Determinants of Profitability of Commercial Bank in Afghanistan

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PLAGIARISM STATEMENT

I have written this project using my own words and ideas, except otherwise indicated. I have subsequently attributed each word, idea, figure, and table which is not my own to their respective authors. I am aware that paraphrasing is plagiarism unless the source is duly acknowledged. I understand that the incorporation of material from other works without acknowledgment will be treated as plagiarism. I have read and understand the Bard College statement on plagiarism and academic honesty as well as the relevant pages in the Student Handbook.

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Mohammad Osman Saeedi

Abstract

Over the past two decades, the global financial sector, particularly the banking industry, has undergone significant transformations impacting its performance. Recognizing the pivotal role of the financial sector in economic growth, this study focuses on Afghanistan's banking sector, tracing its roots to the establishment of the first commercial banking institution, Bank Millie Afghan, in 1933. Following decades of war, the banking sector experienced revitalization after 2001, marked by the emergence of a new government, international aid inflow, and increased business activities. Despite remarkable growth, Afghanistan's banking sector faces challenges such as security concerns, cultural issues, and a developing banking culture. The sector comprises 15 banks, with growth attributed to market economy reforms. However, the sector's vitality poses opportunities and challenges, necessitating attention to technology, experience, and regulatory frameworks. The 2010 Kabul Bank crisis underscored weaknesses in banking regulation and international standards enforcement. This study addresses the problems and gaps in the literature concerning Afghanistan's banking sector, focusing on factors influencing bank profitability. The research questions explore determinants of profitability, the Central Bank's role, and factors affecting bank performance. The study aims to investigate these factors for 11 Commercial Banks from 2015 to 2019, examining internal and external elements and their impact on profitability ratios. The significance of the study lies in its contribution to identifying determinants of profitability, benefiting bank managers, regulators, depositors, investors, and policymakers. Findings may guide policies to stabilize, profit, and make the banking system investor-friendly. Additionally, the study is a reference for future research on the relationship between risks and bank profitability in Afghanistan, offering insights into research procedures and unexplored areas. The banking sector in Afghanistan, with both Islamic and commercial banks, provides a choice between risk and security, catering to diverse preferences for stability and potential profits.

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Introduction

Throughout the last two decades, the global financial sector, in particular the banking industry, has experienced some major changes in its environment that have had a significant impact on its performance (Wright, 2018). It is believed that the financial sector plays a key role in the economic growth and development of a nation. The financial sector ensures the mobilization of domestic resources, encourages investment, and generates savings. The significance of an efficient financial system in an economy dates to the theories of Hamilton in 1781, who said that "banks are the happiest engines that were ever invented to spur economic growth" (Aiyar, 2015). Of all financial intermediaries, commercial banks are crucial as they channel and mobilize funds, particularly for the private sector, for the purpose of investment in other businesses. Based on the literature, commercial banks are significant institutions in most of the emerging economies. As a matter of fact, banks represent one of the most essential groups of financial intermediaries, which play a key role in channeling funds. Their main role is not only transferring funds from the savers to the investors but also ensuring that these funds are transferred to the most important sectors of the country (Mullan, 2017). Therefore, it is necessary to recognize the factors that really affect the bank's profitability. This project will focus on the banking sector of Afghanistan. Afghanistan's banking system was founded in 1933 establishing a commercial banking institution sector for the purpose of investment in other businesses. Based on the literature, commercial banks are significant institutions in most of the emerging economies. As a matter of fact, banks represent one of the most essential groups of financial intermediaries, which play a key role in channeling funds. Its main role is not only transferring funds from the savers to the investors but also ensuring that these funds are transferred to the most important sectors of the country (Wales, 2017).

Afghanistan's banking system was founded in 1933 with the commercial institution Bank Millie Afghan (BMA), which had an initial capital of Afghanis 9.6 million consisting of 72% private shares and 28% state-owned shares (Mohmand, 2015). The first central bank of Afghanistan was established in 1939 with an initial capital of Afghanis 120 million and took over the responsibility and authority in order to adapt all the banking sector affairs related to the financial sector of the country (Fitrat, 2018).During the three decades of war and conflict, the banking and financial systems in Afghanistan were destroyed and ruined. The banking sector of Afghanistan consisted of only six state-owned banks, which were mostly inactive and mainly operating in the capital city of Kabul. With the emergence of a new government in late 2001[Office1] , the banking sector of Afghanistan grew up intensely with the expansion of public services, the inflow of international aid, and the arrival of local and multinational companies into the country, all of which greatly needed banking services in order to support their operations (Mohmand, 2015).

