

DA AFGHANISTAN BANK
(CENTRAL BANK OF AFGHANISTAN)
Product Outline: Murabaha Financing (Asset Financing)

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

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

**DA AFGHANISTAN BANK, PRODUCT OUTLINE – MURABAHA
FINANCING (ASSET FINANCING)**

PART A: PREAMBLE

1 Background

- 1.1. This product outline for a Murabaha Financing (Asset Financing) (hereinafter referred to as “the Product Outline”) 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. This Product Outline is intended to:
- i) Enable Banks to develop their own Murabaha Financing (Asset Financing) products using this Product outline as a baseline for the product development process; and
 - ii) Illustrate to the Bank global best practices in adopting the Product Outline.
- 1.3. The objectives of this Product Outline are to:
- 1.3.1. Facilitate the development of Murabaha Financing (Asset Financing) products in Banks in the Islamic Republic of Afghanistan; and
 - 1.3.2. Establish a precedent Product Outline that the Banks shall use when developing and operationalising their own Murabaha Financing (Asset Financing) products.
- 1.4. 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

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Board”), to the Shariah Supervisory Board of DAB (hereinafter referred to as “the SSB”) outlining the reasons and justifications for such requests.

- 1.5. If any new or additional guidelines on the Product Outline are to be adopted, the Shariah Board of the Banks shall always be consulted first before the adoption of same.

2 Legal Provision

- 2.1. This Product Outline 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.
- 2.2. This Product Outline shall be read together with the following manuals/guidelines:
 - 2.2.1. National Shariah Governance Framework;
 - 2.2.2. Shariah Review Manual;
 - 2.2.3. Shariah Compliance Manual;
 - 2.2.4. Guidelines on Ibra;
 - 2.2.5. Guidelines on Late Payment Charges;
 - 2.2.6. Other relevant regulations guidelines or circulars that Da Afghanistan Bank (“DAB”) may issue from time to time.

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PART B: PRODUCT OUTLINE – MURABAHA FINANCING (ASSET FINANCING)

3 Product Outline Structure

- 3.1. This financing product shall be based on the Murabaha contract. A Murabaha contract refers to a disclosed cost plus mark-up transaction between parties. Murabaha financing is the prevalent mode of asset financing undertaken by a large number of Islamic banks. It represents a significant portion of Islamic bank financing of either short term or long term asset financing.
- 3.2. A Murabaha transaction can either be a cash sale (spot payment Murabaha) or a credit sale (deferred payment Murabaha) or a combination of both i.e. payment can be in the form of a lump- sum amount or in instalments or a combination of both. Murabaha is not necessarily a deferred payment sale.
- 3.3. The most essential element of a Murabaha transaction that distinguishes it from the conventional interest-bearing loan is that once the sale is executed, the selling price **cannot** be changed under any circumstances. This condition must be strictly applied even when handling cases of early payment or late payment or restructuring of the financing in the case of default.

4 Concept and Basic Conditions

- 4.1. The following are the key conditions that have to be complied with for a Murabaha sale transaction to be in line with the Shariah principles, as per the Accounting and Auditing Organization for Islamic Financial Institutions (“AAOIFI”) Standards, (Shari’a Standards No. 8):
 - 4.1.1. The subject matter of sale must exist at the time of sale. Thus, anything that may not exist at the time of sale cannot be sold and its non-existence makes the Murabaha contract void.
 - 4.1.2. The subject matter should be in the ownership of seller at the time of sale. If the seller sells something that is not owned by him, the sale becomes void.

