

**DA AFGHANISTAN BANK  
(CENTRAL BANK OF AFGHANISTAN)**  
**Guidelines on Late Payment Charges for Islamic Financing  
Products**

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***Guidelines on Late Payment Charges for Islamic  
Financing Products***

Accountable Executive & Custodian	Islamic Banking Department
Policy Owner	Head of Islamic Banking Department

Approved by DAB Governor:	Date .....	DAB Board Secretary .....
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**ISLAMIC REPUBLIC OF AFGHANISTAN**

**DA AFGHANISTAN BANK, GUIDELINES ON LATE PAYMENT  
CHARGES FOR ISLAMIC FINANCING PRODUCTS**

**PART A: PREAMBLE**

**1. Background**

- a) These Guidelines on Late Payment Charges for Islamic Financing Products (hereinafter referred to as “the Guidelines”) are issued by the Da Afghanistan Bank (hereinafter referred to as “DAB”) which shall be adopted and become the guiding principles for Islamic Financial Institutions, Financial Institutions operating with an Islamic Window and Financial Institutions operating with an Islamic Unit (collectively referred to as “the Bank”) in the Islamic Republic of Afghanistan (hereinafter referred to as “Afghanistan”) offering Islamic financial products.
- b) These late payment charges (hereinafter referred to as “the Late Payment Charges”) are as per the Shariah principle of ta’widh (compensation) and gharamah (penalty) which are imposed on defaulters as a means of deterrence against delays of the financed party in making their respective payment obligations as well as to compensate the actual loss that the Bank suffers due to the late payment. It must be emphasized that the Late Payment Charges are not, and shall never be, calculated on the basis of retribution against the customers.
- c) According to the Accounting and Auditing Organization for Islamic Financial Institutions (“AAOIFI”), Shari’a Standards on “Default in Payment by a Debtor” item 2/6:

*“Default in payment is established when, following a normal demand for payment, a debtor who has not proved that he is insolvent fails to settle the debt on its due date”*

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Hence, only after fulfilling these two conditions i.e. the debtor fails to settle his debt on its due date and that he is not being insolvent may entitle and thus allow a Bank, via approval by its Shariah Board to proceed with the Late Payment Charges onto the customer.

## **2. International Practices on Late Payment Charges**

### **2.1. Basis of the Imposition of Late Payment Charges**

a) Standard of Late Payment Charges by AAOIFI:

The practice of imposing the Late Payment Charges has been accepted by international Shariah scholars and applied in many institutions offering Islamic products worldwide. The basis of this can be found in the AAOIFI Shari'a standards at item 5/6 of "Murabaha to the Purchase Orderer" as follows:

*"It is permissible that the contract of Murabaha consist of an undertaking from the customer to pay an amount of money or a percentage of the debt, to be donated to charitable causes in the event of a delay on his part in paying instalments on their due date. The Shari'a supervisory board of the institution must have full knowledge that any such amount is indeed spent on charitable causes, and not for the benefit of the institution itself"*

The above clause clearly indicates that the Shariah basis of this penalty is the wa'd (undertaking) by the customer to give for donation a certain amount of money or a percentage of the debt if the customer is late in meeting his scheduled payments . This is not the imposition by the Banks but rather the undertaking by the customer himself to make such donation when the defined default event takes place. This undertaking by the customer must be duly signed by the customer or otherwise, the imposition of the Late Payment Charges is not permissible under the Shariah principles.

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### b) Modified Practice of AAOIFI Standard:

Some Shariah Boards of Islamic Financial Institutions (hereinafter referred to as "IFI") have modified the abovementioned item 5/6 of AAOIFI on the Late Payment Charges to make it more flexible to suit the financial conditions of the defaulting customer. For this purpose, the customer will provide an undertaking either in the main document or in the schedule of any debt-based financing document as follows:

*"I, hereby undertake that in the case I have defaulted my payment as agreed in schedule [as applicable], I will donate [as applicable] amount of money/ [as applicable] a certain percentage of the debt to be given to a charitable body as approved by the Bank's Shariah Board only in the case when the Bank has sent the notice of Late Payment Charges to me".*

