



**Da Afghanistan Bank**  
**Financial Supervision Department**  
**Islamic Banking Division**

**Regulation for Conversion of a Conventional Bank into an**  
**Islamic Bank**

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## **1.0 Introduction**

This Regulation on Conversion of a conventional Bank into an Islamic Bank is Pursuant to the authority granted to DAB by article 89 (3) of Banking Law.

Da Afghanistan Bank (DAB) is committed to the promotion and development of Islamic banking in Afghanistan through setting up legal and regulatory framework for Islamic banking industry. This is in accordance with article 1(2) of the Banking law which stipulates that “The Government shall take necessary measures for encouragement, promote and support of the Islamic Banking”.

Up to date, DAB has issued license to several Islamic banking windows of conventional banks, licensed windows are currently offering Islamic banking products and services in line with the requirements of Shariah.

However, the existence of Islamic banking windows only is not sufficient to fulfill the needs of the industry and there is dire need for full fledged Islamic banks in Afghanistan. Therefore, through this regulation the Da Afghanistan Bank setup detailed guideline and required criteria for conversion of existing conventional bank into full fledge Islamic bank.

## 2.0 Eligibility Criteria

The eligibility criteria for conversion of conventional bank into Islamic bank shall be as follows:

1. Only Conventional banks having Islamic banking windows can apply for conversion into full-fledged Islamic bank.
2. The bank which not yet has Islamic banking window shall first obtain DAB's approval for opening Islamic banking window and provide Islamic banking products and services through window at least 2 years before applying for conversion into full-fledged Islamic bank.
3. To be eligible for conversion, the conventional banks must have CAMEL rating not lower than 3 in latest DAB on-site financial supervision.
4. The Non-performing assets (classified in doubtful and loss category) must be lower than 10% of all classified assets by latest on-site financial supervision and latest off-site financial inspection. In addition the bank must have appropriate plan for disposal of such asset as these asset will not be qualified to convert to Islamic banking products.
5. The asset classified in Sub-Standard category must not exceed 10% of total classified assets and the bank must provide appropriate plan for disposal or improvement of the quality of this category to be converted to Islamic banking products.
6. The bank must suggest Islamic banking mechanisms through which the asset classified under standard and watch-list would be converted to Islamic banking products.
7. The impaired and non-performing LCs and BGs should not exceed 5% of the total LCs and BGs. In addition, the bank must propose appropriate plan for disposal of non-performing LCs and BGs.
8. The applicant bank shall be compliant with Minimum Capital Requirements (MCR), Capital Adequacy Ratio (CAR) and all other requirements as applicable on full-fledged Islamic banks, from time to time.
9. The bank capital must be equal or more than required level as stipulated by Da Afghanistan Bank related regulations.

### **3.0 Necessary Measures for Conversion**

The conventional bank will only be eligible to start the process of conversion into Islamic bank and proceed with this section if it can fulfill the eligibility criteria as stipulated in the preceded section. In addition:

1. The bank shall develop a comprehensive conversion strategy with clear milestones and defined timelines for conversion duly approved by bank's Supervisory Board.
2. The bank shall start conversion process in line with Shariah rules and principles within maximum six months from the grant of in-principle approval, failure to do so will lead to revocation of the in-principle approval.
3. The bank shall notify the plan of conversion to the public at least one month before the initiation of conversion process.
4. The bank shall complete the conversion process within a maximum period of two year from the date of in-principle approval. In case of delay, the bank shall justify extension request with reasons and evidence, duly approved by its Shariah Board and Supervisory Board.
5. The bank should form Shariah Committee and internal Shariah compliance department in accordance the National Shariah Governance Framework (NSGF) and governance standards issued by AAOIFI for Islamic financial institutions wherever applicable.
6. The bank shall also train and develop the personnel required for proper implementation of the procedures of conversion and train the personnel to deal with the application of Islamic banking practice.
7. The bank shall dispose all assets classified under loss and doubtful to third party and dispose or improve the assets classified under sub-standard category during the first quarter after starting the conversion process.
8. The bank shall set up all necessary procedures, create the required tools, and explore alternatives to Shariah non-permissible products & services, operations & arrangements.
9. The bank shall open accounts with local or international Islamic banks and revamping of the accounts that are maintained with local or corresponding conventional banks during the first quarter after starting the conversion. Any dealing with conventional banks must

be limited the magnitude of the need to do so and subject to Bank's Shariah committee approval.

