
EXECUTIVE BRIEF
ISLAMIC BANKING IN THE PHILIPPINES
(PRIMER FOR GCC INVESTORS)
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The Opportunity for Islamic Banking and Finance in the Philippines

The Philippine banking industry is a \$275 billion sector by total assets and is a cornerstone of the Philippine economy. Philippine corporations have relied on bank lending as the primary form of financing. Even for expansion and further capital investment, bank borrowing remains the primary method of funding. Despite the recent growth in the Philippine economy, the number of companies listed on the Philippine Stock Exchange (PSE) marginally increased from 251 to 268 over the last five years. Philippine banks are expected to sustain access to healthy deal flow from Philippine companies and to profit from a robust book of corporate business.

Banks in the Philippines are categorized as universal, commercial, thrift, rural, cooperative or Islamic. While universal and commercial banks are the dominant ones with the 3 largest accounting for 21% of total assets, there is only one Islamic bank in the country: Al-Amanah Islamic Investment Bank of the Philippines.

The Philippines is poised to exceed GDP growth forecasts and go beyond 6% again this year. This growth will continue to be sustained by a strong domestic economy, robust inflow of remittances and continued dollar earnings from IT business process outsourcing (BPO) firms. Government is rolling out a US\$170 billion infrastructure program through 2022 to boost the US\$313 billion economy confident that financing will be less of a problem, noting the high level of liquidity in the market, additional revenues from the planned tax reform, and official development assistance (ODA) from Japan and China.

AL-AMANAH ISLAMIC INVESTMENT BANK OF THE PHILIPPINES

Al-Amanah was created in 1973 to aid in the development of Mindanao. A political creation nonetheless, to date, it is not yet fully operational as a full-fledged Islamic bank, only accepting savings deposits for the Hajj and select Islamic finance contracts. The law that created Al-Amanah only created the bank but not the framework on how to conduct Islamic banking. It is currently a subsidiary of state-owned Development Bank of the Philippines (DBP).

Population of Philippines
106 MILLION

Population of Mindanao
25 MILLION



Branch footprint
(8 in Mindanao, 1 branch in Metro Manila)

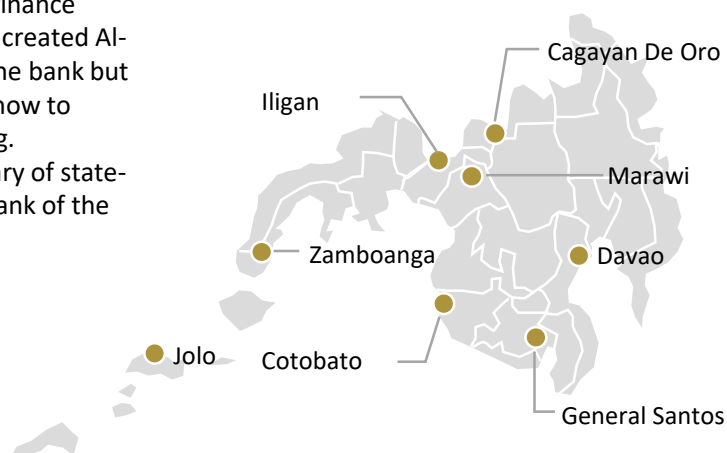


Table 1**Size and Profitability of the Largest Universal/Commercial Banks and Al-Amanah Islamic Bank**

Commercial/Universal Bank Name	Assets (US\$ M)	Profitability (%)		
		ROE	ROA	NIM
BDO Unibank Inc	50,666	9.7	1.1	3.5
Metropolitan Bank & Trust	34,198	8.9	1.0	3.8
Bank of the Philippine Islands	32,728	13.3	1.4	2.8
Land Bank of the Philippines*	32,300	15.0	1.0	3.1
Philippine National Bank	15,596	7.1	1.0	3.1
Security Bank Corp	15,115	9.6	1.3	3.2
China Banking Corp	13,319	9.8	1.1	3.1
Development Bank of the Philippines*	11,941	11.7	0.9	2.3
Union Bank of the Philippines	11,122	11.2	1.4	4.0
Rizal Commercial Banking Corp	8,867	6.7	1.0	4.3
United Coconut Planters Bank	6,177	21.2	1.2	4.5 **
East West Banking Corp	6,023	13.9	1.8	7.8
Al-Amanah Islamic Investment Bank of the Philippines*	15	(20.1)	(6.6)	3.5
Total/ Industry Average	275,273	9.9	1.1	3.8

