

DA AFGHANISTAN BANK
(CENTRAL BANK OF AFGHANISTAN)
Regulations on Licensing to Islamic Bank/Window

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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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**DA AFGHANISTAN BANK
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ISLAMIC REPUBLIC OF AFGHANISTAN

**DA AFGHANISTAN BANK – REGULATIONS ON LICENSING TO
ISLAMIC BANK/WINDOW**

PART A: PREAMBLE

1 Background

- 1.1 These Regulations on Licensing to Islamic Banks/Windows (hereinafter referred to as “the Regulation”) 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 following are DAB’s requirements for the licencing process and other related matters to guide new entities that wish to apply for a license to conduct Islamic business activities in the Islamic Republic of Afghanistan.
- 1.3 In general any entity that wishes to offer regulated financial services in the Islamic Republic of Afghanistan on a commercial basis will require a licence from DAB. Each financial institution/bank will be governed by the existing Decree Law of Banking (Law of Banking) Act 1983 (the “Decree Law of Banking”) for conventional and Islamic financial services respectively.
- 1.4 The Regulation as applicable hereto shall be the additional requirements to the Afghanistan Licencing Regulations that shall be applicable for new Islamic banking set-ups either full-fledged Islamic Banks or conventional banks operating with an Islamic Window/Unit services.

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2 Legal Provision

- 2.1. The Regulation 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. DAB as the regulatory authority for the banking industry in Afghanistan has the right to observe higher regulatory and prudential standards and ensure that the observed standards are in line with internationally accepted standards and best practices.
- 2.3. Internationally accepted standards and best practices refer to the standards issued by the Bank for International Settlements ("BIS"), the Islamic Financial Services Board ("IFSB"), the Accounting and Auditing Organization for Islamic Financial Institutions ("AAOIFI") and other bodies of equal standing.

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3 General Regulation

- 3.1 Application to conduct Islamic banking business activities is open to any qualified foreign-based financial institutions and Afghan local financial institutions.
- 3.2 Where the foreign financial institution is a branch of an overseas bank, in deciding whether to grant a license, DAB shall pay close regards to its activities elsewhere and how these activities are regulated. If the financial institution is not regulated elsewhere or in a jurisdiction not substantially compliant with Basel Core Principles, then an application for licensing can only be considered after exhaustive enquiries into the Bank's shareholders, management structure and financial position.
- 3.3 Upon licensing under the Decree Law of Banking in Afghanistan, the new entity shall be known as Islamic Financial Institution/Islamic Window/Unit operation (hereinafter referred to as "the Bank") and allowed to conduct Islamic commercial banking, investment banking and other banking businesses specified by DAB in its guidelines and procedures.

4 Regulatory Objectives and Functions

- 4.1 The objective of the Regulation is to provide a minimum set of requirements for the operation of Banks in Afghanistan that operates either as a full-fledged Islamic bank, subsidiary or a branch.
- 4.2 The principal regulatory objectives of the Decree Law of Banking are to promote financial stability and compliance objectives with the Shariah principles. In pursuing these objectives, DAB shall:-
- a) foster-
- (i) the safety and soundness of Banks;
 - (ii) the integrity and orderly functioning of the Islamic money market and Islamic foreign exchange market;
 - (iii) safe, efficient and reliable payment systems and Islamic payment instruments;
 - (iv) fair, responsible and professional business conduct of Banks; and

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- b) strive to protect the rights and interests of consumers of Islamic financial services products.
- 4.3 Banks shall exercise their powers and perform the functions under the Regulation in a way which it considers most appropriate for the purpose of meeting the regulatory objectives of the Regulation.
- 4.4 Banks may assign a specific officer to exercise any of its powers or perform any of its functions under the Regulation.
- 4.5 Banks may establish a Special Committee and may authorize that Committee to undertake actions for the purpose of exercising any of the powers or performing any of the functions of the Bank under the Regulation.
- 4.6 Banks may, either generally or in a particular case, appoint a person, whether in or outside the Islamic Republic of Afghanistan, who is not its own officer to:-
 - a) render such assistance in the exercise of any of the Bank's powers or performance of any of its functions under this Act; or
 - b) exercise any of the Bank's powers or perform any of its functions on behalf of and in the name of the Bank.