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- 4.1.3. The subject of sale must be in the physical or constructive possession of seller when he sells to the buyer. Constructive possession means a situation where the owner has not taken the physical delivery of the asset(s), yet it has come into his control and all rights and liabilities of the asset(s) are passed on to him, including the risk of the destruction of the asset(s).
- 4.1.4. The sale must be instant and absolute. Thus, a sale attributed to a future date or a sale contingent on a future event is void. For example, 'A' tells 'B' on 1st January that A's car stands sold to B effective 1st February; the sale is void as it is attributed to a future date.
- 4.1.5. The subject matter should have some value. Thus, asset(s) having no value cannot be sold or purchased.
- 4.2. The Murabaha Financing seeks to provide **asset financing** whereby the customer only seeks to obtain the required **asset** now in return for a payment in the future. So the customer can gain use of the asset without having to pay the full purchase price of the asset upfront. This is a cash management product for both individuals and companies.
- 4.3. This type of Murabaha is most commonly called a "Murabaha to the Purchase Orderer" ("MPO"). It is used widely around the world to facilitate Shariah compliant asset financing.

5 Key Features

- 5.1. Murabaha is a contract that comprises several principal features namely:-
 - 5.1.1. Price of Murabaha sale;
 - 5.1.2. Asset of Murabaha sale;
 - 5.1.3. Duty of full disclosure of cost and profit; and
 - 5.1.4. Wa'd (promise) to buy.

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5.2. Murabaha Sale Price:

- 5.2.1. The Murabaha sale price shall be determined based on the disclosed acquisition cost with an added mark-up amount or percentage to be determined prior to the conclusion of the Murabaha contract.
- 5.2.2. The mark-up, in the form of an absolute amount or a certain percentage of acquisition cost shall be determined and specified before the conclusion of the Murabaha contract.
- 5.2.3. Any mutually agreed benchmark, including but not limited to conventional financial benchmark such as London InterBank Offered Rate ("LIBOR"), may be used to determine the mark-up in the Murabaha contract. Any benchmark adopted to determine the mark-up shall be specified and agreed upfront by the parties.
- 5.2.4. The determination of the mark-up may either be based on an agreed percentage of acquisition cost or specified amount for a known and agreed currency.
- 5.2.5. The agreed mark-up that is determined shall not be subjected to price variation or affected by currency fluctuation as payment due is pre-determined at agreed currency.
- 5.2.6. In an agreement where several Murabaha contracts are separately concluded and executed, each Murabaha contract mark-up may be priced differently.
- 5.2.7. For this product, if several assets in several Murabaha to the Purchase Orderer contracts are sold by the same Bank under a Master Murabaha to the Purchase Orderer Agreement to the Customer, the total acquisition cost plus the total mark-up may be stated in one clause in the Master agreement, provided that the details of each asset's acquisition cost and mark-up must be appended to each sales contract.
- 5.2.8. Indirect expenses such as staff wages, labour charges, which are not part of the cost of acquisition, shall not be included in the acquisition cost.
- 5.2.9. Cost of services integral to an asset such as installation cost may form the cost portion of the asset acquired.
- 5.2.10. Whenever a purchase order involves a transaction requiring the issuance of a Letter of Credit ("LC"), commission for issuing the LC shall not be part of the acquisition cost. The financier may include the commission as part of the total selling price.

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- 5.2.11. Any additional direct expenses not specified in the agreement relating to a Murabaha contract which is incurred post conclusion of the Murabaha contract shall be borne by the financed party, provided that such a clause to that effect is already incorporated in the contract. These additional charges, however, shall not be taken into consideration in determining the Murabaha sales mark-up.
- 5.2.12. Any discount on cost of acquisition obtained upon purchase by the financier shall be reflected as a reduction in the acquisition cost.
- 5.2.13. Any asset purchased in local or foreign currency by the financier may be sold to the customer in any other agreed currency. The acquisition cost shall be based on the exchange rate on the day the financier purchases the asset from supplier.
- 5.2.14. The financier and the financed party may agree to make settlement in a currency which is different from the currency specified in the contract at the prevailing exchange rate on the day of payment.
- 5.2.15. Rescheduling of debt in another currency is not permissible. However, full settlement of outstanding debt in another currency is permissible and it shall be executed based on the exchange rate of the settlement date.
- 5.2.16. A financier at its sole discretion may reward the financed party when it honours the terms of the Murabaha contract by waiving part of the price or by awarding some points for certain gifts, etc.

