

DA AFGHANISTAN BANK
(CENTRAL BANK OF AFGHANISTAN)
Approval Procedure Manual for Islamic Financial Products

Approval Procedure Manual for Financial 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, APPROVAL PROCEDURE MANUAL FOR
ISLAMIC FINANCIAL PRODUCTS**

PART A: PREAMBLE

1. Background

- 1.1 This Approval Procedure Manual for Islamic Financial Products (hereinafter referred to as "the Manual") is 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 offering Islamic financial products.
- 1.2 The offering of Shariah-compliant financial products (hereinafter referred to as "the Products") to the market to meet the demand of the customers is one of the major deliverables of all Banks. In this regard, Banks must ensure that their product development processes are comprehensive enough to ensure that the Products offered shall not be subjected to challenges and the possibility on being nullified on Shariah grounds.
- 1.3 Shariah-compliant products refer to the various Shariah contracts outlined under the Islamic commercial laws such as Murabaha, Ijarah, Istisna', Wadi'ah, Mudarabah, Musharakah, etc. The Bank's Shariah Department/Islamic Banking Department shall scrutinize the nature, features and operational issues surrounding the Shariah contracts as they are adopted in the various Products.

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- 1.4 The need for this Manual is primarily to provide confidence to the customers and stakeholders on the Shariah compliance of the Islamic banking activities of the Bank.
- 1.5 This Manual shall constitute an integral part of the general operational procedures of the Bank and shall be read and interpreted in the light of the Shariah Governance Framework ("SGF") of the Bank.
- 1.6 The responsibility of monitoring this Manual shall be vested with the Shariah Department (for full-fledged Islamic Financial Institutions) and the Islamic Banking Department/Unit (for Islamic Window or Islamic Unit) of the Bank..
- 1.7 For the avoidance of doubt, whenever any provision refers to "Shariah Department", reference is made to a full-fledged Islamic Financial Institution and whenever any provision refers to "Islamic Banking Department or Islamic Banking Unit", reference is made to a financial institution with an Islamic window or Islamic Unit. For the purpose of this Manual, all will hereinafter be referred to as the "the Shariah Department".
- 1.8 Any particular exemption to any of the provisions as provided herein shall only be permitted via a formal application being submitted by the Bank, after prior consultation with its Shariah board (hereinafter referred to as "the Shariah Board"), to the Shariah Supervisory Board of DAB (hereinafter referred to as "the SSB") outlining the reasons and justifications for such request.
- 1.9 If any new or additional guidelines on Shariah compliance are to be adopted on product specifics, the Shariah Board of the Banks shall always be consulted first prior to the adoption of same.

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2. Basis of Approval Procedures from International Practices

2.1 The basis of these approval procedures for Shariah compliant products is established under item no. 4 of the Governance Standard for Islamic Financial Institutions (GSIFI) No. 2 of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) (hereinafter referred to as “the Standard”). The principles and procedures can be derived from the Shariah Review section since the essence of both principles are intertwined and are aimed at satisfying for the same objective. Accordingly, item 4 provides as follows:

4. “The objective of a Shari’a review is to ensure that the activities carried out by an IFI do not contravene the Shari’a. The achievement of this objective requires that the Shari’a as defined in para 1 above is mandatory” (para 1 defined below):

1. “The purpose of this Governance Standard for Islamic Financial Institutions (GSIFI) is to establish standards and provide guidance to assist Shari’a Supervisory Boards (SSB) of Islamic Financial Institutions (IFIs) in performing Shari’a reviews to ensure compliance with Islamic Shari’a Rules and Principles as reflected in the fatwas, rulings and guidelines issued by them (hereinafter, the Shari’a...”

2.2 Practice and Standard of Malaysia:

The requirement for approval procedures for Islamic financial products are encapsulated in Malaysia’s Shariah Governance Framework under Appendix 7 whereby it is defined and explained under the product development process specifically under the pre-product approval section.

