

Salam Product Guide

Policy	Person / Function
Accountable Executive	Islamic Banking Division
Policy owner	Head of Islamic Banking Division

Approved by DAB Shariah Supervisory Board :	Date:
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1 INTRODUCTION

1.1 PURPOSE

- 1.1.1 This *Salam* Product Guide (“the Guide”) is an integral part of the overall Shariah Governance Framework (“SGF”) developed by the Islamic Banking Division (“the IBD”) of Da Afghanistan Bank (“DAB”), the Central Bank of the Islamic Republic of Afghanistan and sets out guidance for the application of *Salam* contract to various products and services for use by any Islamic Finance Institution (“IFI”), Islamic Window Operation or an Islamic Unit operating in Islamic Republic of Afghanistan (collectively referred to as “the Bank”) in developing products and services using the *Salam* contract.
- 1.1.2 The Guide shall, however, be read in conjunction with other related internal and external policies, manuals and guidelines and specific/general transaction documentation issued by DAB from time to time.
- 1.1.3 All relevant staff in the Bank are expected to be familiar with the policy and understand their roles and responsibilities with respect to application of the *Salam* contract to various products and services.

1.2 REVIEW AND UPDATE OF POLICY

- 1.2.1 This Guide shall be reviewed periodically by the Head of the IBD of DAB to ensure that it is in line with the leading industry practices and caters to the customer requirements as well as ensure that the Guide is in line with other applicable changes introduced by DAB and other regulatory authorities.

1.2.2 Amendments to the Guide may be required as a result of one or more of the following reasons (not exhaustive):

- i. Changes in laws and regulations
- ii. Changes in functions and activities of the Banks in the Islamic Republic of Afghanistan
- iii. Changes in business processes
- iv. Changes in the organizational structure of the Bank
- v. Changes in job roles, duties, and descriptions
- vi. Any other changes, where the management deems necessary to update the Bank's policies and procedures
- vii. Any significant modifications arising out of the review shall be recommended by the Head of IBD reviewed by the Supreme Council of DAB and presented to the DAB Shariah Supervisory Board (the "SSB") for their approval.

2 OBJECTIVES AND SCOPE OF APPLICATION

2.1 OBJECTIVES

2.1.1 The objective of this Guide is to describe the features and the characteristics of the Shariah contract of *Salam* to be referred to by DAB to assist Banks in developing and offering Shariah compliant products which adopt the underlying Islamic contract of *Salam*.

2.1.2 The Guide is a framework which shall ensure that the process of product development and product offerings adopting the *Salam* contract at the Bank is governed by a set of clear guidelines to be adopted by the Bank staff.

2.1.3 The Guide shall outline and communicate the key guidelines for the application of *Salam* contracts to various products and services. More specifically, the primary objectives of the Guide is to:

- i. Provide concept and legitimacy of the *Salam* contract under Shariah;
- ii. Provide features of the *Salam* contract; and
- iii. Provide guidelines on the application of the *Salam* contract.

2.2 SCOPE OF POLICY

The Guide applies to the Bank, its subsidiaries and branches.

3 GOVERNANCE AND OVERSIGHT

3.1 SHARIAH SUPERVISORY BOARD OF DAB

3.1.1 The Shariah Supervisory Board (“SSB”) is the authority for approval of the Guide.

3.2 HEAD OF IBD

3.2.1 The Head of IBD is the Guide owner providing, in consultation with the SSB, the necessary oversight which shall consider the following:

- i. ensuring the Guide is in line with the current business strategy, governance framework and business structures;
- ii. ensuring that detailed procedures are in place across the Bank to ensure compliance with the Guide;
- iii. assisting in providing subject matter expertise, support and technical guidance to the business in accordance with the Service Level Agreements (SLAs) signed with various departments; and
- iv. Communicating the Guide to the business units and concerned functions and ensuring it is understood.

3.2.2 The Head of IBD is consulted on dealing with executive decisions and/or actionable issues arising from the *Salam* product offerings process and any deficiencies.

3.3 ISLAMIC BANKING DIVISION

3.3.1 The IBD is the Accountable Executive (AE) for the Guide with the head of IBD shall be the Policy Owner.

3.3.2 The IBD assumes oversight and supervisory responsibilities for the framework used in the *Salam* product development, offerings process and ultimate

responsibility for the ongoing review and for recommending alterations to the Guide.