5.3. Assets:

- 5.3.1. Assets such as traded goods, production materials, property, equipment and fixtures, and other intangible and non-monetary assets (such as Intellectual Property rights, software, golf membership or education services or airtime), are eligible assets for sale provided that they are not specifically prohibited in the Quran and Sunnah such as usurious items in the category of medium of exchange, liquor and flesh of swine.
- 5.3.2. For the purposes of the MPO the assets to be acquired will be Shariah-compliant assets that will be acquired by the Bank and on sold to the customer.
- 5.3.3. Generally in an MPO the Bank will appoint the customer as its agent to accept delivery of the asset on its behalf and shall then acquire same on an "as is where is basis". The Bank may not have the expertise to know exactly how the asset should operate (e.g. a printing press) and

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shall utilise the services of its customer (as agent) to vet the asset and ensure that all technical manuals and maintenance records (if any) are as per industry practice.

5.3.4. If the asset is not fit for the intended Shariah-compliant use then the customer shall reject delivery of the asset (as agent for the Bank) and the Bank shall acquire another asset on the open market and sell same (once delivery is accepted by the Customer) to the customer via an MPO

5.3.5. Assets commonly acquired by Banks on MPO for retail customers are automobiles. The MPO is an excellent product for automobile financing.

5.4. Duty of Full disclosure

5.4.1. The purchase cost of the asset payable by the financier (in this product, the Bank) to the seller shall be disclosed to the financed party (in this product, the Customer) before concluding the Murabaha contract. The cost shall include the purchase price and direct expenses related to the acquisition of the assets.

5.4.2. The cost of acquisition is the **direct acquisition costs** incurred by the Bank in acquiring the asset on behalf of the customer. The acquisition costs can include delivery costs, storage costs and insurance (takaful to be sought wherever possible) paid by the Bank.

5.4.3. The failure of the financier to properly disclose the purchase price as cost to determine the mark-up to the financed party shall render the Murabaha contract null and *void ab initio*.

5.4.4. The Depositor shall disclose to the Bank the mark-up to be added to the purchase price. The mark-up could either be a fixed amount or a percentage of the purchase price.

5.4.5. Any defect caused by force majeure in the asset which is discovered by the financier or the financed party before delivery of the asset shall duly be communicated to each other. Both the parties may either mutually agree to adjust the terms of the contract or rescind it.

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5.5. Ancillary Shariah principles

5.5.1 Late Payment Charges

5.5.1.1. The Bank is allowed to charge late payment charges to the Customer if he is defaulting on his payments. The late payment charges can be documented in the contract to deter morally irresponsible behaviour, i.e. to deter the Customer from defaulting on his obligations.

5.5.1.2. This practice is permissible based on the undertaking (wa'd) by the Customer to donate an amount of money either in the fixed form or a percentage if the Customer delays any payment of financial obligation which is due. This payment is only due upon the request by the Bank. This provision must be included in the MPO document, otherwise it cannot be levied on the customer.

5.5.1.3. The Bank is entitled to reimburse its actual loss and expenses from this penalty amount whereby the remaining, if any, shall be channelled to charitable bodies approved in advance by the Bank's Shariah Board. The Bank shall undertake in the transaction documentation to carry out this disbursement to charity. The manner and frequency of this payment to charity bodies are to be determined by Bank's Shariah Board.

5.5.1.4. The imposition of late payment charges must be in line with the Guidelines on Late Payment Charges as issued by DAB.

5.5.2 Rebate (Ibra')

5.5.2.1. All Banks may grant their customers an Ibra' for an amount to be determined by the Bank when the customer prepays or wishes to make early settlement of their financing contract with the Bank due to any one of the following reasons:

5.5.2.1.1 Prepayment or early settlement of the financing contract leading to ending of the contract;

5.5.2.1.2 Cases of default of payments leading to termination of the financing contract; or

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5.5.2.1.3 A judicial decree/ court order for an accelerated settlement.