This practice is done as a way to give some flexibility to the Bank to release some of its customers from fulfilling the undertaking when the customer is facing genuine financial difficulty. Otherwise, the customer has to donate this amount to charity irrespective of whether he is in dire difficult need (insolvent) or not. This has been followed by some of IFIs as this is more equitable and fair to the customer who is not financially healthy. This is also in consonance with the Quranic verse:

*"And if the debtor is in difficulty, grant a delay until a time of ease. But if ye remit it (the debt) by way of charity, that is best for you if ye only knew" (2:280)*

### c) Practice and Standard of Malaysia:

The Central Bank of Malaysia ("BNM") issued the Guidelines on Late Payment Charges for Islamic Financial Institutions in 2010 to regulate late payment charges imposed by Banks onto customers of Islamic banking products. Unlike the AAOIFI standard and some practices in the Middle

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East, the Shariah Advisory Council of the Central Bank of Malaysia has deemed all the customers as financially capable even when they default in their payment (whereby the liability of the proof of the insolvency is vested with the defaulting customer). Thus, every defaulter is deemed as capable of paying their debt and thereupon, his action of defaulting could be punished as per the Prophetic Tradition which says (translation):

*“The procrastination of the (financially) able debtor may subject his reputation to be tarnished or to some punishment”.*

However, in order to be consistent with the Shariah principles, the way and manner of this punishment must be decided by the authority which is the Central Bank instead of the Banks themselves. This is to avoid the Banks from taking advantage of their customers by imposing an excessive rate for the penalty.

- d) DAB Adopted Practice on Basis of the Imposition of Late Payment Charges:

The modified practise of AAOIFI Shari'a Standard as stipulated in Clause 2.1(b) above shall be the practice adopted by the DAB for Banks in Afghanistan.

## **2.2. The Rate /Percentage of Late Payment Charges**

- a) AAOIFI and Modified Practice of AAOIFI Standard:

There is no specific rate mentioned in the two practices, hence the rate shall be on a discretionary but equitable basis. Essentially, it can be of any amount since the Bank can only take the portion of compensation (based on actual expenses incurred by the Bank) and the remaining should be given to a charitable body(s) as approved by the Bank's Shariah Board.

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b) Malaysian Practice:

The rate for compensation as specified in the regulation is strictly limited to one percent (1%) of the overdue amount, whenever the default occurred during the tenor of the contract. If the default occurred or continues to occur after the end of the tenor of the contract, the prevailing rate of the Islamic Interbank Money Market at that time shall apply. This is based on the concept of ta'widh (compensation) to the Bank. Banks are further allowed to charge more than one percent (1%) on the basis of gharamah (penalty) but the entire amount has to be channelled to a charitable body(s).

c) DAB Adopted Practice on Rate/Percentage of Late Payment Charges:

The modified practice based on AAOIFI Shari'a Standard as stipulated in Clause 2.2(a) above shall be the practise adopted by DAB for Banks in Afghanistan. However, a specific rate should be agreed by DAB Shariah Board based on the prevailing market conditions in order to compensate the Bank and as a means of deterrence against delays by defaulting customers.

### **2.3. The Usage of Late Payment Charges**

a) AAOIFI Standard:

The entire amount collected from the Late Payment Charges shall strictly be channelled to charitable body(s) as approved by the Bank's Shariah Board and not be treated as an income to the Bank. However, Banks' are allowed to deduct any actual and direct costs and expenses incurred by the Bank as a result of the defaulting event by the Customer. Direct and actual expenses include the legal charges, cost of notices, dedicated man-hour for monitoring the defaulted accounts, etc.

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b) Modified Practice:

Due to the difficulty of ascertaining the actual cost incurred by the Bank as a result of the defaulting event by the customer, some Shariah Board of IFIs have decided to allocate forty-nine percent (49%) or any percentage not exceeding forty-nine percent (49%) of the total amount collected from the Late Payment Charges as the expenses cost and treating it as an income to the Bank for the said purpose (compensation). The remaining fifty-one percent (51%) of the amount must be channelled to a charitable body(s) as approved by the Bank's Shariah Board.

c) Malaysian Practice:

The entire one percent (1%) ta'widh or the rate of the Islamic Interbank Money Market (as the case may be) may be kept by the Bank as its income on the basis that it is charged as compensation for the actual loss suffered by the Bank. Any further amount charged on the basis of gharamah (penalty), less any actual and direct costs attributable to the delay in payment, must entirely be channelled to a charitable body(s) as approved by the Bank's Shariah Board.

d) DAB Adopted Practice on the Usage of Late Payment Charges:

As DAB shall adopt the modified practise of AAOIFI, the entire Late Payment Charges as collected shall follow the practise as stipulated under Clause 2.3(b) above, and more particularly explained under Clause 3 hereto.