Afghanistan's banking sector is relatively small and consists of 15 banks, 9 private, 3 state-owned, and 3 foreign commercial banks as of 2019 were reported (DA Afghanistan Bank, 2019). The banking system of Afghanistan operates based on the concept of universal banking, where banks can offer all types of banking services. The banking sector of Afghanistan experienced remarkable growth during the last few years. The number of banks increased from a few state-owned banks to 15 banks across the country. The growth in size and deposits of this sector are two important outcomes of the market economy reforms that were carried out in Afghanistan (Mohmand, 2015). The growth of the financial sector in Afghanistan is in its initial stages, with no more than 15 years of experience, and it is considered an opportunity as well as a challenge for the country. Security and banking culture issues are the major obstacles to the efficient growth of the banks in Afghanistan. Meanwhile, it is a newly created industry with a range of challenges in the fields of technology, experience, and regulatory frameworks. On the other hand, the existing situation of the banking industry can be viewed as an opportunity to establish a vision and work toward creating a plan for an inclusive financial sector in Afghanistan (Wafa, 2014).

Problem Statement

Regarding the fact that the banking sector in Afghanistan is quite young, it is faced with several challenges in different areas such as technology, standards, and regulatory framework. Besides, insecurity, banking culture and weak governance system issues are other obstacles to the growth of the commercial banks in Afghanistan.

Due to these issues the banking sector of Afghanistan has faced many challenges such as the Kabul Bank crisis in 2010 which was a major setback for the sector. The fraud in Kabul Bank, the largest private bank of the country, caused the withdrawal of nearly half of the bank's deposits. As a result of this crisis, the Afghan government and its people lost almost one billion $ 1 billion (Fitrat, 2018). The Kabul Bank crisis underlines the weakness of the central bank of Afghanistan in regulating the banking system, implementing international standards, and enforcing the bank supervision. The problems discussed above in the banking sector of Afghanistan regarding the performance in general and profitability and as well as the gap in the literature require a full investigation. There are many factors which affect the profitability of commercial banks in theory, but it is of high importance to conduct empirical research in order to know the exact factors which can affect the commercial bank's profitability in Afghanistan. Therefore, the problem of this study is to examine some key factors (bank-specific and macroeconomic) of commercial banks' profitability as well as the extent to which these factors influence the profitability of these banks in Afghanistan.

Research Question

This paper attempts to answer the following questions:

· What are the determinants of profitability of commercial banks?

- What is the role of the Central Bank in relation to the commercial Banks operation In Afghanistan?

· What factors significantly influence the performance and profitability ratio of commercial banks in Afghanistan?

· What policy, reform and recommendations should be promoted to enhance banks profitability and performance in Afghanistan?

- What ensures the banking sector stability?
- What regulatory structure prevents the failure of the bank?
- How the Islamic Banking operates under Islamic law In Afghanistan?

Research Objective

This study aims to investigate the determinants of profitability of 11 Commercial banks in Afghanistan for the period of 2015-2019 by analyzing both internal (bank-specific) and external (macroeconomic) factors, assessing the quantitative impact of each significant factors on profitability ratios (Return on Asset ROA, Return on Equity (ROE)) as well as to fill the gaps in previous studies and add to the empirical pool of knowledge about banking sector inAfghanistan.

Significance of The Study

Since the banking sector is believed to be an important source for financing economic activities in every single economy, it is of high importance to devise every possible means for identifying the determinants of profitability of commercial banks. Therefore, this study is significant for the users who participate in the banking activities such as bank managers, regulators of banks or monetary authorities, depositors, investors, researchers and the policy making institutions of the country. This significance of the study is further explained in the following ways:

First, the findings of this study are important for the managers of the banks because the level of profitability of Banks indicates the ability of the banks to adapt to shocks such as financial crises. The profitability of banks serves as a good sign for the managers of the banks in order to understand the strength of their banks against the general banking industry. Secondly, this paper is important for the monetary authorities who oversee improving the liquidity and financial stability in the banking sector of Afghanistan. With the results of this study the monetary authorities will be capable of adopting policies which can make the banking system more stabilized, profitable and investor friendly.

Moreover, this study may serve as a reference material to the students, lecturers and future researchers who wish to carry out further research about the relationship between the risks and profitability of banks in Afghanistan. This is because the researchers who are interested in this area can use this study as a guide for further investigating this topic. This paper gives a clearer picture about the procedures of doing a research and as well as it leads them to examine or bring about something which is still unknown.