5 Application for Licence

- 5.1 Any entity that wishes to apply for a licence to conduct Islamic business activities, must apply a licence/approval from DAB.
- 5.2 The application must contain all the relevant particulars and information and accompanied by documents as specified by DAB. The minimum documents that shall be furnished by the Bank for the application are as follows:
 - a) Business plan (including at least human resource plan, marketing plan, operational plan, overall business model and capital structure, internal controls mechanism and governance structure);
 - b) Strategic conversion plan (where applicable);
 - c) Financial model/feasibility study;
 - d) Risk management policies;
 - e) Product plan;

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- f) Shariah compliance mechanism; and
 - g) Other documents as deemed relevant and important by DAB from time to time.
- 5.3 The Regulation hereto sets the requirements for the issuance of a licence. Such requirements shall include the legal form of the applicant bank, the location of its head office, the minimum capital and reserve requirements and the limits of capital adequacy requirements.
- 5.4 DAB shall conduct verification process on the application and its related documents to ensure that the applicant bank satisfies all the rules and conditions required. DAB may also require amendments to the documents submitted or make requests for additional information to enable it to make a decision regarding the application.
- 5.5 The applicant bank may, at any time before a decision has been made regarding its application, withdraw its application or make amendments to any errors therein or in the supporting documents in accordance with the Regulation issued by DAB in this respect.
- 5.6 DAB shall grant a licence to the applicant bank if DAB is satisfied that all the rules and conditions as set out in the Regulation and Decree Law of Banking are duly fulfilled and observed by the applicant bank.
- 5.7 DAB may specify in the license the venue(s) of where the Islamic banking activities may be offered and impose other specific terms and conditions on the Bank as it deems necessary for the purpose of ensuring good performance of the Islamic business activities of the Bank.
- 5.8 DAB shall have in its records a specific section on the "Registration of Licensed Islamic Financial Institutions/Banks in the Islamic Republic of Afghanistan" whereby all applications together with their supporting documents for the respective license application are kept intact. Also, the section shall note all actions taken by DAB towards the Banks (if any) in the course of conducting its Islamic business activities.

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6 Eligibility

- 6.1 The Banks shall comply with the following criteria before they become eligible to apply for a license to conduct Islamic business activities:
- 6.1.1 The Bank has to be a well-capitalised and be of a reputable licensed financial institution;
 - 6.1.2 For a foreign financial institution, it has to adopt the international banking standards formulated by international standard-setting bodies;
 - 6.1.3 For a local financial institution, it has to be regulated and supervised by a competent home regulatory authority; and
 - 6.1.4 The Bank must possess a sound track record.
- 6.2 The application for the license are governed by the Decree Law of Banking and the Bank is allowed to conduct Islamic business activities in the Afghani local currency or other international currencies within the amount approved by DAB.
- 6.3 Islamic banking business activities in international currencies include:
- 6.3.1 commercial banking business;
 - 6.3.2 investment banking business; and
 - 6.3.3 other banking businesses in Afghanistan, as may be specified by DAB.
- 6.4 All entities that wish to apply for a license to conduct Islamic business activities shall ensure that in its Memorandum or Articles of Association, it is stated that its Islamic business activities shall strictly comply with the internationally accepted principles of Shariah.

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7 The Grant of the License

- 7.1 Further to the provisions under Clause 6 hereto, DAB shall review the application and duly advise the applicant bank in writing when it has:
- a) Granted the application without condition(s);
 - b) Granted the application subject to the fulfilment of certain condition(s) specified by DAB; or
 - c) Refused the application, stating the ground(s) on which the application has been refused and the process for appealing against that decision.
- 7.2 DAB will provide a formal decision on the licence application within sixty (60) days after all the required documentation has been submitted in a form acceptable to DAB.