However, it must be noted that before this practice can be adopted, there must be a rate that the DAB Shariah Board has already approved (such as four percent (4%)) or otherwise the Banks may decide their own rate which may be too onerous on the customer as well as giving the Bank more than the normal rate of actual expenses due to the late payment event.

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**3. Purpose and Application**

- a) These Guidelines provide the requirements and standards for the imposition of Late Payment Charges on Islamic products with the aim of ensuring transparency, disclosure and standardisation of practices amongst Banks offering Islamic products.
- b) These Guidelines shall be applicable to all types of Islamic products comprising of debt-based and equity-based Islamic financing products. For the avoidance of doubt, although the regulation under AAOIFI as stated under Clause 2.1(a) above only provides for the permissibility of Late Payment Charges in a Murabaha contract i.e. debt-based Islamic product, it shall be the position of the DAB SSB that the same treatment shall also apply to equity-based Islamic products in the absence of any specific regulation on such requirement under the AAOIFI or other international best practises code. However, in the case of equity based products, it should only be applicable to any payment which is due and not any payment which is not yet realised.
- c) The principles as mentioned in the DAB adopted practices as provided in these Guidelines shall constitute a general guideline for the guidance to Banks and all Banks are expected to provide their own detailed management processes and procedures such as the explanation on the frequency of distribution to charities and the accounting system for its implementation. These specific information shall be deemed acceptable so long that they do not explicitly contravene any of the provisions as contained in these Guidelines hereto.

**4. Legal Provision**

- a) These Guidelines are issued pursuant to Article 2.2 of the Afghanistan Bank Law gazetted on 12/17/2003 (corresponding to 30/10/1382) in relation to the powers of DAB to regulate and supervise Banks in the Islamic Republic of Afghanistan and any amendments thereto.

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- b) These Guidelines shall be read together with the following guidelines:
  - i. Guidelines on Product transparency and disclosure;
  - ii. Guidelines on the Imposition of Fees and Charges on Banking Products and Services;
  - iii. Guidelines on Ibra' (Rebate) for Islamic Debt-based Financing Products; and
  - iv. Other relevant regulations guidelines or circulars that DAB may issue from time to time.

## **PART B: POLICY AND PROCEDURES**

### **5. General Principles**

- a) All Banks are allowed to impose Late Payment Charges on their customers who have defaulted in their payment obligations. This is subject to the proviso that the Bank and the customer have already agreed the mechanism to calculate the Late Payment Charges and set out the circumstances in which a Late Payment Charges may arise.
- b) The Late Payment Charges is due and payable by the customers commencing from the first default of the customers' scheduled commitment until the date of full settlement of the entire defaulted amount.
- c) However, in upholding Islamic principles and as a means to ensure justice is properly served on the customers, Banks are strongly encouraged to provide their customers with a reasonable period of time to allow the customers to present any reasonable explanation or justification that Banks may take into consideration in deciding whether or not, in its absolute discretion, whether to waive the Late Payment Charges as accrued by the customers.
- d) Among the reasonable considerations or mitigating factors that Banks may take into account in making a decision pursuant to Clause 5 (c) above are situations which occurred out of the control of the customer and forced him to default on his contractual duty of payment such as the

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occurrence of serious disease/illness resulting in the customer being out of job or in the event of a natural disaster that damaged the customer's property (if this is a case of asset financing), and that is not covered by the insurance/takaful policies. In this regard, Banks are expected to always act with empathy and compassion and that this shall be on a case by case basis. However, in all circumstances Banks shall retain absolute discretion on whether they decide to waive the Late Payment Charges in full or in part.

- e) The above Clause 5(c) and 5(d) is adopted based on the modified practice of AAOIFI Standard as stated under Clause 2.1 (b) above.