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Accordingly, the section explains on the processes involved in the pre-product approval stages which include; product structuring, Shariah decisions, review exercise, etc which all shall be duly vetted and approved by the Shariah Board before the offering of such product to the customers.

3. Purpose and Application

- 3.1 This Manual shall be applicable to the Shariah-compliant financial products of the Bank comprising of debt-based, fee-based and equity-based Islamic financial products.
- 3.2 The principles as provided in this Manual shall constitute a general guideline for the guidance to Banks and all Banks are expected to have their own internal Approval Procedure manual pursuant to their internal set-up and governance structure. Such specific principles as provided in the Banks' internal Approval Procedure Manual shall be deemed acceptable so long that it does not explicitly contravene any of the provisions set out in this Manual hereto.

4. Legal Provision

- 4.1 This Manual is 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.
- 4.2 This Manual shall be read together with the following manuals/guidelines:
- a) National Shariah Governance Framework;
 - b) Shariah Compliance Manual;
 - c) Shariah Review Manual; and
 - d) Verification Process Manual for Islamic Banking Products.

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PART B: POLICY AND PROCEDURES

5. General Overview

- 5.1 Generally, Shariah non-compliance instances may occur during the product development processes that could originate from improper structuring of products, lack of internal research in understanding the appropriate Shariah concepts and issues, and misrepresentation of the product at the product offering stage.
- 5.2 The Bank must acknowledge that managing Islamic Banking business activities needs to be a continuous process, and it requires the Bank to have in place adequate and appropriate measures and controls, including risk-mitigating instruments that could address or mitigate Shariah non-compliance instances.
- 5.3 As such, the Bank is expected to refer all Shariah issues related to its end-to-end product development design and processes to the Bank's Shariah Board for guidance whenever deemed necessary. The requirement for advice or a decision, as the case may be, must be made in a comprehensive manner to enable effective deliberation by the Bank's Shariah Board on the specific issue or subject matter. This will include explaining the process involved, justification grounds/reasoning and other necessary information relevant to the matter.
- 5.4 The final stage of the product development process is the endorsement process by the Bank's Shariah Board whereby the Shariah Board will certify that the product complies with all the necessary Shariah requirements, backed by the relevant citations/texts, evidence and reasoning, before such product is made available to the customer. The format of such certification will take the format of a resolution (Shariah endorsement) signed by all members of the Shariah Board.

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5.5 Product development covers both pre-product approval (i.e. process of product structuring and development prior its introduction to the market) and post-product approval process (i.e. process after the product has been offered to the customers and transactions have been carried out). This Manual will only cover the pre-product approval stage by understanding the necessary requirements and approval processes. The post-product stage shall be covered in a separate Manual entitled, "Verification process of Islamic Banking products".

6. Purpose of Approval Procedure

6.1 The purpose of this Manual is to ensure that, prior to the offering of any of the Shariah-compliant products to the customers, the relevant Shariah principles are:

- a) captured comprehensively for each contract and all of the pillars of each contract exist and are complied with;
- b) comprehensible and facilitative so that it smoothen the implementation and operationalization process of the product itself;
- c) robust and provides a continuous element of certainty so as to enhance stakeholders' confidence in Islamic banking practices;
- d) legitimate to the prevailing laws of the country;
- e) reliable based on approved Shariah sources such as AAOIFI standards, Islamic Fiqh Academy and other recognized Shariah resolutions and research; and
- f) applicable to the current position of Islamic banking in the Islamic Republic of Afghanistan i.e. the product is commercially feasible in the context of the current framework.

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6.2 The whole processes shall be guided by the Bank's Shariah Board which shall be involved from inception of the product to ensure that the structure being adopted by the product development team of the Bank is sound. The Shariah Department and the Shariah Board must provide a holistic and informative perspective in their review / structuring of the products by combining their sound Shariah knowledge coupled with strong practical sense of the issues on the ground that impact each of the products under development.