8 Islamic Financing Modes and Instruments

- 8.1 Subject to the requirement that a license has been duly granted to the Bank to conduct Islamic business activities, the Bank shall only be permitted to conduct business activities using financing modes or instruments that are compliant with the Shariah principles and such structures must be approved by DAB.
- 8.2 Establishment and operation of an Islamic subsidiary, window or branch of a conventional bank:
- 8.2.1 Conventional banks and other financial institutions operating in Afghanistan may offer or sell products and services in line with the Shariah principles through subsidiaries, windows or branches only.
 - 8.2.2 An Islamic subsidiary, window or branch of a conventional bank shall be established and operated in line with the guidelines on windows/branches issued by the DAB.
- 8.3 Cross-selling of products/services and shared facilities:
- 8.3.1 The Islamic subsidiaries, windows or branches may operate using the existing facilities or branch network of the conventional bank. The subsidiary, window or branch shall however, not sell products/services that do not comply with the Shariah principles.

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8.4 Execution of Service Level Agreements in respect of shared services:

8.4.1 Conventional banks or other financial institutions with Islamic subsidiaries, branches or windows shall execute a Service Level Agreements ("SLA") in respect of shared services between Islamic subsidiaries, branches or windows and the conventional banks.

8.5 Separate banking operation:

8.5.1 For the Islamic business activities, the parent conventional bank must have an adequate firewall process to ensure absolute separation of banking operations to avoid co-mingling between the Islamic and conventional funds. This is to ensure the integrity of Islamic business activities and sanctity of Islamic funds.

8.5.2 The firewall process shall include separate capital funds, cheque clearing systems, clearing accounts with the Central Bank, settlement account and reporting systems.

8.6 Shariah governance:

8.6.1 All Banks conducting Islamic business activities whether through full-fledged or window/unit operation must comply with the guidelines and requirements as enshrined under the National Shariah Governance Framework ("NSGF") as issued by DAB.

9 The Approved Islamic Business Activities

9.1 The following activities are the Islamic business activities approved by DAB:

9.1.1 Accepting Shariah compliant money placements/deposits:

a) Accepting money placements/deposits for safe-keeping (Wadi'ah/Qard) in a Shariah compliant framework, under which it will be paid/repaid, either on demand or in circumstances agreed by the parties, and does not require the provision of security.

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9.1.2 Offering Shariah compliant financing products:

- a) Entering into or making arrangement for another person to enter into, a contract to provide financing in accordance with Shariah contracts and principles such as Murabahah, Salam, Ijarah and Istisna'.

9.1.3 Managing unrestricted Shariah profit sharing investment accounts:

- a) Managing account, portfolio or fund, whereby a sum of money is placed with the service provider on terms that a return will be made according to an agreed Shariah compliant profit-sharing arrangement, such as a Mudarabah or Musharakah partnership without the customer laying down any restrictions as to where, how and for what purpose the funds should be invested. Such equity of unrestricted investment account holders shall be recorded in the books of the bank (AAOIFI Standard FAS 6).

9.1.4 Managing restricted Shariah profit sharing investment accounts:

- a) Managing an account, portfolio or fund whereby a sum of money is placed with the service provider on terms that a return will be made according to an agreed Shariah compliant profit sharing arrangement, such as Mudarabah and Musharakah partnership where the customer imposes certain restrictions as to where, how and for what purpose the funds should be invested. Such assets and liabilities relating to the equity of restricted investment account holder shall be treated separately from the bank's assets and liabilities (AAOIFI Standard FAS 6).

9.1.5 Dealing in Shariah compliant financial instruments as principal:

- a) Dealing in Shariah compliant financial instruments as principal means buying, selling, subscribing for or underwriting any Shariah-compliant financial instrument on its own account.

9.1.6 Dealing in Shariah compliant financial instruments as agent:

- a) Buying, selling, subscribing for or underwriting Shariah compliant financial instruments on behalf of a client. A licensee that carries out these activities does not use its own financial resources for the purpose

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of funding the transaction. It may however receive or hold assets in connection with the transaction, in its capacity as an agent of its client.

