive to the unique needs and challenges of the region.

A key component of this strategy is to focus on capacity building. Training regulators, stakeholders, and industry professionals on the principles and products of Islamic finance is crucial for the successful implementation and governance of Islamic financial services. This foundational knowledge will empower these key players to effectively manage and regulate Islamic finance in a way that aligns with both Sharia law and the financial needs of the region.

In tandem with capacity building, a robust public awareness campaign is necessary. Enhancing financial literacy about Islamic financial products among the general public will help to increase demand and understanding, particularly in a region where Islamic finance might be perceived as complex or inaccessible. Such campaigns can demystify Islamic banking and encourage broader participation across the region.

Given BARMM's unique socio-economic landscape, there should be a strong focus on financial inclusion. Islamic finance can play a pivotal role in reaching populations that have historically lacked access to formal banking services. Community-oriented approaches to financial inclusion can align closely with the cultural and religious values of the local population, increasing acceptance and participation in Islamic financial products.

Moreover, Islamic finance instruments like zakāt, waqf, qard al-hasan, and sadaqah offer powerful tools for poverty alleviation. By fostering social cohesion and mutual support, these instruments can contribute to poverty reduction in ways that are deeply integrated with the community's values. This approach can also promote sustainable, community-driven development, reducing reliance on external financial entities and helping to build local financial management skills and institutions.

Pilot programs should be a part of the strategic rollout. Implementing pilot Islamic finance programs, particularly those based on Salam contracts and waqf, allows for testing and refining approaches before they are introduced on a wider scale. These pilot programs can provide valuable insights and adjustments that ensure the success of broader implementation.

Finally, community engagement is critical to the success of Islamic finance in BARMM. Working closely with local community leaders and organizations will help to build trust and a deeper understanding of Islamic financial products. This engagement not only facilitates the smoother adoption of these products but also ensures that they are tailored to meet the specific needs and expectations of the community.

PATHS TOWARDS MAINSTREAMING ISLAMIC FINANCE

As Islamic financing continues to take root in BARMM, the ultimate goal is to establish a fully Sharia-compliant banking and financing system. However, achieving this vision will require a phased and adaptive approach, informed by the historical trajectories of countries like Malaysia and Indonesia, where Islamic finance has successfully evolved over time.

In the initial phase of this adaptation, pragmatism will likely play a crucial role. Similar to the experiences of Malaysia and Indonesia, conventional or non-Sharia banks in BARMM may be the first to venture into the realm of Islamic banking and finance. These institutions could be encouraged to develop Islamic contracts and products, thereby rapidly expanding financial access across the region. This fast-tracked approach could significantly increase coverage, especially benefiting the poor and unbanked populations who have historically lacked access to formal financial services.

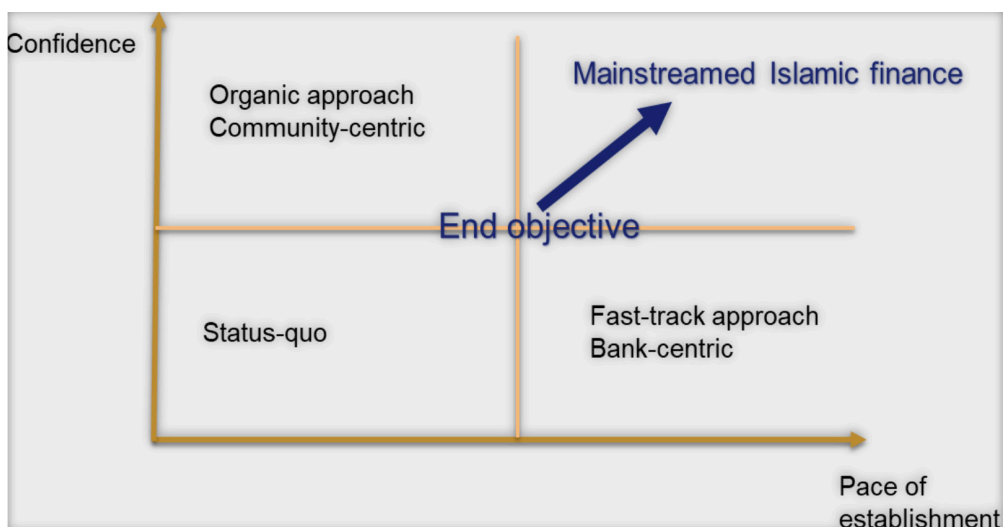
However, while this approach might lead to swift expansion, it may also be accompanied by a certain level of skepticism among the populace regarding the full Sharia compliance of these financial instruments. In the early stages, confidence in the true adherence of these products to Islamic principles might be low, particularly if conventional banks are perceived as primarily profit-driven entities rather than custodians of Sharia-compliant finance.

For Islamic finance to truly flourish in BARMM, it is essential that the community gains confidence in the authenticity and religious integrity of these financial instruments. The full power of Islamic finance will only be unleashed when the people view it as not just a financial tool, but as a vehicle for fulfilling their religious obligations, such as zakat and mutual aid. This is why community-based approaches, although slower to implement, are vital. They help to build and reinforce the trust necessary for a robust Islamic finance ecosystem.

Trust is the cornerstone of any financial system, and this is even more pronounced in Islamic finance, where compliance with religious principles is paramount. Community-based institutions, rooted in local customs and values, play a critical role in establishing this trust. While this gradual approach might take longer to scale, it helps create a strong foundation of confidence and acceptance among the local population.

Therefore, the path forward for Islamic finance in BARMM may well lie in a combination of fast-track institutionalization and gradual community-based development. The fast-track approach can quickly address the immediate need for financial inclusion, bringing more people into the formal financial system and driving economic development. At the same time, the more deliberate, community-oriented strategies will help build the trust infrastructure essential for the long-term sustainability and success of Islamic finance in the region.