The Initial Conditions Following the Taliban Era

The banking systems of Afghanistan were severely damaged in the aftermath of prolonged conflict, particularly in the latter part of 2001. There were six state-owned commercial banks in

Afghanistan that were licensed, primarily located in Kabul and exhibited a significant degree of inactivity. The banking institutions exhibited deficiencies in terms of interconnectivity, dependable data pertaining to their assets and liabilities, and adherence to universally recognized accounting principles. The 1994 Law on Money and Banking established the minimum capital requirements. However, according to the International Monetary Fund (IMF) report of 2003, the absence of risk management systems that bear resemblance to contemporary banking was noted. Provisioning was not made for nonperforming loans and they were not written off. The managers appointed to oversee the bank lacked relevant banking experience and were primarily chosen for their political affiliations. Additionally, the bank staff exhibited limited knowledge and capacity. During the Taliban regime, the functioning of commercial banks was impeded due to the prohibition of interest payments and charges in accordance with Islamic law. Consequently, financial institutions had discontinued all loan disbursement operations, leading to a shift towards the unregulated economy. Despite this, the banks possessed considerable assets, mainly in the form of real estate, which were recorded in their financial statements. As a result, they remained financially viable, and a few even generated revenues from foreign currency deposits held overseas. The Law on Money and Banking, which regulated the conduct of commercial banks, was also the legal framework for DAB (Da Afghanistan Bank) operations, although with inadequate enforcement and infrequent adherence. According to the International Monetary Fund (IMF) in 2003, the institution in question exhibited characteristics of Soviet-style dirigisme by intervening in the process of credit allocation and interest rate determination.(IMF,2003,P116).The central bank of Afghanistan (DAB) failed to define and execute seven crucial functions, while the country lacked a trustworthy and established payment system. The primary issues of concern were the lack of adequate prudential requirements, including provisioning, loan classification, and exposures, as well as the absence of enforcement mechanisms by the Deposit Assistance Board (DAB). One of the principal functions attributed to DAB(Da Afghanistan Bank) was to provide financial support to the government, a factor that had resulted in swift devaluation of the currency. Simultaneously, DAB(Da Afghanistan Bank) participated in commercial banking activities by functioning as a deposit-accepting entity for the general public and providing extended-term loans. (*IMF,2003,p124*).[1]

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[1] Pavlović , Jelena, and Joshua Charap. “Development of the Commercial Banking System in Afghanistan: Risks and Rewards.” IMF Working Paper, 2009. https://www.imf.org/external/pubs/ft/wp/2009/wp09150.pdf.

Transformation of the Banking and Financial Sectors

The Banking system in Afghanistan was first ever founded in 1933 where the Institution BMA (Bank e Mili Afghanistan) was involved with activities such as managing state banking affairs prior to the establishment of DAB (Da Afghanistan Bank). " According to the CM (Council Of Ministers) Approval number 152 dated May 28th 1939 wolesi Jirga (House of Representatives) approval number 11 dated February 6th 1939 Meshrano Jirga (senate) historical approval dated february 26th 1939 and then-king's approval number dated January 27th 1940. Da Afghanistan Bank was established in capital Kabul with an initial asset of 120 million Afghanis, which, with its defined authorities and responsibilities, was able to set up its branches and subsidiaries inside and outside the country. Da Afghanistan Bank was established in capital Kabul with an initial asset of 120 million Afghanis, which, with its defined authorities and responsibilities, was able to set up its branches and subsidiaries inside and outside the country.[2]

The establishment of Da Afghanistan Bank (DAB) occurred in 2001, when it first functioned as a commercial bank responsible for overseeing state financial matters. However, following the year 2003, it transitioned into a separate establishment with distinct obligations and responsibilities, and was given the status of the Central Bank of Afghanistan. The main goal of DAB is to maintain price stability. It is in possession of formulating, carrying out and adopting monetary policies, foreign currency policy, producing banknotes, and minting coins. DAB, functioning as a state banker and financial institution, grants licenses to banks, foreign exchange dealers, financial services providers, and securities, while also ensuring the provision of a secure and stable payment system.

Since 2003, Afghanistan's banking and financial industries have changed, with new legislation controlling bank lending. The 2004 Da Afghanistan Bank (DAB) Law improved bank supervision and monetary policy. The Banking Law legalized commercial banks in September 2003, and eleven were licensed by 2005. Most banks offered basic services, but bad management, unethical behavior, and inadequate legal and regulatory frameworks affected them. Isolated commercial banks faced obstacles by weak and corrupt courts and security and uncertainty. Afghanistan's financial system has 15 commercial banks, 183 branches, 332 foreign

[2] "DAB History." Da Afghanistan Bank. Accessed December 08, 2023. https://www.dab.gov.af/dab-history.

currency dealers, and 100 regulated money service providers in March 2008. Localized hawala is simpler, faster, cheaper, and more convenient than commercial banks.[3]

Sarafi's (Sarafs)

The Hawala method has remained relevant in various transactions due to the public's familiarity with its operations. The system is thought to offer faster, more cost-effective, and more convenient services compared to commercial institutions since it is better suited to local conditions. This is a result of the absence of documentation or bureaucratic procedures necessary for client authentication, risk evaluation, or transaction authorization.