Notes: * - State-owned; ** - 2015

Sources of Basic data: Bangko Sentral ng Pilipinas; Annual Reports; WSJ

Capturing the opportunities from the country's growth calls for increased banking and financial services and better diversity of sources of capital. Easing regulations have helped. The liberalization of financial services allowed 100% foreign ownership of banks and investment houses. With the entry of Chinese, Japanese, and Korean banks, the economy has tapped into other sources of financing. There is room for more players in the market, especially those from the Gulf Cooperation Council (GCC) who can effectively enter and position themselves within the niche of Islamic banking.

Through Malia Prime Investments' knowledge of both the GCC and the Philippine banking markets, we highlight the following opportunities in Islamic banking and Islamic finance:

1. Consumer banking
2. Bond market ("sukuk" issuance)
3. Halal industry (trade finance and SME)
4. Wealth and asset management
5. Development and financial inclusion



1. Consumer banking: while we see conventional banking continuing to dominate the financial landscape, Islamic banking shall trigger the development of the following consumer banking segments: Muslims in Mindanao, Overseas Filipino Workers (OFWs) in the Middle East and a promising alternative for the mainstream market. Of the country's 106 million population, 6% are Muslim and are mainly in Mindanao. Largely underserved, Muslims can now have access to a true Islamic banking service. Amanah Islamic today, due to the absence of a regulatory framework is forced to provide conventional banking despite its Islamic charter. For OFW's in the Middle East, with most coming from outside Manila, a GCC-backed Islamic bank shall create a channel for remittances and synergies with banking products backed by income generated in the GCC. An OFW who can take a mortgage from the GCC to finance a single-family home in Mindanao will likely bank with one who has presence in both GCC and the Philippines. Largely unknown to the mainstream banking consumer in the Philippines is their option to avail of products and services from an Islamic bank as well, in the same way that Filipinos in the United Arab Emirates avail of loans and mortgages from Emirates Islamic, Dubai Islamic Bank or Abu Dhabi Islamic Bank.



2. Bond market ("sukuk" issuance): as conglomerates breach their regulatory single borrower's limit, they tap other sources of financing such as the bond market. This development comes with the improvement in the country's macroeconomic fundamentals: declining debt-GDP ratio and issuance of longer dated government securities helping build greater confidence among investors and enhance stability in the financial market. From only 0.2% of GDP, the corporate local currency bond market surged to 6.5% or \$20B in 2017. There is potential for more, especially through Islamic finance and the issuances of sukuk for both corporate and government institutions. The government is looking to issue a maiden sukuk for its infrastructure projects. State-owned National Home Mortgage Finance Corporation's (NHMFC) announcement of a planned issuance of sukuk highlights further interest in Islamic finance. The corporate bond market is a greenfield and corporations will definitely take advantage of sukuks once the floodgates have been opened. The Qatar Investment Authority (QIA), for example, signified interest in investing some US\$1 billion in logistics and tourism in the country following the signing of an investment protection agreement, the QIA prefers to do this via a sukuk issuance possibly through Amanah Islamic.



3. Halal industry (trade finance and SME): in 2016, the Philippine Halal Export Development and Promotion Act was implemented. The trade department targets the Philippines to export about US\$1.4 billion worth of halal products in 2018, up from the annual average of US\$800 million, following the implementation of the law and the establishment of the Asian Halal Center in Mindanao. Located in the Zamboanga Ecozone in Mindanao, the center aims to be the hub of halal industry in the Philippines and in the recently rejuvenated ancient trading routes in the Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA). For tourism and SME's, the Philippines is now a full member of the International Halal Accreditation Forum (IHAF). Tourism authorities have rolled out the Philippine Halal Tourism Program and have been working with halal certification bodies such as Singapore-based CrescentRating to accredit hotels, resorts, and restaurants in key cities of the country. SME's especially those based in Mindanao who would like to participate in the growing halal sector who can access Islamic finance shall gain tremendously from the presence of an Islamic bank.