3.3.3 Any deviations or exceptions to the Guide must be based on a proposal by the IBD and/or other relevant authorised senior management person, to the SSB, who shall approve or deliberate on such exceptions periodically. Any material deviation or exception shall be referred to the SSB for guidance or approval.

3.3.4 The IBD shall review the Guide's validity, relevance and accuracy as and when needed.

4 DEFINITION

Literally, *Salam* means to advance.

Technically, *Salam* refers to a sale in which advance payment is made to the seller for deferred supply of goods.

For the purpose of this Guide, the technical definition is adopted in the financial sector when the IFI would essentially request the customer to deliver a specified good on a specified future date and the IFI shall pay the customer immediately upon the execution of the contract.

5 LEGITIMACY OF SALAM CONTRACT

The legitimacy of *Salam* contract is founded on the basis of the Holy Quran, the Sunnah of the Prophet Muhammad, Peace Be Upon Him (PBUH) and the consent of Muslim Jurists (*Ijma'*).

5.1 THE HOLY QURAN

Surah al-Baqarah, verse 282:

“O you who believe! When you deal with each other, in transactions involving future obligations in a fixed period time, reduce them to writing.”

Ibn Abbas said I declare that a salaf (*Salam*) contract in which the commodity is guaranteed for future delivery has been permitted by Allah. It is reported that Ibn Abbas said this verse is a revelation for the particular purpose of making *Salam* permissible.

5.2 THE SUNNAH OF THE PROPHET MUHAMMAD (PBUH)

The Narration of Ibn Abbas

Ibn Abbas had narrated during the migration of Prophet Muhammad (peace be upon him) from Makkah to Madinah, he found that the people used to pay in advance the price of fruit (or dates) to be delivered within one, two and three years. However, such sale was carried out without specifying the quality, measure or weight of the commodity or the time of delivery. The Holy Prophet said: "Whoever pays money in advance (for fruit) (to be delivered later) should pay it for a known quality, specified measure and weight (of dates or fruit) along with the price and time of delivery."

(Bukhari, Sahih Bukhari, 2/781 and Muslim, Sahih Muslim, 3/1226)

5.3 THE IJMA' OF THE MUSLIM JURISTS

Ijma' constitutes a juristic basis for the legality of *Salam*. Ibnu Munzir said that the scholars agreed that a *Salam* contract is permissible. In addition, legality of *Salam* is also recognized by contemporary established Shariah bodies such as International Islamic Academy of Fiqh under the patron of Organization of the Islamic Conference (OIC).

6 FEATURES OF THE SALAM CONTRACT

The principal features of *Salam* are:-

- i) Binding contract;
- ii) Price of *Salam*;
- iii) Subject matter (*Salam* asset);
- iv) Changes to the *Salam* asset; and
- v) Delivery of *Salam* asset.

6.1 BINDING NATURE OF SALAM CONTRACT

- 6.1.1 *Salam* contract may be concluded using the word *salam*, or *salaf*, or *sale*, or any other terminology which indicates sale of a prescribed commodity for deferred delivery in exchange for an immediate payment of the price.
- 6.1.2 It is permissible to initiate multiple *Salam* contracts with different parties through negotiations.
- 6.1.3 *Salam* contract can be drawn up through a master agreement that consists of an understanding to conclude successive *Salam* contracts where each of which will take place at a prescribed time.
- 6.1.4 If the *Salam* contract is concluded pursuant to a master agreement, the contents of the master agreement shall become part and parcel of the contract unless mentioned otherwise. The master agreement only provide general principles on which the contract may take place in the future.
- 6.1.5 It is permissible for both parties, after the conclusion of the contract, to cancel the *Salam* contract in return for repayment in full of the amount of the *Salam* price.
- 6.1.6 It is permissible for both parties to agree for partial cancellation i.e. cancellation of the delivery of some parts or amount of *Salam* asset in return of repayment of a corresponding part of the price of *Salam* which has been cancelled.

6.2 PRICE OF SALAM

- 6.2.1 The price of *Salam* shall be in the form of cash. In this case, the currency, amount and mode of payment shall be clearly defined.