The Hawala system is well regarded and dependable for both the general population and investors in Afghanistan. This system has been integral to Afghanistan and the broader Middle East region for centuries. The primary catalyst for the success of this informal market transaction is the trust that has been developed among individuals over many years of operation. Nevertheless, additional elements that bolster the efficacy of the hawala system include the established protocols and guidelines, as well as the streamlined procedure for transmitting and receiving funds, circumventing the protracted procedures of traditional banking institutions.

DAB has to take certain measures to control this informal market. DAB must explore potential solutions to regulate and supervise this market without pushing it underground. The two alternatives proposed by the IMF include extending banking regulations and supervision practices to money dealers, which would likely push the activity underground. Firstly, the hawala dealers could subject themselves to self-regulation and supervision, utilizing an association that enforces unwritten rules. Secondly, recognizing the unique features of the hawala system, special regulations and supervision techniques could be developed to increase transparency while maintaining efficiency. Moreover, these regulations could include registration but not licensing of dealers, enabling customers to identify and maintain records, and cooperation in investigations. The DAB could also enter and inspect money dealers' premises if necessary. Lastly, through information campaigns, the DAB could educate money dealers about their responsibility to report suspicious activities. And I strongly agree with this approach because it

[3] Pavlović , Jelena, and Joshua Charap. "Development of the Commercial Banking System in Afghanistan: Risks and Rewards." IMF Working Paper, 2009. https://www.imf.org/external/pubs/ft/wp/2009/wp09150.pdf.

will help maintain the efficiency and transparency of the hawala market in Afghanistan, which plays a vital role in the financial sector of the country.[4]

Islamic Banking in Afghanistan

In Afghanistan, Islamic banking has grown a lot in the past few years. In 2009, Bakhtar Bank became the country's first Islamic bank. Since then, several other Islamic financial institutions have opened, such as the Islamic Banking Branch of the Afghanistan International Bank, Ghazanfar Bank, and the Islamic Window of First Microfinance Bank. Islamic banking is growing in Afghanistan because of various factors, such as the growing demand for financial services that are in line with Shari'ah, the country's predominantly Muslim population, and the government's efforts to promote Islamic banking to promote financial inclusion and economic growth. Afghanistan's Islamic banks offer various financial products and services, such as savings accounts, loans, investment opportunities, and insurance. Murabaha (cost plus sale), Musharaka (partnership), Mudaraba (profit sharing), and Ijarah are the most common types of financing that Islamic banks in Afghanistan offer (leasing). The Afghan government has supported Islamic banking and has taken several steps to help it grow. These include issuing regulations for Islamic banking and setting up a Shari'ah supervisory board to monitor how Islamic financial institutions work. Overall, the growth of Islamic banking in Afghanistan is good for the country's financial sector because it can help promote financial inclusion and economic growth, especially in rural areas that don't have easy access to money (International Journal of Economics, Commerce, and Management (2016).

After Bakhtar Bank became an Islamic bank in Afghanistan, Khalid and Ullah (2020) examined the strategic move to align operations with Islamic principles and address rising demand for Islamic financial services. The study examined the bank's performance before and after the transformation using quantitative and qualitative data. Islamic banking appears more resilient and profitable than traditional banking, with higher returns on equity and assets. From 2009 to 2019, the Islamic Bank of Afghanistan has superior returns on assets, equity, liquidity, solvency, and leverage ratios. The study found that Islamic banking is more successful in Afghanistan than

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[4] Schaetzen, Bruno de, Louis Dicks-Mireaux, Felix Fisher, Thierry Kalfon, and Ron van Rooden. Edited by Adam Benett. Reconstructing Afghanistan, 2005. https://www.imf.org/external/pubs/nft/2005/AFG/ENG/REAF.pdf.

traditional banking. The essay also examines Afghanistan's Islamic banking system's history and rapid global growth along with its potential demands.[5]