7. Pre-Product Approval Processes

7.1 Pre-product approval processes involve namely product structuring or design processes backed by comprehensive Shariah research, vetting of contracts and agreements as well as compliance checks before the product is offered to the Bank's customers. The final stage is the endorsement of the product by the Bank's Shariah Board.

7.2 There shall be a formal and transparent procedure for issuance of Shariah decisions which are well documented and approved by the Bank's Shariah Department and its Shariah Board.

7.3 The Bank shall ensure that the pre-product approval processes include, among others, a review of the concept, structure, term sheet, documentations, policies and procedures, pamphlets, brochures and advertising materials.

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8. Product Approval Stages

8.1 Below are the generic product approval stages for Banks to comply with throughout the course of an offering of a new Shariah-compliant Financing product:

1. The Product Development Team (or equivalent) of the Bank will originate and design a proposed product structure for a new Shariah-compliant product;
2. The Shariah Department of the Bank will vet the product structure and identify any potential Shariah issue and accordingly, the following will occur:
 - a) If a Shariah issue exists: the Shariah Department will conduct Shariah research on the specific issue and provide the decision/resolution on his own capacity accordingly. However, whenever that specific issue involves and requires a greater degree of Shariah deliberation beyond the capacity of the Shariah officer, he may request for the assistance of any one (1) of the Shariah Board members; or
 - b) If there is no Shariah issue identified: the Shariah Department will give preliminary approval for the product and allow the Product Development Team to proceed with the next stages of the product development processes.
3. Subsequent to this, the product will be presented to the Risk Department where the product will be examined by the Risk management team taking into account risks issues including Shariah risk. The following may arise:
 - a) If there is a potential Shariah risk issue: the matter will be transferred back to the Shariah Department who will deliberate the issue with the Management Board (hereinafter referred to as "Management") (if necessary) and propose a solution accordingly; or

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- b) If there is no Shariah risk issue or involves non-related Shariah risk issue: the Product Development Team will proceed with the next stages of the product development processes or the Risk Committee team will advise accordingly, as per the respective situation.
- 4. After the above, the product will be presented to the Compliance Department to check whether there are any legal or regulatory issues on the product and they will propose remedies accordingly (if any).
- 5. Subsequently, the Management will review the product and give its approval when all the requirements have been satisfied.
- 6. When all of the above processes have been passed in a satisfactory manner, the Shariah Department will prepare an Executive Summary of the product to be presented to the Shariah Board for their final review with all the product documentation being attached together for their perusal. Accordingly, the following will occur:
 - a) If any of the Shariah Board members identifies an issue or raises a question regarding the product: The Shariah Department shall provide the Shariah Board member(s) with the relevant answer to the satisfaction of the Shariah Board member(s); or
 - b) If there is no issue/question that arises from any of the Shariah Board members: The below processes will follow.
- 7. In the case the Shariah Board members are satisfied with the product and its related documentation, the Shariah Board will issue a resolution on the product. The resolution shall be drafted by the Shariah Department and signed by the Shariah Board members upon their approval. The resolution can be issued either by:
 - a) a Shariah Board meeting convened during the ordinary course of the scheduled Shariah Board meeting of the Bank/ any ad-hoc Shariah Board meetings convened at any other time; or
 - b) via circulation.