## **6. Calculation of Late Payment Fee**

- a) Banks are allowed to charge the maximum amount from the Late Payment Charges rate as specified by the DAB Shariah Board, more particularly described under Clause 2.2 and 2.3 (d) hereto.
- b) The above percentage is fixed on a monthly basis and shall not be compounding.
- c) However, on the basis of "deterrent" rather than "retribution", it shall be the requirement that the Bank shall be entitled to retain the actual costs incurred by it due to the late payment of the customer up to a maximum of forty-nine percent (49%) of the Late Payment Charge recovered from the customer with the majority of the Late Payment Charge i.e. fifty-one percent (51%) being channelled by the Bank on behalf of the customer to a charitable body(s). This cap is a mechanism to ensure that the Bank does not profit from its customer's misfortune. The Bank's actual costs may well be in excess of forty-nine percent (49%) of the Late Payment Charge but the Bank, in exercising its charitable intent and to comply with these Guidelines, shall forego the balance of its as incurred expenses and channel same to the pre-approved charities.

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- d) The permission for the Banks to retain their actual costs incurred from the Late Payment Charges as set out in Clause 6(c) above is set out in the AAOIFI Shari'a Standard No. (3) on Default in Payment by a Debtor, item 2/1 (d) which reads as follows:

*"The debtor in default bears all legal and other expenses incurred by the creditor in order to recover his debt"*

- e) Clause 3(d) above shall exclude any type of calculation of loss such as:
- i. Loss of profit that the Bank would have earned if the financing continued and completed without any event of default;
  - ii. Opportunity cost based on the assumption that the Bank would have obtained other non-delinquent customer that would have afforded the Bank with the maximum amount of profit as calculated; and
  - iii. Any other type of cost that which would have given an interpretation of loss to the Bank.

This requirement is as specifically stated in the AAOIFI Shari'a Standard No. (3) on Default in Payment by a Debtor, item 2/1 (c) which states as follows:

*"It is not permitted to stipulate any financial compensation, either in cash or in other consideration.....in respect of loss of income (opportunity loss)..."*

- f) It must be emphasized that the imposition of Late Payment Charges are only permissible on strict conditions as set out in the financing documentation and not upon the sole discretion of the Banks. The Bank however, using its absolute discretion, is permitted to waive all or any portion of the Late Payment Charges if it wishes. In the event that the Bank decides to waive the Late Payment Charges, the charities that are approved of by the Bank's Shariah Board or the DAB Shariah Supervisory Board (hereinafter referred to as the "SSB") have no cause of action

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against the Bank or the customer for any portion of the Late Payment Charges that they would otherwise have been entitled to, had the Bank insisted on recovering the Late Payment Charges from the defaulting customer.

## **7. Late Payment Account and Management of Late Payment Charges**

- a) All Banks are required to create a separate and independent account for the Late Payment Charge (hereinafter referred to as the "Late Payment Account"). The Late Payment Account is to ensure better administration and governance by close monitoring of the collection process and utilization of the Late Payment Charges.
- b) Banks are required to disclose in its annual report and/or financial statements as well as the financing contracts with its customers on the use of the Late Payment Charges recovered for charitable purposes. The Bank's Shariah Board must also endorse the list of the charitable bodies entitled to receive the monies. Banks however are not allowed to benefit from this charitable actions that it performs in one way or another e.g. media coverage of giving out this amount of monies to the organisations.
- c) The Shariah Board of the Banks must perform a continuous oversight role over the management of the Late Payment Account.
- d) In cases where there arises any issue in relation to Late Payment Charges or the Late Payment Account and cannot be decided by the Bank and its Shariah Board or conflicting application by Banks, reference shall always be made to the SSB for a final decision and such decision and issued thereupon shall be binding upon all Banks.

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**8. Custodian of the Document**

These Guidelines shall be under the safe custody of the Islamic Banking Division ("IBD") of DAB. Any changes to these Guidelines shall be made by the IBD with prior consultation with the SSB, as reviewed by the DAB Executive Board and upon approval by DAB Supreme Council. A copy of the amended Guidelines shall be made available to all stakeholders and SSB members for reference and implementation.

**9. Effective Date of the Document**

The Effective date of these Guidelines is the \_\_\_\_\_ day of \_\_\_\_\_ 20\_\_\_\_