Tahani (Al-Adwani, 2015) researched the impact of service quality on the performance of banks in Kuwait. This paper states that banks (both conventional and Islamic) offer products and services compiled according to Sharia Law and embodied with new technology. The services that are provided by both types of banks are the same, but they are based on different principles and have different natures. Hence, it is important to see how the services and products of these two types of banks play a role in customers' satisfaction. This paper aimed to study the perceived service quality and customer satisfaction and their role in bank performance and profitability. This paper develops a service quality model to identify service quality dimensions, assess customer satisfaction, and find the relation between service quality and a bank's performance. This paper included variables such as staff professionalism, operation efficiency, convenience, competitive cost, and the bank's image as independent variables. The data were collected through questionnaires from 400 customers. The data were analyzed using the OLS regression method, and the results show that operation efficiency, reliability, and assurance positively correlate with customer satisfaction and the bank's performance. The author states that further research should be done in this area by adding more variables related to customer satisfaction.[6][7][8]

Kabir (Hassan, 2015) studied the profitability determinants of Islamic banks. He stated in his research that since 1990, Islamic banks have expanded their network to more than 60 countries, generating assets worth around 166 billion dollars. The paper adds that the competitive emergence of Islamic banks in the banking sector raised many questions regarding what policies

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[5] Arslan, Erdal, Ali Bora, and Abdul Hasib Amanat. "Comparative Analysis of Conventional and Islamic Banking: The Case of Bakhtar Bank Transforming into Islamic Bank of Afghanistan." YÖNETİM VE EKONOMİ, 2020. https://www.researchgate.net/publication/348162954_Comparative_Analysis_of_Conventional_and_Islamic_Banking_The_Case_of_Bakhtar_Bank_Transforming_into_Islamic_Bank_of_Afghanistan_Geleneksel_ve_Islami_Bankaciligin_Karsilastirmali_Analizi_Bakhtar_Bank%27i.

[6] Al-Adwani, Tahani S., Rashed S. Al-Ajmi, and H. I. Hamdy. "Service Quality in Islamic and Conventional Banks in Kuwait: Analysis of Customers' Perceptions." In *Islamic Finance: Performance and Efficiency (Volume 3)*, edited by Mehmet Asutay and Abdullah Q. Turkistani, 309–32. Gerlach Press, 2015. https://doi.org/10.2307/j.ctt1df4hbd.15.

[7] In *Islamic Finance: Performance and Efficiency (Volume 3)*, edited by Mehmet Asutay and Abdullah Q. Turkistani, 309–32. Gerlach Press, 2015. https://doi.org/10.2307/j.ctt1df4hbd.15.

[8] Al-Adwani, Tahani S., Rashed S. Al-Ajmi, and H. I. Hamdy. "Service Quality in Islamic and Conventional Banks in Kuwait: Analysis of Customers' Perceptions."

should be implemented to increase the efficiency and profitability of Islamic banks while preventing a financial crisis in the banking sector. This paper aimed to explore both internal and external factors affecting Islamic banks using a sample of 43 Islamic banks from 21 countries for the period of 1994–2001 Internal and external factors are extracted from the IMF database and the Bank Scope Database. Four indicators, margin (NIM), profit margin (BTP/TA), return on assets (ROA), and return on equity (ROE), are used as proxies for measurement of the performance of banks. The result indicates that capital ratio and GDP growth are positively related to the performance of Islamic banks, while loan ratio and bank size are negatively related. The author suggests that future researchers conduct regression analysis on mixed samples of both Islamic and conventional banks.

Samir (Srairi, 2015) conducted research on the efficiency and stock market performance of Islamic banks in GCC countries. According to this research, Islamic banks have emerged in most of the Middle East and south-central Asia in 75 countries, contributing to a $1 trillion financial value by 2010, and it is expected that their assets will increase to $4 trillion by the end of 2020. It is also stated that the efficiency of Islamic banks has been growing at an average rate of 20%–30% per year. This paper aimed to study the relationship between the efficiency of Islamic banks performance in the Gulf Cooperation Council and stock market performance for the period of 2003–2009, taking a sample of 25 GCC Islamic banks. The non-parametric data envelope analysis method is used to find the relationship between the efficiency of Islamic banks and share prices in the market. The result indicates that the technical efficiency of Islamic banks is 66%, indicating that there should be a revision on the cost and revenue of the bank's operation. It is stated that Islamic banks can improve their efficiency by saving costs, increasing their size, and improving their operational scale. There was found to be no relation between scale efficiency and stock return, while there has been observed to be a positive relation between managerial efficiency and stock return. Finally, it is derived from the regression that book-to-market value of Islamic values has a positive relation with stock return. The author suggests that future researchers investigate the relationship between Islamic banks and stock performance in less developed countries.[9] Kabir (Hassan, 2015)

[9] Srairi, S., Kouki, I., & Harrathi, N. (2012). *Efficiency and stock market performance of Islamic banks in GCC countries*. IslamicMarkets. https://islamicmarkets.com/index.php/publications/efficiency-and-stock-market-performance-of-islamic-banks-in-gcc