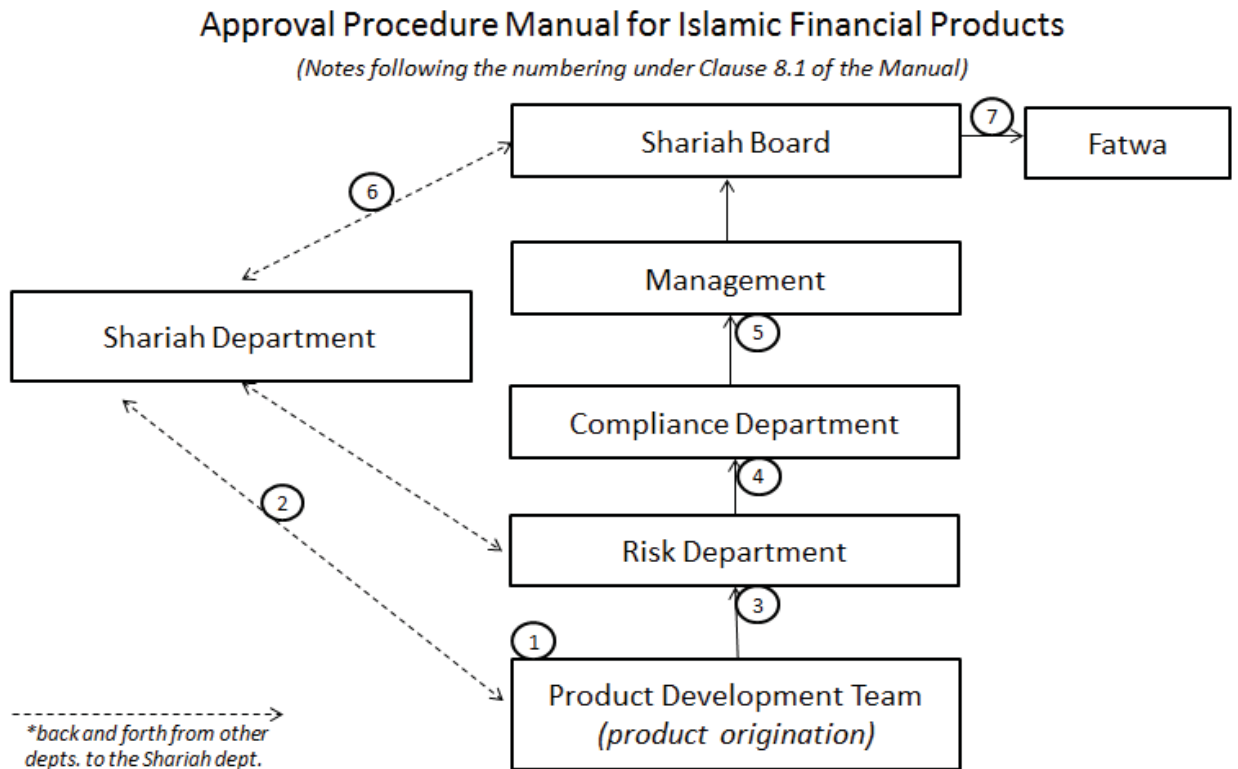
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8. In the interest of time and when the Bank needs an approval on an urgent basis, the Chairman/Executive member of the Shariah Board may issue a preliminary approval certificate endorsing the product as Shariah compliant but subject to the product being fully approved by at least the majority members of the Shariah Board during the formal Shariah Board meeting of the Bank.

9. The resolution shall be presented to the Product Development Team, Business Unit and Marketing Department of the Bank for product offering purposes to the customers/ public at large. The above processes can be illustrated as per Diagram 1 below:

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Diagram 1: Product Approval Stages for Islamic Financial Products



8.2 It must be noted that the abovementioned stages are mainly described as a generic guide on the approval stages for the offering of a new Shariah-compliant Financial product of a Bank. The processes may vary according to the internal set-up and governance framework of the Bank. Nevertheless, it shall be the requirement that all Banks must ensure that the above processes and procedures must be in place to ensure a good governance to approve an Islamic financial product.

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9. Custodian of the Document

This Manual shall be under the safe custody of the Islamic Banking Division (“IBD”) of DAB. Any changes to this Manual 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 Manual shall be made available to all stakeholders and SSB members for reference and implementation.

10. Effective Date of the Document

The Effective date of this Manual is the _____ day of _____ 20____