9.1.7 Managing Shariah compliant financial instruments:

- a) Managing on a discretionary basis Shariah compliant financial instruments on behalf of another person.

9.1.8 Safeguarding Shariah compliant financial instruments:

- a) Safeguarding of Shariah compliant financial instruments for the account of clients.

9.1.9 Arranging deals in Shariah compliant financial instruments:

- a) Making arrangements for the benefit of another person, whether as principal or agent such as buying, selling, subscribing for or underwriting deals in Shariah compliant financial instruments.

9.1.10 Advising on Shariah compliant financial instruments:

- a) Giving advice to an investor or potential investor (or a person in his capacity as an agent to the investor or potential investor) on the merits of buying, selling, subscribing for or underwriting a particular Shariah compliant financial instrument or exercising any rights conferred by such financial instrument. The advices may include the suitability of the financial instrument, or the characteristics or performance of the financial instrument or credit facility concerned.

9.1.11 Providing money exchange/remittance services between currencies and the provision of wire transfer or other remittance services.

9.1.12 Issuing/ administering means of payment:

- a) Dealing or issuing of payment instruments, or the selling or issuing of stored value (e.g credit cards, travellers' cheque etc).

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10 Shariah Requirements for the Banks

10.1 Duties of the Banks:

10.1.1 Banks that apply for the license to conduct Islamic business activities have to ensure that it shall comply with the Shariah principles.

10.1.2 Banks that conduct Islamic business activities shall ensure that the aims and operations of its business are in compliance with Shariah principle at all times. An end to end Shariah compliant control mechanism shall be established in all aspects of its business operations to ensure that all activities are fully Shariah compliant.

10.2 Establishment of a Shariah Board:

10.2.1 Banks conducting Islamic business activities must establish a Shariah Board consisting of not less than three (3) members with appropriate qualifications and experience in Shariah. The Shariah Board members shall consist of qualified scholars who are able to deliberate Islamic finance issues brought before them and provide sound Shariah decisions. The requirements for selecting the Shariah Board members must comply with the NSGF and Terms of Reference of the Shariah Board as issued by DAB.

10.3 Shariah Governance Framework:

10.3.1 Banks that are granted a licence to conduct Islamic business activities must establish a sound and robust Shariah Governance Framework (hereinafter referred to as "SGF"). The Bank's SGF must comply with the guidelines and requirements as set out under DAB's National Shariah Governance Framework. This is to ensure that the overall Islamic business activities of the Bank shall operate in accordance with Shariah principles. The DAB NSGF shall be the first layer of the two-tier Shariah governance infrastructure in the Islamic Republic of Afghanistan which consists of the DAB Shariah Supervisory Board (hereinafter referred to as the "SSB") sitting at the national level and the Shariah Board of each bank sitting at the institution level.

10.4 Audit on Shariah compliance:

10.4.1 Subject to the requirements as provided under the NSGF, Banks shall ensure that a Shariah audit is conducted on at least an annual basis

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on the Islamic business activities of the Bank. This shall be a periodical assessment conducted from time to time to provide an independent assessment and objective assurance in ensuring that a sound and effective internal control system for Shariah compliance is established within the Bank's internal framework.

10.4.2 The function shall be performed by the Internal Audit team with the assistance of the Shariah Department (for full-fledged Islamic banks) or the Islamic Banking Department/Unit (conventional banks with an Islamic Window/Unit operation), who have acquired adequate Shariah-related and audit knowledge and training.

If the Bank still has not developed its internal capacity to conduct Shariah audit, it may outsource such function to an external party provided that this complies with the requirement as set out under the Guidelines on Outsourcing of Islamic Banking Operations and Guidelines on External Audit of Islamic Bank/Window as issued by DAB in respect to this matter.

11 Custodian of the Regulation

The Regulation 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.

12 Effective Date of the Regulation

The Effective date of the Regulation is the _____ day of _____ 20____