Islamic and Traditional Banking Systems of Afghanistan

The present study aimed to examine the activities of Islamic banking and conventional Banking in Afghanistan, as well as the impact of Islamic banking on commercial banking. Additionally, the study sought to assess customers' satisfaction levels and their awareness regarding banking activities in the country. The study aimed to examine the activities of Islamic and conventional banking, assess the impact of Islamic banking on commercial banking, evaluate customer satisfaction, and assess customer awareness of banking activities. A sample size of 250 questionnaires was distributed among the respondents, out of which 162 questionnaires were retrieved. The focal points of the discussion were centered around the concepts of profitability, customer satisfaction, improved performance, customer awareness, customer preferences, efficiency of Islamic banking, adherence to Shariah principles, and the risk level associated with Islamic banking. Da Afghanistan Bank, also known as the Central Bank of Afghanistan, was established in the city of Kabul in 1939 through the infusion of 120 million Afghani in investments. Prior to the establishment of the Central Bank of Afghanistan (Da Afghanistan Bank), the management of Afghanistan's national banking activities was under its purview. As per the tenets of the Doctrine of Appropriateness of Behavior the primary responsibility of the central bank is to ensure the stability of the currency's value. To this end, it is tasked with the issuance of licenses, regulation of other financial institutions such as banks, foreign exchange dealers, and securities providers, as well as the provision of a secure and comprehensive payment infrastructure within the country. The year 2008 marked the introduction of Islamic banking to the banking market of Afghanistan, which was facilitated by the establishment of a local commercial bank known as Afghan United Bank. (Istanbul Aydin University).

In 2011, Ansari and Rehman conducted a study which concluded that Islamic banks exhibit superior liquidity, risk management, and efficiency when compared to commercial banks. Additionally, the study found that Islamic banks experience a positive trend in their performance over time.

From the beginning until 2002, the Central Bank of Afghanistan engaged in commercial operations to traditional financial institutions, in addition to overseeing national banking operations. In 2003, in accordance with Article 12 of the Afghanistan Constitution, the Central Bank of Afghanistan was established as an autonomous entity with distinct responsibilities, objectives, mission, vision, and accountabilities. The primary responsibility of the central bank is to maintain the constant value of currency in accordance with the law of DAB. In order to fulfill this obligation, the central bank is tasked with planning, executing, and implementing monetary policies, as well as foreign currency policies. Additionally, the central bank is responsible for providing, printing, and minting banknotes and coins. Furthermore, in its capacity as the primary financial entity and regulator of the government, the central bank of Afghanistan, as stipulated by the country's legislation, is responsible for granting licenses, overseeing other banks and financial institutions, foreign exchange dealers, financial services providers, securities, and establishing a secure and all-encompassing payment infrastructure within the nation. In 2008, the Afghanistan banking market saw the introduction of an Islamic banking window through a local commercial bank called Afghan United Bank, marking the first instance of such an occurrence. AUB is a conventional bank that operates domestically and obtained its official registration and license from the central bank of Kabul, Afghanistan on October 4, 2007. (Istanbul Aydin University).

Despite its establishment in 1939, the legal financial system in Afghanistan was virtually non-existent by the end of 2001. The sole responsibility of the Afghan Central Bank (DAB), as stated by DAB itself, was to issue the national currency. In 2003, the Afghan government modified the statute that governs the control of the DAB. Due to this legislation, the Afghan government has delegated to DAB the task of ensuring price stability within the country, fostering a robust financial system, supporting an efficient national payment system, and facilitating sustainable economic growth. In order to achieve this, the DAB formulates and implements the government's monetary policy, grants licenses to, and monitors all financial institutions in Afghanistan. The Financial Supervision Department (FSD) of Da Afghanistan Bank (DAB) ensures the soundness of the banking industry. It achieves this by regulating the licensing of banks and other non-formal financial institutions, such as hawala (money transfers conducted by intermediaries) and foreign exchange traders. The agency is responsible for overseeing the regulation of Afghanistan's commercial banks and other financial institutions. The International Monetary Fund (IMF) achieves this by remotely monitoring the economic activity of countries and performing on-site audits to assess their adherence to policies, procedures, laws, and regulations. In September 2010, the Afghan financial sector encountered a substantial setback when reports of extensive fraud at Kabul Bank led to the withdrawal of approximately half of the bank's savings. This nearly resulted in the collapse of the country's largest bank, which also serves as the main source of government wages. By September 2010, the Afghan Bank of Afghanistan (DAB) had substantial difficulties in the financial industry. The Afghan government and DAB have since updated the banking system, amending its governing statute in 2003. The primary duties of the DAB encompass ensuring stability in domestic prices. Promoting the development of a stable financial system.