5.5.2.2. As for the pre-requisite of the granting of Ibra', the Bank may agree on a certain period of time when the Ibra' may be granted to avoid the customer acting in bad faith causing unnecessary administrative and commercial difficulties to the Bank.

5.5.2.3. The Shariah Board of the Banks must perform a continuous oversight role over the implementation of Ibra' by the Bank.

5.5.2.4. The practise of Ibra' must be in line with the Guidelines on Ibra' as issued by DAB.

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6 Process flow

6.1. A brief Product process flow using auto finance as the asset being acquired by the Customer is as follows:

6.1.1. Customer identifies desired vehicle, pays an "earnest fee" (at least 10%) directly to the seller.

6.1.2. Customer approaches the Bank for financing of the remaining balance price of the vehicle. Submits formal application. The Bank will conduct its internal processes, assess Customer's credit risk etc.

6.1.3. Upon approval, Customer will execute a "Promise to Purchase Undertaking" to the Bank undertaking to immediately purchase the vehicle from the Bank upon the full purchase of the vehicle by the Bank from the seller.

6.1.4. Bank will meet seller and purchase the vehicle for the balance outstanding of the purchase price. The 10% earnest fee amount as paid by the Customer will only be treated as an "earnest fee" by the Customer to seller. This will show the Customer's commitment to purchase the asset but will not be treated as obtaining ownership of the asset by the Customer.

6.1.5. Murabaha sale and associated steps:

6.1.5.1. The Bank and the Customer will enter into a Murabahah contract whereby the Bank will sell the vehicle to the Customer at a cost plus mark-up sale price on a deferred payment basis ("the Deferred Sale Price") for a specific tenure. The monthly instalment paid by the Customer towards the Deferred Sale Price will be on a fixed rate basis.

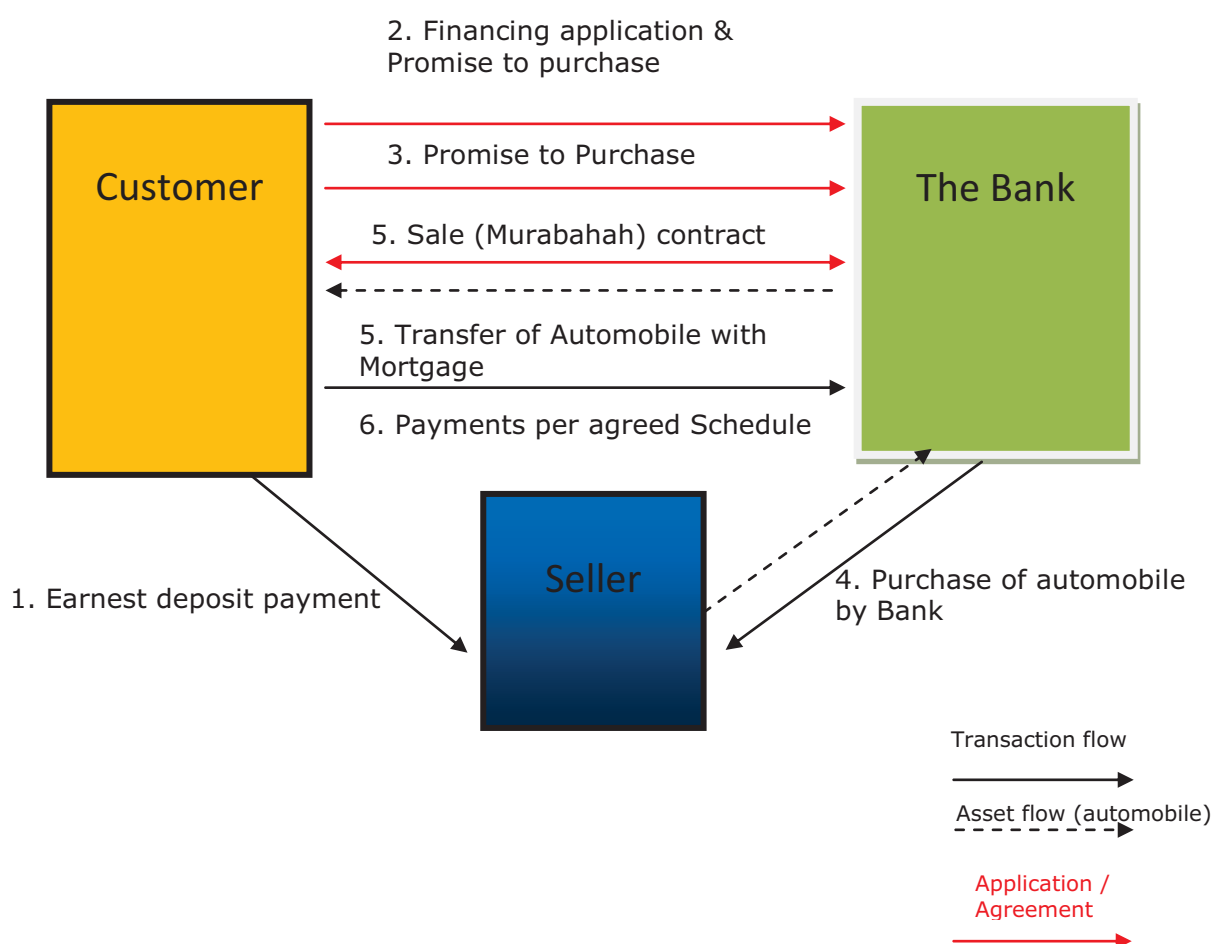
6.1.5.2. Upon execution of the Murabahah contract, the title of the vehicle will immediately transfer to the Customer but a lien on the vehicle will be noted under the Bank's name (Bank as beneficial owner) until the completion of the payment schedule or early settlement of the Deferred Sale Price by the Customer.