## **4.0 Process of conversion**

The Conversion process shall consist of three steps:

- A. In-principle approval from Da Afghanistan Bank (DAB) for initiating full-fledged conversion of the conventional bank into an Islamic Bank;
- B. Conversion of conventional bank into Islamic bank; and
- C. Issuance of Islamic Bank license.

### **A. In principle approval**

Prior to application for in principle approval, the bank should fulfill the eligibility criteria as stipulated in section 2.

1. By fulfilling the eligibility criteria, the bank shall submit their application to the Da Afghanistan Bank. The application shall comprise of the comprehensive conversion plan duly approved by bank's supervisory board and bank's Shariah committee. The conversion plan shall contain detailed process and procedures along with well thought-out timelines and milestones regarding conversion of all products and services and segments etc. The bank should submit the following documents along with its application:

#### **a. Supporting documents:**

- i. Resolution of bank's board of supervisors for conversion of the bank into an Islamic bank;
- ii. Proposed changes in by-laws (Memorandum and articles of Association), along with an opinion of an external legal consultant;

- iii. Information about the controlling / major shareholders / sister concerns / group companies / subsidiaries;
- iv. Profiles of members of Supervisory Board & Key Executives of the bank;
- v. Existing and proposed organizational structure;
- vi. Strategic conversion plan;
- vii. Financial model/ feasibility study alongwith assumptions and projected key financial figures & ratios;
- viii. Risk management policies;
- ix. Product plan;
- x. Shariah compliance mechanism;
- xi. Details of existing branches and Islamic banking windows network and employee strength;
- xii. Latest audited financial statements; and
- xiii. Other documents deemed relevant and important by DAB from time to time.

**b. Strategic Business Plan:**

- i. Mission and Vision for conversion of the conventional bank into an Islamic bank;
- ii. Five years business plan of the bank including at least: human resource plan, marketing plan, operational plan, overall business model and capital structure, internal controls mechanism and governance structure which include Shariah Governance framework;
- iii. Feasibility study on market opportunity and economic potential;
- iv. Operational / execution plan for mobilization and channeling of funds, and steps to be taken to carry out conversion;
- v. Capital adequacy compliance plan; and
- vi. Plan for conversion of Asset and Liability side products along with off-balance sheet items.

**c. Position and treatment of Shariah impermissible items:**

- i. Position and proposed treatment of all Shariah impermissible existing assets and liabilities with corresponding Shariah compliant solutions.
- ii. Position and proposed treatment of all off balance sheet items with corresponding Shariah compliant solutions.
- iii. Position of non-performing assets (i.e. classified in Sub-standard, doubtful and loss categories) and proposed treatment of the same.
- iv. Details of Shariah non-compliant income / earnings and mechanism adopted for its disposal.
- v. Details and treatment of Shariah non-compliant collaterals / securities.
- vi. Details of all the existing products and services being offered by the bank including deposits, loan/advances, trade finance, treasury, export refinance, liquidity management, online services, third party products like bancassurance etc., along with methodology adopted for their conversion into Shariah compliant forms including treatment of collaterals i.e. lien, hypothecation, pledge, mortgage, any form of encumbrance / charge.
- vii. Details and proposed treatment of investment portfolio such as T-Bills, bonds, shares etc. along with existing position such as amount, nature, maturity, payments, accruals etc.
- viii. Information on all conventional financing arrangements with Da Afghanistan Bank.
- ix. Details and proposed treatment of Nostro / Vostro Accounts and Shariah compliant alternatives.
- x. Wherever necessary, before submitting the documents to DAB, the Shariah approval of the Shariah Committee of the Bank shall be obtained.