Advocating for the establishment of a highly effective domestic payment system to support long-term economic development. FSD (Financial Supervision Department) oversees the issuance of licenses for banks and other informal financial organizations. The Kabul Bank crisis in 2010 exposed shortcomings in the performance of the DAB (Da Afghanistan Bank) and FSD (Financial Supervision Department). These deficiencies included insufficient scrutiny of shareholders' backgrounds, failure to verify the bank's operations, absence of on-site inspections, absence of an information technology expert, failure to obtain required permits, and failure to impose penalties when Kabul Bank failed to maintain minimum reserves. The user did not provide any text.[10]

The Evolution of the Afghan Banking System and its Regulation

According to the 2011 International Monetary Fund report, Afghanistan is still getting used to modern banking and the credit culture that goes along with it. People have been using informal money service providers for hundreds of years and still do so today to move money, make small loans, and accept deposits. These people, who call themselves "hawala dealers," do business based on personal connections. At the moment, the central bank gives licenses to and keeps an eye on 320 money service providers, some of which have hundreds of agents. The government and international community have supported the formalization of financial services since 2002. This stimulated the growth and capitalization of the formal banking industry, with assets and deposits expanding by more than 50 percent per year since 2006 as banks competed strongly to

[10] "Afghanistan's Banking Sector: The Central Bank's Capacity To Regulate Commercial Banks Remains Weak." SIGAR | Special Inspector General for Afghanistan Reconstruction, January 2014. https://www.sigar.mil/pdf/audits/SIGAR-16-32-AR.pdf.

collect deposits from newly hired civil officials and to facilitate the flow of foreign aid. Wherever it has occurred, such rapid expansion has typically proved troublesome. Aside from five branches of foreign banks, which largely service the donor and international sectors, Afghanistan's 12 domestic banks struggled to develop normal banking practices and skills. The legal and accounting infrastructure to support non-relationship lending was nonexistent, weak, or untested, as were the procedures and skills of the banks' staff. An ineffective judiciary and corruption hampers establishing or recovering collateral and enforcing contracts. In a country where most births are unregistered, normal documentation of all sorts is generally nonexistent. In such an environment, bank lending tends to be based more on relationships than loan risk assessments. Indeed, many local banks have been established around business groups, and loans are being channeled to related businesses. But when investments go wrong, the interests of the groups tend to supersede those of the depositors. As the banking system in Afghanistan grew in size and political influence, asset quality and governance suffered.

Strengthening The Governance and the Financial Sector

The authorities have taken immediate measures to address the Kabul Bank situation. The bank has been placed in receivership, its license has been canceled, and the rights and interests of its stockholders have been extinguished. The government has formed a bridge bank, the New Kabul Bank, and developed a business plan to sell it in 2012. An audit of Kabul Bank is proceeding to determine the sums owed by the bank's shareholders and linked parties. As of October 30, 2011, approximately US$75 million in cash and US$153 million in assets available for sale had been recovered. Payback arrangements for 270 million dollars have been negotiated, with terms ranging from three to nine years. Parliament approved the first amortization payment on October 15, 2011, after the minister of finance issued an eight-year bond to recapitalize the central bank for the costs of the Kabul Bank crisis. In addition, the authorities have taken action against Azizi Bank, which is the second-largest bank in the country. Throughout the course of an in-depth assessment at Azizi Bank's physical location, the supervisor identified a few key areas that could use some improvement. An audit is being carried out by a well-known worldwide accounting firm. The results of the audit will be communicated to the bank's management as well as its supervisor, who will learn the extent to which laws or regulations were breached and how the organization can be improved. In the first quarter of 2012, it is anticipated that the final audit report will be finished and ready for distribution. In light of the findings of the on-site inquiry and the preliminary audit, the bank and its supervisor have come to an agreement regarding a strategy to increase the bank's capital while simultaneously reducing its large exposures. As required by the central bank, the bank's largest shareholder has resigned from his position as chairman of the board in order to remove any potential conflicts of interest. This is consistent with the actions taken by other banks whose greatest shareholders held similar positions. To ensure that financial institutions are in compliance with all banking laws and regulations that are currently in effect, continual vigilance is required.[11]