4. Wealth and asset management: a strength of banks in the GCC is their wealth and asset management offering. By gaining a foothold in the Philippines through Islamic banking, GCC banks can bring their proven capabilities and provide a compelling value proposition to the Philippines' growing segment of high net worth individuals benefiting from the country's growth. GCC wealth and asset management services are world class and provides clients with a range of investment products and access to opportunities that may not be provided by local banks to the same degree of breadth and sophistication. The entry of a GCC-based bank can also facilitate inward investments by GCC investors into the country. In the equities market, the Philippine Stock Exchange is regularly updating the list of Shariah-compliant securities; out of the 268 listed securities, 60 are found to be compliant and with a GCC-based bank coming in, investments can be better facilitated on behalf of GCC investors.



5. Development and financial inclusion: with the President hailing from Mindanao and the region's development one of his priorities, the Islamic bank will have a role in developing cities and rebuilding communities. Marawi City has been devastated from fighting between the military and Islamic State inspired rebels. Restoring peace and addressing extremist threats is a priority of the national government and through economic development which a strong bank can help facilitate, jobs generated in the region should help get the people of Mindanao on a path of improved socio-economic outcomes and increase financial inclusion. Muslim Mindanao remains the region with the lowest GDP per capita and least banking presence in the country. GCC nations are leading stakeholders in the promotion of peace, elimination of Islamic extremism and extension of humanitarian aid and support. The entry of a GCC-based bank into Mindanao can be supported from a government foreign policy standpoint as well.

Table 2**Economic and Banking Statistics Across Key Areas of the Country**

	GDP Per capita, US\$*	Banking Offices	Non-bank institutions*	Deposits, US\$M	Loans, US\$M
Luzon	3,578	8,486	12,378	199,131	47,928
Visayas	1,877	1,706	2,628	20,229	7,862
Mindanao	1,742	1,552	3,133	14,733	5,425
Zamboanga Peninsula	1,543	225	525	2,154	546
Northern Mindanao	2,416	396	628	3,449	1,148
Davao Region	2,533	447	782	4,807	1,961
Southern Mindanao	1,650	250	710	2,490	1,229
Northeastern Mindanao	1,209	215	327	1,572	505
Muslim Mindanao	547	19	161	262	36
Philippines	2,805	11,744	18,139	234,094	161,215

Note: * 2016

Sources of Basic Data: Bangko Sentral ng Pilipinas; Philippine Statistics Authority

Key Challenges Remain

A critical component of the Islamic banking and finance ecosystem in the country is the absence of a governing legal and regulatory framework. A bill is pending in Congress requiring further review and deliberation. Any international investor or Islamic bank needs to undertake thorough legal due diligence and perhaps be encouraged to make suggestions given their knowledge and experience on the sector. As the Philippines crucially requires foreign investment, assurance on regulations will have to be provided by the government. Taxation is another important issue that needs to be tackled especially the tax treatment of sukuk and the treatment of underlying assets behind each Islamic banking product. Further clarity is also required on the establishment of deposit insurance for Islamic banks based on takaful principles. Capacity building and developing Islamic banking talent is also a major gap. Enhancing the proficiency of both Bangko Sentral ng Pilipinas (BSP), the country's central bank and training bank employees of Amanah Islamic is a major initiative that must be undertaken. Through initiatives that will address these challenges, Amanah Islamic can be launched into its transformation from a purely political creation to a true and world class Islamic bank.

Conclusion

Malia Prime Investments believes that there is a unique opportunity and scope for synergies with the entry of a GCC based Islamic bank into the Philippine market. The specific opportunities we have highlighted above are largely green-field and with the level of expertise and capabilities from the Gulf, a GCC Islamic bank with an effective entry strategy, a balanced view of risks and rewards and an intimate insight grounded on local context can benefit from the growth potential of Islamic banking and finance in the Philippine market. We are available to discuss and explore this opportunity further with GCC Islamic banks, Islamic economy stakeholders, institutional investors and other parties who have a strong interest.



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