**d. Training and Capacity Building:**

- i. The bank should provide details of preliminary training provided to all or selected employees of key departments of the bank, prior to applying for conversion.
- ii. A complete list of Islamic Banking certification / training programs to be conducted in local and international institutions shall be submitted to DAB with a comprehensive training plan (specifying contents, trainers, schedule etc.). The training will be provided for the bank's staff designated at the Head Office including: Risk, Audit, Compliance, Business, Operations, Regional / Area Offices and at the branch level including Branch Managers, Operation Managers and Relationship Managers.
- iii. In the same manner, the bank shall specify arrangements / plan for training and capacity building of BOS, Key Executives, staff of Head Office and other bank officials to be entrusted with the execution of conversion process.

**e. Policies and procedures:**

The bank should develop relevant policies and procedures/ manuals related to all main functions of the Islamic banking business including by not limited to; Islamic Financing Policy. Deposit policy, Internal Shariah Audit Policy, Risk management policy, Operations Policy and Procedures, Marketing policy, Profit Distribution Policy, Shariah Compliance Policy, Investment Policy, Liquidity and Treasury Management Policy, Human Resource Policy, Letter of Credit Manual, Bank Guarantee Manual and Product manuals for Islamic products and services.

All these policies and manuals must be duly approved by Shariah Board and Board of Supervisors. In addition, the bank should provide plan for contingency funding and plan for IT integration / migration from conventional bank into Islamic bank.

**f. Core Banking System and controls:**

- i. A specialized core banking system for Islamic banking is required to offer full fledged Islamic banking services, hence the applicant bank shall submit information about the availability of systems and applications, with controls, for conducting full-scale Islamic banking operations including profit distribution & pool management and other required specialized tools for Islamic banking.
- ii. The bank shall ensure that proper systems and controls are in place to protect the interest of customers and minimize the risks arising from banking operations.

**g. Audit and Review:**

- i. The bank shall submit plans for resolution of adverse findings of internal, external and Da Afghanistan Bank Supervision reports; especially regarding NPL, fraud, forgery, money laundering and terrorist financing (if any) before conversion.
- ii. The banks shall submit plans to undertake comprehensive internal audit on the operations of the bank both at pre and post conversion stages.
- iii. The bank shall set up Shariah Compliance Department and the Shariah compliance department of the bank shall arrange for periodic internal Shariah review and prepare a report in coordination with Monitoring Committee. The report shall be submitted to BoS on a quarterly basis till the completion of conversion process.

**h. Public Awareness and Marketing Arrangements:**

- i. The bank shall submit a comprehensive marketing plan such as (if any) brand name, logo and tagline for launching full-fledged Islamic banking business and related details.

- ii. The marketing plan shall be inclusive of strategy for informing bank's customers and general public about conversion through direct contact, print and electronic media and other public awareness arrangements that deemed necessary for conversion.
- iii. The plan shall highlight the process for obtaining consent from existing customers for conversion to Islamic banking products and services (assets and liabilities) both locally and internationally (if applicable).
- iv. The marketing plan shall be inclusive for settlement of all assets and liabilities of customers unwilling to continue relationship with the bank on new terms and conditions and suggest alternatives if any.

**i. Other requirements:**

- i. The bank shall provide the list of proposed Shariah committee members and seek approval from the Da Afghanistan Bank.
  - ii. The bank shall provide details about bank's subsidiaries such as branch network, nature of business, management structure, major shareholding, staff strength etc.
  - iii. The bank shall provide the future strategy / plan for conversion of bank's conventional subsidiaries (if any).
  - iv. Plans for conversion of Shariah non-compliant employee benefits / facilities into Shariah compliant modes.
  - v. Information about activities / cases which do not have corresponding Shariah compliant solutions and where the income has to be channeled to charity if any.
  - vi. Summary of the court cases under litigation and the bank's plan for settlement of customers' and shareholders' rights and obligations. The bank shall also provide a legal opinion that the cases under litigation (if any) will have no effect on the conversion process.
2. By fulfilling all the above requirements and submitting the required documents, Da Afghanistan Bank will evaluate the proposal of the bank keeping in view merits of the case and upon its satisfaction, will grant an in-principle approval to the bank to initiate the conversion process.