6.2.2 The price of *Salam* is also permissible in the following form:

- a) fungible goods (such as wheat, oil, etc.) in which case the parties must make sure that they do not fall into *riba* with regards to the two countervalues of exchange, namely the price and the commodities to be delivered in the future;
- b) items of material value (such as livestock);
- c) general usufruct of a particular asset (such as living in a house or having the use of an aircraft for a certain period)

In this case, the kind, type, specifications and quantity of these items shall be clearly defined.

6.2.3 The price of *Salam* should be made known between the seller and purchaser to eliminate uncertainties and avoid the possibility of dispute.

6.2.4 The price of *Salam* shall be paid immediately at the place where the contract is concluded. However, the payment may be delayed up to a maximum of three days.

6.2.5 Debt cannot be recognized as the price of *Salam* since debt may be obtained or otherwise.

6.3 SUBJECT MATTER OF SALAM

6.3.1 The subject matter of *Salam* must be from fungible goods, which may be weighed, measured or counted, the attributes of which do not differ in any significant manner.

6.3.2 Subject matter of *Salam* is not permitted in the following forms:

- a) anything specific like "this house".

- b) anything for which the seller may not be held responsible, like lands, buildings or trees;
 - c) Items that have subjective variable values, like jewellery and antiques.
- 6.3.3 It is also not permissible to stipulate that the *Salam* must be from a specific item, terrain or area.
- 6.3.4 The seller may present to the purchaser with any available items that comply with the contract specifications, irrespective of the source of the item.
- 6.3.5 It is not permissible for both the subject matter of *Salam* and the price of the *Salam* contract to be in the form of currency or gold or silver.
- 6.3.6 The subject matter of *Salam* must be specifiable so that the seller may be held responsible for its conformity to the specification.
- 6.3.7 The specification of subject matter of *Salam* must be unambiguous in accordance with the customary practices present in the place and at the time in which the *Salam* contract is concluded.
- 6.3.8 Custom and the experience of experts shall be the precedent for which specifications of the subject matter shall be made.
- 6.3.9 Both seller and purchaser must know the quantity of the subject matter of *Salam*. The quantity of each item is determined according to its condition and nature with regard to weight, measurement, volume and number.
- 6.3.10 In order for the seller to be able to discharge his duty to deliver the item(s) to the purchaser, the subject matter must be commonly available under normal circumstances at the place where it should be on the delivery date.
- 6.3.11 The date of delivery for the subject matter of *Salam* must be clearly specified and known by both parties.

6.3.12 It is permissible for the contracting parties to set various dates on which the delivery of the subject matter may take place, provided that the price of *Salam* was paid at the time the contract was concluded.

6.3.13 The contracting parties should determine the place of delivery of the subject matter, otherwise the place at which the contract was concluded will be regarded as the place of delivery. If it is impossible to make delivery to such a place then the place of delivery is to be determined according to customary practice.

6.3.14 Subject matter of *Salam* may be secured by a pledge or a guarantee or any other permissible means of securing payment.

6.4 CHANGES TO THE SUBJECT MATTER OF SALAM

6.4.1 The purchaser is not permitted to sell the *Salam* asset before taking possession of the asset.

6.4.2 As a general rule, the purchaser is not allowed to exchange the subject matter of *Salam* with other goods other than the subject matter that has already been agreed in the contract. However, the purchaser is allowed to do so based on the following conditions:

- a) The substitution may only be done after the delivery date falls due;
- b) The provision for such substitution was not initially stipulated in the contract;
- c) The substituted subject matter must be something which is suitable to be replaced with the original subject matter for the same price as agreed;
- d) The substituted subject matter must not be greater in market value from the original subject matter valued at the time of the delivery;

- e) The substitution must be mutually agreed between both parties;
- f) The substitution must be adduced in writing;
- g) The substitution must be for a valid reason e.g. if the original subject matter cannot be delivered due to unforeseen changes in the weather making the original subject matter impossible to be produced/completed within time;
- h) This rule shall not be applicable for financial instruments e.g. investment products; and
- i) Any other requirements as decided by the Shariah Board from time to time based on the development of this matter.

6.5 DELIVERY OF SALAM ASSET

- 6.5.1 The seller has the obligation to deliver the *Salam* asset to the buyer on the due date at the place of delivery (as per 6.3.1) in accordance with the terms of the contract, such as agreed specifications and quantity.
- 6.5.2 The purchaser must accept the goods and will be compelled to do so provided they meet the specifications stipulated in the contract.
- 6.5.3 If the seller offers delivered goods of a better quality than is required in the contractual specifications, the purchaser must accept the goods unless the seller seeks a higher price for the better quality. However this applies only if the inferior description specified in the contract is not itself deemed absolutely necessary.
- 6.5.4 If the quality of the delivered asset is lower than is required by the contractual specifications, the purchaser has the right to either reject or to accept the asset in such condition. If the purchaser accepts, it is permissible for the contracting parties to agree to a settlement on terms of acceptance of the asset even at a discounted price.

