

**DA AFGHANISTAN BANK
(CENTRAL BANK OF AFGHANISTAN)
Product Outline: Investment Account - Mudarabah**

Product Outline: Investment Account Mudarabah

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

Approved by DAB Shariah Supervisory Board:	Date
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ISLAMIC REPUBLIC OF AFGHANISTAN

**DA AFGHANISTAN BANK, PRODUCT OUTLINE – SAVINGS ACCOUNT -
MUDARABAH**

PART A: PREAMBLE

1 Background

- 1.1. This product outline for an Islamic Investment Account (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 Islamic investment account 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 Islamic investment accounts 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 Islamic investment account 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 Parameter on Mudarabah;
 - 2.2.3. Shariah Review Manual;
 - 2.2.4. Shariah Compliance Manual;
 - 2.2.5. 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 – ISLAMIC INVESTMENT ACCOUNT

3 Product Outline Structure

- 3.1. This product is based on the Islamic concept of Mudarabah. Mudarabah is a form of partnership where one partner provides the funds while the other provides expertise and management. The former is referred to as Rabb al-Maal and latter as the Mudarib. Any profit earned is shared between the partners on a pre-agreed ratio, while loss is borne by the provider of the capital.
- 3.2. In case of investment accounts under Mudarabah arrangement, the customer becomes a capital provider (Rabb al-Maal), and the Bank becomes the Manager (Mudarib) of the funds deposited by the customers. Besides acting as Mudarib, the Bank can also invest a share of its equity in the Mudarabah Pool.
- 3.3. The salient features of an investment account are as follows:
 - 3.3.1 The Rabb al-Maal may be allowed to withdraw their capital from the bank as per the terms of the investment account and the effective amount of investment is as per agreed between the two parties.
 - 3.3.2 The sharing of profit between the Mudarib (the Bank) and the Rabb al Maal (Customer) is in accordance with an agreed Profit Sharing Ratio; and
 - 3.3.2 All losses in Capital are borne by the Rabb al-Maal (Customer). The Mudarib (the Bank) loses only his time and effort in managing the Rabb al-Maal's savings.
- 3.4. The customer will enter into a Mudarabah agreement with the Bank serving as his Mudarib (entrepreneur) to allow the utilization of his deposit to be invested in Sharia-compliant transactions whereby the investment decision will be at the full discretion of the Bank. The customer and the Bank will then share the profit (if any) from the investments made by the Bank based on a pre-agreed **Profit Sharing Ratio (PSR)**.
- 3.5. All the funds for investment are collected in a pool of funds which will be used to invest in profit oriented Shariah-compliant financing and investments. Both

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the Rabb al-Maal and the Mudarib will agree to a PSR prior to the start of the investment.

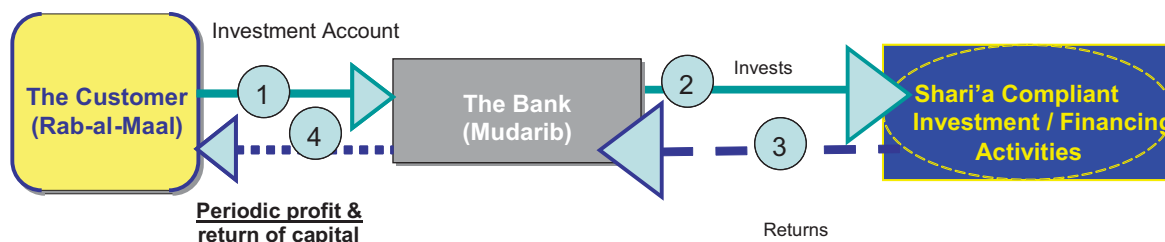
4 Product Features

- 4.1 Mudarabah investment accounts will be considered as Unrestricted Investment Accounts ("URIA"). In case of URIA, the account holders authorize the Bank to invest the funds in a manner which the Bank deems appropriate without laying down any restrictions as to where, how and for what purpose the funds shall be invested.
- 4.2 Profit for investment accounts (if any) shall be calculated based on a pre-determined accrual basis and will be paid on the maturity of the investment or any other periodical basis as agreed in the contract.
- 4.3 Profits will be distributed at the gross income level. The gross income will be calculated after deducting only the direct expenses payable by the customer to the Bank for the investment account facility.
- 4.4 Profit will be distributed based on the agreed Profit Sharing Ratio and proportionate to the respective investment amount.
- 4.5 Unlike deposit accounts based on Qard, this account allows the Bank to advertise the expected profit based on historical performance.
- 4.6 In some jurisdictions, long term investment account (6 months and more in terms of tenure) may be deemed as part of Tier 2 capital for the Bank under Basel II. In such a situation, the funds may not be withdrawn prior to its maturity. Alternatively, the Bank may opt to allow early withdrawal but will either penalize the customer for any early withdrawal of these funds or request that the customer waives any profit realized should the customer opts for early withdrawal. This is to deter the practise of early withdrawal of Mudarabah funds from the investment account. The Bank's Shariah Board will be consulted with for any mechanism to this effect.
- 4.7 Account can be opened with a minimum balance to be decided by the Bank for investment account.
- 4.8 Transaction charges for other services shall be in line with the Bank's approved Schedule of Charges.