3. The bank shall be prohibited from expanding its conventional banking network from the date of grant of in-principle approval.
4. The bank shall set up a helpdesk & a well-defined complaint handling mechanism with respect to customers' queries regarding conversion of the bank, with proper record keeping and reporting to appropriate predefined level.
5. For smooth streamlining of business operations and conversion of conventional banking portfolio, the bank shall identify / hire experienced and trained key staff to handle the conversion process.
6. The bank shall form two core committees i.e. Implementation Committee (IC) and Monitoring Committee (MC) and submit their Terms of Reference (ToRs) to Da Afghanistan Bank, duly approved by bank's Board of Supervisors. The committees shall present a report on the conversion progress and related details, on a quarterly basis, to the bank's Board of Supervisors.
7. The bank shall submit a quarterly report on conversion progress and related matters duly signed by the CEO / President along with Shariah Board's certificate to Da Afghanistan Bank till the completion of entire conversion process.

## **B. Conversion of Conventional Bank into Islamic Bank**

- i. Once the in-principle approval is granted to the bank by Da Afghanistan Bank, the bank shall immediately start conversion process within a month time (maximum 6 months time) after receiving in-principle approval.
- ii. The bank will have a maximum of two-years from the date of in-principle approval to fully convert its activities from the conventional banking into Islamic banking.
- iii. The bank will strictly follow the commitments and plans submitted to the DAB for in-principle approval.
- iv. The implementation Committee (IC) and Monitoring Committee (MC) will submit report on the conversion progress and related details duly approved by the bank's Shariah Committee and Board of Supervisors to Da Afghanistan Bank on quarterly basis.

- v. The bank shall follow the AAOIFI Shariah standard No. (6): for conversion of a conventional bank to an Islamic Bank, during the process of conversion.

### **C. Issuance of Islamic Banking license**

1. Once the bank has successfully completed all requirements in light of conversion plan and as stipulated in-principle approval, this successful completion will be dully approved by the bank Shariah committee and Board of Supervisors. The bank shall then apply for the issuance of full-fledged Islamic Banking license. The application will be supported and accompanied by the following documents:
  - i. Comprehensive list of Islamic banking asset and liability side Shariah compliant products with details and modus operandi duly approved by Shariah committee and BoS of the Bank;
  - ii. Revised Memorandum & Articles of Association of Islamic Bank along with summary of changes made;
  - iii. Shariah Review Report and Shariah committee's Certificate confirming that the whole conversion process has been undertaken in conformity with Shariah;
  - iv. A comprehensive post-conversion report containing status on areas mentioned in the preceding sections, duly certified by bank's Shariah committee and Board of Supervisors;
  - v. Evidence that policies and procedure/process manuals as mentioned in preceding section including but not limited to; Operations, Credit & Risk Management, Treasury, Internal Control including Shariah Compliance, Shariah Audit, Information Technology Systems and all products have been prepared / revised and approved by the Shariah Committee and the Board of Supervisors of the bank;
  - vi. Confirmation that all HR policies including employee benefits and facilities have been converted from conventional modes into Shariah compliant modes;

- vii. Summary of changes made in the systems & controls and policies & procedures for conducting Islamic banking operations;
  - viii. Detailed report about the initiatives taken for capacity building / training of human resource regarding Islamic Banking;
2. The relevant authorities of Da Afghanistan bank will review the documents provided, based on satisfactory review, the bank shall issue a full license of an Islamic Bank while the conventional banking license shall be surrendered by the bank to Da Afghanistan Bank.
  3. Once the bank received Islamic banking license from Da Afghanistan Bank, the bank shall only engage in Shariah compliant banking operations.
  4. The conversion from an Islamic bank into conventional bank is not permissible and will not take place.
  5. The newly licensed Islamic bank is subjected to all prevalent banking and other laws, Islamic banking guidelines and regulations and circulars issued by Da Afghanistan Bank from time to time.
  6. The new Islamic bank will be given six months interim period after issuing Islamic banking license. Within this six months timeframe, the bank will familiarize its staff with new core banking system, Islamic banking operations and financial reporting formats.

## **5.0 Enforcement**

In order to properly enforce this regulation, if needed DAB will provide specific interpretations and impose additional requirements through circulars.

## **6.0 Effective Date of Regulation**

This regulation is effective immediately upon adoption by the Supreme Council of the Afghanistan Bank.