- 6.5.4 It is not permitted for a seller to deliver the *Salam* asset in the form of a commodity different from the one agreed upon if the commodity is considered to belong to the same genus as the specified *Salam* asset. However, the delivery of the *Salam* asset in the form of a different type of commodity from that agreed upon may take place only on the basis of the conditions for the replacement of the *Salam* asset by other goods.
- 6.5.5 Delivery of *Salam* asset may take place before the due date on condition that the asset complies with the agreed specifications and quantities. If the purchaser has a valid reason for rejecting the goods, then he will not be compelled to accept them. Otherwise, the purchaser is obliged to accept the asset.
- 6.5.6 If the seller fails to perform his obligation, owing to insolvency, he should be granted an extension of time for delivery.
- 6.5.7 It is not permitted to stipulate a penalty clause in respect of delay in the delivery of *Salam* asset.
- 6.5.8 In case all or part of the *Salam* asset is not available to the seller on the due date, the buyer shall have the following options:
- i) to wait until the *Salam* asset is available
 - ii) to cancel the contract and recover the paid price
 - iii) to agree to replacement of *Salam* asset by other goods.

7 PARALLEL SALAM

- 7.1 It is permissible for the seller to enter into a separate and independent *Salam* contract with a third party in order to acquire goods of a similar specifications to those specified in the first *Salam* contract so that the first *Salam* obligation will be discharged by delivering these goods. Hence the

seller in the first *Salam* contract becomes the purchaser in the second *Salam* contract.

- 7.2 It is permissible for the purchaser to conclude a separate parallel *Salam* contract with a third party for the purpose of selling a commodity whose description corresponds to the description of the commodity to be acquired through the first *Salam* contract. In this situation, the purchaser becomes the seller in the second *Salam* contract.
- 7.3 The two *Salam* contracts as explained in paragraphs 7.1 and 7.2 must be stand alone and cannot become contingent on the outcome of the other.
- 7.4 If one party breaches his obligation under the first *Salam* contract, the other party (the injured party) has no right to relate this damage or loss to the party with whom he concluded a parallel *Salam*. Consequently, he has no right on the basis of his loss or damage under the first *Salam* contract to terminate the second *salam* contract or to delay in performing it.
- 7.5 All the rules of *Salam* as explained in this document are applicable to parallel *Salam* as well.

8 ACCOUNTING REQUIREMENTS

- 8.1 At the time of contracting, *Salam* financing is recognized when cash, kind or benefit is paid in advance by the buyer to the seller. In other words, the financing amount is reported as an asset at face value for the amount disbursed in the balance sheet. The financing amount, either in the form of kind benefit, will be measured at fair value.
- 8.2 Parallel *salam* transaction is recognized when the bank receives the capital of *salam* in cash, kind or benefit. Parallel *salam* is reported as a liability in the balance sheet.

- 8.3 The measurement of capital at the end of the financial period is similar to its value at the time of contract. However, if a decline in the value of the commodity (subject matter of salam) is anticipated, because of variations from the specifications of the contract, provision for the estimated deficit is made.

Reporting of Salam financing depends on the deliverability of commodity (subject matter of Salam)

- 8.4 When goods are received, in accordance with the specifications of the contract, the asset is valued at historical cost or face value of Salam price. Salam financing is replaced with goods valued at the Salam price.
- 8.5 When the goods received are of a different quality, they are reported at a lower cost or market value. The difference between Salam financing and the asset value is recorded as loss.
- 8.6 If the delivery of goods is delayed, the contracting parties may choose either to complete or revoke the contract. If the contract is rejected the financing amount owing is recognized as receivable with provision for doubtful debt i.e. to be received from the supplier.

9 CUSTODIAN OF THE DOCUMENT

This Product Guide shall be under the safe custody of the Islamic Banking Division ("IBD") of DAB. Any changes to this Guide 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 Guide 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 Guide is the _____ day of _____ 20__