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6.1.6. Customer will continue paying the instalment amount as agreed in the Murabahah contract starting from the second month until the last instalment as scheduled.

6.1.7. Upon payment of the final instalment, the Bank's mortgage on the vehicle title will cease to exist. The Customer may then dispose of the vehicle if he so wishes

6.2. The Structure of the MPO process (with an automobile as the underlying asset) looks as follows:



6.3. The above steps constitute a single MPO transaction by the customer that is concluded with the sale by the bank and payment from the customer. Several similar transactions could be executed according to the needs of the customer.

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- 6.4. The customer documents can be obtained at the initial stage. However the recording of transaction should be provided in detail.

7 Required Documentation

- 7.1. The following are the documentation required to deliver the Product Outline deliverable:
- 7.1.1. Murabaha to the Purchase Orderer Application Form (including promise to purchase) to be approved by the Bank's Shariah Board.
 - 7.1.2. Murabaha Agreement to be approved by the Bank's Shariah Board.
 - 7.1.3. Agency Agreement to be approved by the Bank's Shariah Board.
 - 7.1.4. Certificate of acceptance of the asset to be approved by the Bank's Shariah Board.
 - 7.1.5. Accounting treatment to be approved by the Bank's Shariah Board.
 - 7.1.6. Marketing material to be approved by the Bank's Shariah Board.

8 Risks associated with the Product outline

- 8.1. **Credit Risk:** Credit Risk of the customer. Bank to use prudent risk management tools to ensure that only good credits are approved for the MPO product. Bank may require additional security from Customer as collateral for the financing.
- 8.2. **Market Risk:** There may be Market risk due to the particular nature of the financed assets (especially automobiles). Banks to ensure that adequate level of earnest deposit is paid by the customer to ensure that the Bank's exposure to market risk is limited. Suggest that Bank has a financing cap specifically for auto financing as part of its credit policy.
- 8.3. **Operational Risk:**
- 8.3.1. **Process risk:** Strong Know Your Customer("KYC") controls, complete Management Information System of the transactions and daily logs will reduce the processing risk.