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5 Process flow

A step by step process is as follow:-



Step 1

The customer opens an investment account by signing the account opening form (Mudaraba Agreement included) and providing the other required documentation and deposit amount to the Bank. The PSR will be agreed and documented. Neither the capital nor the profit will be guaranteed by the Bank.

Step 2

The Bank invests the funds in Shariah compliant financing and investments.

Step 3

The investment may make profits / incur losses.

Step 4

- a. In case of profit, the total profit from the investment pool is split between the Bank and the account holders, in proportion to their respective shares in the joint investment pool. The Bank then deducts its share as Mudarib from the profit share of the account holders. The remaining profit of the account holders is then shared between different categories of accounts based on their respective weighted average balances.
- b. In case of loss, the total loss from the investment pool is split between the account holders, in proportion to their respective shares in the joint investment pool. The Bank will not get any profit as Mudarib, and the loss of account holders will be shared between different categories of accounts based on their respective weighted average balances.

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- c. Where the loss is suffered due to gross negligence of, or misconduct by, the Bank, the loss will not be borne by the account holders, and the Bank will have to bear this loss.

6 Profit Equalisation Reserve

- 6.1 The Bank will have the discretion to set up a Profit Equalization Reserve (PER) to stabilise the returns to its customers. The reserves features are as follows:
 - a. A portion of the profit generated from the Investment Accounts will be retained in a PER by the Bank.
 - b. The PER will be used to stabilise returns to customers during periods of low profitability or high volatility with the approval of the Bank management. It can also be used to reduce the impact of any losses to the principal.
- 6.2 The Bank management will decide on the percentage to be allocated to the PER from the operating profit arising from Investment Accounts (before expenses and distribution) on a monthly basis.
- 6.3 The PER will not be used to generate any further profit.
- 6.4 The PER will not be used to stabilise returns of other pools of investments.
- 6.5 The size of the PER will be capped to a maximum percentage against the capital of the Bank which will be determined by the Bank management. No further PER will be allocated once the maximum size is reached.
- 6.6 The Bank retains the option to zeroise or partially redistribute the PER at the end of the financial year or at any time as recommended by Bank management and approved by the Shariah Board.

7 Target Market

- 7.1 Target Market and Eligibility
 - 7.1.1 The Product will serve the following customer segments:
 - ▶ Corporate/ institutional clients

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▶ Retail Clients who want to save for:-

- Pilgrimage
- Housing
- Education
- Etc.

7.1.2 Individuals - Self Employed Professionals and Businessmen

7.1.2.1 Self-employed professionals i.e. doctors, engineers, accountants, lawyers, consultants

7.1.2.2 Owners of medium and large business houses in Afghanistan

7.1.2.3 High Net Worth Individuals seeking for Islamic investment products

7.1.2.3 Etc.

8 Required Documentation

The legal documentation for the Product will depend on the actual structure to be adopted by the Bank and the Bank's internal policies and procedures as advised by the respective Bank's legal counsel:-

8.1 The following are the documentation required to deliver the Product Outline deliverable:

8.1.1. Account Opening Application / Request through Internet Banking – duly approved by the Bank's Shariah Board.

8.1.2 Payment amount through fund transfer instruction/cheque/transfer from existing Islamic / conventional account of the customer. This section should define the key elements of standard legal documentation for the product and should specify briefly who is responsible for origination of the documentation.

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8.1.3 Investment Receipt.

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9 Suggested Accounting Entries

Opening Mudaraba Saving Account

DR	Cash in Hand (B/S – Asset)
CR	Customer's Investment Account (B/S – Liability)

Recording of Mudarib Share of Profit

DR	Mudarabah Expense Account (Mudarib Share) (P&L)
CR	Mudarib Income (P&L)

Accrual of Mudaraba Profit Payable

DR	Accrued Profit on Mudarabah Investment Account (B/S – Asset)
CR	Profit Payable on Mudarabah Investment Account (B/S – Liability)

Profit Distribution

DR	Profit Distribution Account (B/S – Liability)
CR	Accrued Profit on Mudarabah Investment Account (B/S – Asset)
CR	Profit Equalization Reserve (B/S – Liability)
CR	Investment Risk Reserve (B/S – Liability)

Profit Payment

DR	Profit Payable on Mudarabah Investment Account (B/S – Liability)
CR	Customer's Investment Account (B/S – Liability)

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Cash Withdrawals or Purchase from Account