By balancing these two approaches, BARMM can create a dynamic and resilient Islamic financial system—one that meets the region’s urgent financial needs while also fostering the deep trust and religious integrity that will ensure its enduring success.



■ **Figure 4.** Pathways to mainstreaming Islamic Finance in the Philippines

ROLES AND RECOMMENDATIONS FOR STAKEHOLDERS

The successful integration of Islamic finance into the BARMM hinges on the coordinated efforts of a diverse group of stakeholders, each playing a pivotal role in this transformative process. At the forefront is the BSP, which has already taken significant steps to establish the necessary regulatory frameworks, aligning Islamic financial operations with both Sharia principles and national financial regulations. The BSP’s phased approach is particularly strategic, offering the flexibility to address evolving challenges as they arise. Moving forward, it is essential for the BSP to continue its efforts in capacity-building, particularly by training regulators and

industry professionals in Islamic finance. Moreover, public awareness campaigns are crucial to improving financial literacy among the public, thereby fostering greater demand and encouraging wider participation in Islamic finance across the region.

The BARMM government plays an equally critical role by fostering an environment conducive to the growth of Islamic finance. Legislative efforts, such as the enactment of the Bangsamoro Revenue Code, ensure that financial activities align with local cultural and religious values, while also providing the legal clarity necessary for Sharia compliance. To reinforce this framework, the government should expedite the codification of Islamic financial contracts to reduce uncertainty and boost confidence among all stakeholders. The government's role extends to deep community engagement, working closely with local leaders and institutions to build trust and ensure that Islamic financial products meet the specific needs of the population. Policies that encourage financial inclusion, particularly for the region's unbanked and economically disadvantaged, are vital for the success of this initiative. By supporting microfinance and social financing initiatives, the BARMM government can help address the region's socio-economic challenges.

Conventional and Islamic banks are at the forefront of delivering Islamic finance products. Conventional banks, encouraged to establish Islamic banking windows, can bridge the gap while fully Sharia-compliant Islamic banks focus on expanding their services. The success of early movers like ASA Philippines and CARD demonstrates the viability of Islamic finance in the region, potentially inspiring a broader influx of banks into this sector. To sustain and enhance this momentum, banks should prioritize staff training to ensure the correct application of Islamic finance principles, which is crucial for maintaining the system's integrity and public trust.

Community-based institutions, NGOs, and private financing foundations, such as the Peace and Equity Foundation, have a critical role in building the trust necessary for Islamic finance to thrive in BARMM. These organizations, with their deep roots in local communities, are well-positioned to ensure that financial products are culturally and religiously appropriate. Grassroots engagement by these institutions is essential, as it fosters confidence in Islamic finance among community members. Pilot programs based on Islamic contracts, such as Salam and waqf, can serve as testing grounds to refine approaches before broader implementation. These organizations are also key in promoting financial literacy and showcasing how

Islamic finance can be leveraged for poverty alleviation and sustainable community development.

Islamic scholars and Sharia advisory councils are indispensable in ensuring that Islamic finance products and practices adhere to Sharia law. Their role is vital in providing the religious legitimacy these financial instruments require. By working closely with financial institutions to certify and maintain Sharia compliance, these scholars help build trust among the populace. Their guidance is also crucial for both the BARMM government and BSP in shaping policies that support the expansion of Islamic finance, ensuring that these policies are in harmony with religious principles.

Academic institutions, universities, and knowledge institutions are integral to the sustainable growth of Islamic finance in BARMM. These institutions should focus on developing specialized curricula that address Islamic finance, producing a new generation of professionals equipped with the necessary knowledge and skills. Universities can also serve as hubs for research and development in Islamic finance, offering insights that can drive innovation and best practices in the field. Collaborating with international Islamic finance institutions and scholars, they can provide a robust intellectual foundation that supports both practical application and theoretical understanding. Additionally, these institutions can play a vital role in public education efforts, raising awareness about the principles and benefits of Islamic finance not only among students but also within the broader community.

International development partners also have a significant role to play, offering technical assistance, funding, and expertise to support the growth of Islamic finance in BARMM. By providing resources for pilot projects, capacity-building initiatives, and public awareness campaigns, these partners can help accelerate the adoption of Islamic finance in the region. They also facilitate knowledge exchange between BARMM and other regions or countries with successful Islamic finance ecosystems, promoting best practices and fostering innovation.

In this collaborative effort, where each stakeholder understands and fulfills their role, BARMM can build a robust and fully Sharia-compliant financial system. This approach not only advances financial inclusion and economic development but also nurtures the trust and confidence necessary for the long-term success and sustainability of Islamic finance in the region.

SUMMARY

In this chapter, paths for mainstreaming Islamic finance were discussed. Ultimately, the path forward especially for the BARMM may lie in a combination of a fast-track institutionalization and gradual community-based development of Islamic finance. There is a need to continue the conversations on Islamic finance and to equip communities not only with financial literacy but also in developing and documenting models of Islamic finance.

Capacity Building on Islamic Finance

A Way Forward for PEF and EMIT C4C

Since the momentum has started on Islamic finance, a next loop of this project could be considered. Since PEF is interested in undertaking capacity building on Islamic finance, this could be the next major step in the action research partnership. Efforts could be made in building the capacity of select PEF and EMIT C4C partners on Islamic finance by taking off from the models (mudarabah, murabaha, ijara, and rahn) that they currently use. Loop two could also involve co-implementing Salam, another Islamic finance mechanism, in an agriculture enterprise. This means involving or tapping experts particularly the ones invited during the stakeholder meeting.

The capacity building could involve both the technical assistance or capacity building and the financing scheme. This could also involve documenting the Islamic finance contracts.

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