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- 8.3.2. **Documentation risk:** Relationship Manager to ensure that complete documents are obtained from the customer.
- 8.3.3. **Loss of security documents:** Central Operations will ensure safe keeping of the documents under dual custody in a fire proof cabinet. The complete details will be entered in the lodgement register.
- 8.3.4. **KYC and Money laundering risk:** Business unit to ensure compliance with all requirements in the money laundering prevention, local regulations concerning KYC and account opening procedures.
- 8.3.5. During the trading process the concerned users need to ensure that correct amount is communicated to the trading desk for purchase and sale of commodity.
- 8.4. **Compliance Risk:** Compliance department to ensure that necessary Central Bank regulations are communicated to appropriate divisions for implementation.
- 8.5. **Commodity Risk:** Commodity risk refers to the uncertainties of future market values and of the size of the future income, caused by the fluctuation in the prices in commodities. MPO can be used to acquire Commodities, the Commodity risk rests with the customer, additional security should be sought as several types of commodity are quite volatile.
- 8.6. **Shariah Risk:** The implications of Shariah non-compliance and risks associated with the Bank's fiduciary responsibilities towards different fund providers would expose the Bank to fund providers' withdrawals, loss of income or voiding of contracts. This in turn could lead to a diminished reputation and / or the limitation of further business opportunities for Bank in this sector. Shariah compliance is critical to the Bank's Islamic operations and such compliance must permeate throughout the organisation.
- 8.7. Shariah compliance is the highest priority in relation to all other identified risks concerning this product.

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9 Common Mistakes

- 9.1. Failure to ensure that Fatwa issued by the Bank's Shariah Board for the Product before offering to clients. Shariah secretariat to confirm with Business Units that the product may be offered to customers.
- 9.2. Inadequate or non-existent documentation – this may render the transaction void *ab initio*.
- 9.3. Incorrect document process flow – this may render the transaction void *ab initio*.
- 9.4. Restructuring a Murabaha payment schedule and increasing the amount payable by the customer. The Bank may, in its absolute discretion, increase the tenor of the financing facility (a Commodity Murabaha – cash financing facility) but the Bank may not increase the Deferred Sale Price. If a customer is in difficulty with their payments the Bank may offer another facility with a longer tenor and use the proceeds from the creation of this second Murabaha financing facility to pay the balance outstanding on the customer's distressed facility. Cash realised from the Commodity Murabaha may be used to pay off the existing Murabaha and principal and profit will be payable in accordance with the new schedule of payments attached to the Commodity Murabaha.
- 9.5. Adding Late payment fees to the Bank's profit account. The Bank's actual costs due to the customer's late payment only may be taken by the bank, the balance (if any) must be channelled to charities previously approved by the Bank's Shariah Board.
- 9.6. Incomplete records of the sources of payments to charities.
- 9.7. Agreeing a rebate with a Customer in advance of providing the facility or in advance of an early settlement request issued by the customer.
- 9.8. Failure to disclose cost price of the asset.
- 9.9. Failure to obtain a promise to purchase from the Customer at the inception of the Murabaha (asset financing). The Customer may renege on the facility at no cost to himself.
- 9.10. Failure to disclose mark up on the cost price.

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- 9.11. Failure to obtain the acceptance certificate from the customer on delivery of the asset.
- 9.12. Failure to exactly describe the asset to be acquired by the Bank on behalf of the Customer in the promise to purchase.

10 Custodian of the Product Outline

- 10.1. This Product Outline shall be under the safe custody of the Islamic Banking Division (“IBD”) of DAB. Any changes to this Product Outline 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 Product Outline shall be made available to all stakeholders and SSB members for reference and implementation.
- 10.2. Banks may further refine the Product Outline to suit their particular structure and policies. Such amendments shall be approved by the Bank’s Shariah Board. The Bank’s Shariah Department/Islamic Banking Department/Unit will have custody over the Bank’s Product Outline for Murabaha Financing.

11 Effective Date of the Document

The Effective date of this Product Outline is the _____ day of _____ 20____