For Cash Withdrawals

DR Customer's Investment Account (B/S – Liability)
CR Cash in Hand (B/S – Asset)

For Purchases

DR Customer's Investment Account
CR Card Schemes Settlement Account

For Inter – Branch/ Online Transactions

For Cash withdrawals – using ATM / Debit Card

DR Transit Account (Suspense Account)
CR Cash – at ATM (B/S – Asset)
DR Customer's Investment Account (B/S – Liability)
CR Transit Account (Suspense Account)

On Issuance of Pay order / DD/TT/MT

DR Customer's Investment Account (B/S – Liability)
CR Pay Order Issued / DD / TT / MT Suspense Account
CR Commission / Charges Income Account (P&L)

Periodical Fee/ Service charges (if any)

Transactions should be mapped only for those charges approved by the Bank's Shariah Board. Based on the given criteria, system shall pass the following entry:

DR Customer's Investment Account (B/S – Liability)
CR Respective Fee/ Charges/ Income Account (P&L)

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Closure of Investment Account:

- DR Customer's Investment Account (B/S – Liability)
- CR Account Close Fee/Charges Due (if any)
- CR Cash in Hand/ Pay Order Account (B/S – Asset/ Liability)

Profit Equalization Reserve

Reserves may be recorded in the Notes to the Financial Statements as follows:-

In accordance with [state the legal reference], XX% of the net income every year must be transferred to the Profit Equalization Reserve until its balance reaches the percentage [as prescribed by the legal reference that determines what is to be done with the reserve]

	XXX (year)		XX (last year)	
	Reserve	Total	Reserve	Total
	Monetary Unit	Monetary Unit	Monetary Unit	Monetary Unit
Balance brought forward	[insert figure]	[insert figure]	[insert figure]	[insert figure]
Transfer from net income for the year	[insert figure]	[insert figure]	[insert figure]	[insert figure]
Current balance	[insert figure]	[insert figure]	[insert figure]	[insert figure]

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10 Risks associated with the Product

General Risks

Risk Category & Nature of Risk	Mitigating Factors
Documentation Risks	
Incomplete Documentation	Obtain all the common and business related documents stated in the manual and ensure completeness in all respect before opening of account
Quality Related Risks	
Customer Identification	Original identification documents to be personally checked by Customer Services Officer KYC formalities to be completed Returned mails should be properly reviewed
Employee Fraud	Establish a set of internal controls to prevent and detect fraud.
	Tools of segregation of duties shall be employed to mitigate the risk
Loss of Computerized Data	Daily back up by IT department
	Ensure contingency planning
Lower profit distributions	Build effective risk management framework and ensure its implementation Keep Profit Equalization Reserve

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Risk Category & Nature of Risk	Mitigating Factors
	and pay account holders out of such reserves if needed, in order to maintain a certain level of returns to the account holders.
Fiduciary Risk	Build effective risk management framework and ensure its implementation
Operational Risks	
i) Shariah Compliance	Terms and conditions for opening of account shall be reviewed and approved by the Shariah Board
ii) IT system implementation	The IT system will be modified to meet the requirements of the new product and properly checked before implementation
iii) Sequence of documentation is not correct	Implementation of internal Shariah Audit and Shariah compliance mechanism to ensure correct sequence of documentation and Proper training of staff
Business Risks	
i) Rate of return	The Bank will gather market information about similar products and ensure that the pricing of the product is competitive

Note: These risks and mitigants are not exclusive and are for illustrative purposes only.

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Specific Risks

Risk Category	Mitigating Factors
<p>Displaced Commercial Risk</p> <p>Bank may confront commercial pressure to pay returns that exceed the rate that has been earned on its assets financed by account holders.</p>	<p>Bank may forgo part or its entire share of profits in order to retain its account holders and dissuade them from withdrawing their funds.</p>
<p>Equity Investment Risk</p> <p>Risk arising from entering into partnership for the purpose of undertaking or participating in a particular financing or investment activity and in which the capital provider shares in the business risk.</p>	<p>Prudent selection of investment activities and robust selection criteria for financing candidates.</p>
<p>Rate of Return Risk</p> <p>Potential impact on returns caused by unexpected change in rate of returns.</p>	<p>Effective asset and liability management policy.</p>

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11 Common mistakes

- 11.1 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.
- 11.2 Inadequate or non-existent documentation – this may render the transaction void *ab initio*.
- 11.3 Failure to properly treat the investment account product as an investment-based product with no guarantee of return instead of a fixed income product with a guaranteed return.
- 11.4 Renewal of Mudarabah investment account without a properly placed procedure distinct to the nature of the product.
- 11.5 Failure to properly represent to clients as to the nature and features of the investment account based on Mudarabah.

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12 Custodian of the Product Outline

- 12.1 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.
- 12.2 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 savings accounts.

13 Effective Date of the Document

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