

**DA AFGHANISTAN BANK
(CENTRAL BANK OF AFGHANISTAN)**

Guidelines on Prohibition on Specific/Restricted and Loss Bearing Fund Placement from Islamic Banks to Parent Banking Institutions

Guidelines on Prohibition on Specific/Restricted Investment and Loss Bearing Fund Placement from Islamic Banks to Parent Banking Institutions

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|-----------------------------------|------------------------------------|
| Accountable Executive & Custodian | Islamic Banking Department |
| Policy Owner | Head of Islamic Banking Department |

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| Approved by DAB Governor: | Date | DAB Board Secretary |
|------------------------------|---------------|------------------------------|

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ISLAMIC REPUBLIC OF AFGHANISTAN

**DA AFGHANISTAN BANK, GUIDELINES ON PROHIBITION ON
SPECIFIC/RESTRICTED AND LOSS BEARING FUND PLACEMENT
FROM ISLAMIC BANKS TO PARENT BANKING INSTITUTIONS**

PART A: PREAMBLE

1. Background

- 1.1 This Guidelines on Prohibition on Specific/Restricted and Loss Bearing Fund Placement from Islamic Banks to Parent Banking Institutions (hereinafter referred to as “the Guidelines”) 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 need for these Guidelines are mainly to provide confidence to the customers and stakeholders on the Shariah compliance of the Islamic banking activities of the Bank.
- 1.3 These Guidelines 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.

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- 1.4 The task of monitoring these Guidelines shall be upon the Shariah Department (for full-fledged Islamic Financial Institutions) and the Islamic Banking Department/Unit (for Islamic Window or Islamic Unit) of the Bank.
- 1.5 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".
- 1.6 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 requests.

2. Basis of Approval Procedures from International Practices

- 2.1 The Accounting and Auditing Organization for Islamic Financial Institutions (hereinafter referred to as "AAOIFI") was set up primarily to develop accounting and auditing thoughts relevant to Islamic Financial Institutions. The objectives of AAOIFI are set out in the introduction section of both, the AAOIFI Accounting, Auditing and Governance Standards as well as the Shari'a Standards for Islamic Financial Institutions (hereinafter referred to as "the Standards") which states the following:

"AAOIFI carries out these objectives in accordance with the precepts of Islamic Shari'a which represents a comprehensive system for all aspects of life, in conformity with the environment in

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*which Islamic financial institutions have developed. The activity is intended both to enhance the confidence of users of the financial statements of Islamic financial institutions in the information that is produced about these institutions, **and to encourage these users to invest or deposit their funds in Islamic financial institutions and to use their services***

(emphasis added)

- 2.2 Practice and Standard of Malaysia where the directive on this requirement is encapsulated in Malaysia's regulation entitled "Guidelines on Prohibition on Specific/Restricted and Loss Bearing Fund Placement from Islamic banks to parent banking institutions" that was issued on the 13th of January 2010 by the Malaysian Central Bank.

As stated, the reason for the prohibition was due to the reason that:

"...placement to conventional parent banking institutions is prohibited as these institutions do not conduct Islamic banking business"

3. Purpose and Application

- 3.1 These Guidelines shall be applicable to the Islamic/Shariah-compliant financial products of the Bank comprising of investment-based Islamic financial products such as Mudarabah and Musharakah contracts.
- 3.2 The principles as provided in these Guidelines shall constitute a general guideline for the guidance to Banks and all Banks may have their internal Guidelines on the subject matter which are explained in a more detailed manner, pursuant to their internal investment policies. Such specific

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guidelines as provided in the Banks' internal Guidelines shall be deemed acceptable so long that it does not explicitly contravene any of the provisions set out in these Guidelines 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:
- i. National Shariah Governance Framework;
 - ii. Shariah Compliance Manual;
 - iii. Shariah Review Manual;
 - iv. Shariah Parameters on Mudarabah; and
 - v. Shariah Parameters on Musharakah

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PART B: POLICY AND PROCEDURES

5. Practice Requirement

- 5.1 Compliance with the Islamic rules is a fundamental aspect of all Shariah-compliant-based banking or financial products.
- 5.2 Banks must ensure that the relevant departments in the Bank play a vital role in ensuring that end-to-end Shariah-compliant processes and procedures are adhered to, by implementing strict monitoring exercises at both the pre-product and post-product approval stages.
- 5.3 Meanwhile, DAB, as the regulator, will play its role by issuing the necessary regulations at the national level, on the governance and application of Islamic banking activities in the Islamic Republic of Afghanistan to ensure strict compliance of the Islamic standards and this will come via guidelines, manuals, procedures, circulars etc.
- 5.4 Islamic contracts involve a variety of types according to its nature and requirements. Among others, these include contracts which are general and specific, restricted and unrestricted, and loss bearing and non-loss bearing, which the brief explanation are set forth as follows:
- a) Specific/Restricted contract: Investment through Mudarabah contract whereby the types of investment activities are detailed or specified. It is known as Mudarabah Muqayyadah (specific/restricted Mudarabah);
 - b) General/Unrestricted contract: Investment through Mudarabah contract whereby the types of investment activities are unrestricted. It is known as Mudarabah Mutlaqah (general/unrestricted Mudarabah);

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- c) Loss bearing contract: It refers to a Musharakah(partnership) contract where the loss of the venture is shared between the contracting parties based on the proportion of the capital contribution; and
 - d) Non-loss bearing contract: It refers to a contract where one party does not bear the loss of any investment/venture undertaken by the investor such as in the case of Wakalah Bi Al-Istithmar where the agent for the investment will not be liable for the loss of the capital.
- 5.5 Due to the strict compliance to the Shariah requirements for an Islamic banking window, it shall be a requirement that Banks are not allowed to make any specific/restricted and loss bearing fund placements with the parent banking institutions as activities of the parent companies are not compliant with the Shariah principles.
- 5.6 The purpose of this requirement is to protect the Islamic funds from the Islamic deposits from being used to finance non-compliant financial activities.
- 5.7 The application of the requirement under Clause 5 hereto shall be read together with the Shariah Parameters on Mudarabah and Musharakah and any other relevant Islamic contract parameters.
- 5.8 Exception to the general rule:
- For the avoidance of doubt, the requirement as provided hereto shall not be applicable under the following situations:
- a) existing placements already conducted by the Bank (if any), provided that they shall not be rolled over upon maturity; and

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- b) if the parent bank is already a full-fledged Islamic banking institution, or later changes its structure to become a full-fledged Islamic bank, which conducts Islamic financial activities.

6. Custodian of the Document

These Guidelines shall be under the safe custody of the Islamic Banking Division ("IBD") of DAB. Any changes to these Guidelines 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 Guidelines shall be made available to all stakeholders and SSB members for reference and implementation.

7. Effective Date of the Document

The Effective date of these Guidelines is the _____ day of _____
20__