Despite its establishment in 1939, the legal financial system in Afghanistan was virtually non-existent by the end of 2001. The sole responsibility of the Afghan Central Bank (DAB), as stated by DAB itself, was to issue the national currency. In 2003, the Afghan government modified the statute that governs the control of the DAB. Due to this legislation, the Afghan government has delegated to DAB the task of ensuring price stability within the country, fostering a robust financial system, supporting an efficient national payment system, and facilitating sustainable economic growth. In order to achieve this, the DAB formulates and implements the government's monetary policy, grants licenses to, and monitors all financial institutions in Afghanistan. The Financial Supervision Department (FSD) of Da Afghanistan Bank (DAB) ensures the soundness of the banking industry. It achieves this by regulating the licensing of banks and other non-formal financial institutions, such as hawala (money transfers conducted by intermediaries) and foreign exchange traders. The agency is responsible for overseeing the regulation of Afghanistan's commercial banks and other financial institutions. The International Monetary Fund (IMF) achieves this by remotely monitoring the economic activity of countries and performing on-site audits to assess their adherence to policies, procedures, laws, and regulations. In September 2010, the Afghan financial sector encountered a substantial setback when reports of extensive fraud at Kabul Bank led to the withdrawal of approximately half of the bank's savings. This nearly resulted in the collapse of the country's largest bank, which also serves as the main source of government wages. By September 2010,

[11] Schaetzen, Bruno de, Louis Dicks-Mireaux, Felix Fisher, Thierry Kalfon, and Ron van Rooden. Edited by Adam Benett. Reconstructing Afghanistan, 2005. https://www.imf.org/external/pubs/nft/2005/AFG/ENG/REAF.pdf.

the Afghan Bank of Afghanistan (DAB) had substantial difficulties in the financial industry. The Afghan government and DAB have since updated the banking system, amending its governing statute in 2003. The primary duties of the DAB encompass ensuring stability in domestic prices. Promoting the development of a stable financial system.
Advocating for the establishment of a highly effective domestic payment system to support long-term economic development. FSD (Financial Supervision Department) oversees the issuance of licenses for banks and other informal financial organizations. The Kabul Bank crisis in 2010 exposed shortcomings in the performance of the DAB (Da Afghanistan Bank) and FSD (Financial Supervision Department). These deficiencies included insufficient scrutiny of shareholders' backgrounds, failure to verify the bank's operations, absence of on-site inspections, absence of an information technology expert, failure to obtain required permits, and failure to impose penalties when Kabul Bank failed to maintain minimum reserves. The user did not provide any text.[12]

Steps that Da Afghanistan Bank Took After Kabul Bank Crisis

Da Afghanistan Bank proposed a three year Economic program for 2012- 2014 which included the key components of the government's future development strategies which was later agreed at the Bonn conference in December 2011 asking for Extended Credit Facility to Islamic Republic of Afghanistan from the International Monetary Fund.

The key objectives of the program were to:

> "...(i) make significant progress toward a stable and sustainable macroeconomic position while managing the challenges of the withdrawal of the international presence in Afghanistan; (ii) strengthen the banking system and address the governance and accountability issues highlighted by the Kabul Bank crisis; (iii) move toward fiscal sustainability; and (iv) improve the transparency and efficiency of public spending and

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[12] "Afghanistan's Banking Sector: The Central Bank's Capacity To Regulate Commercial Banks Remains Weak." SIGAR | Special Inspector General for Afghanistan Reconstruction, January 2014. https://www.sigar.mil/pdf/audits/SIGAR-16-32-AR.pdf.

> services to protect the poor. We will pursue policies to keep inflation low, improve banking supervision and financial integrity, amend the banking law, and strengthen the framework to deal with financial crime. In addition, we intend to achieve sustained increases in domestic revenues (with proper focus on the extractive industries sector), prioritize public spending and improve expenditure management, and reduce fiscal risks from public enterprises." (IMF 2011 p48).

The outcome of this conference was successful and the IMF approved "**US$133.6 Million Arrangement Under the Extended Credit Facility for the Islamic Republic of Afghanistan"** (IMF, 2011p136).

The economic program in Afghanistan, supported by the IMF, sought to attain a stable macroeconomic state and tackle concerns pertaining to the withdrawal of foreign forces. The program's primary objectives were to enhance the banking system, tackle governance and accountability concerns, encourage budgetary sustainability, and augment openness in public expenditure and services. The Afghan authorities have established an objective of sustaining a real GDP growth rate of 6-7 percent for the next three years, notwithstanding a decline in international contributions. Their objective was to reduce inflation and enhance the balance of payments in order to foster equitable economic growth. The government's objectives were to enhance the banking and financial sectors, tackle governance issues, and settle the crisis surrounding the collapse of Kabul Bank. The program's objective is to achieve a 0.6% growth in domestic revenues during the following three years, resulting in a revenue-to-GDP ratio of about 16% by 2017 and 2018. (*IMF,2011,P137*).

Comparative Analysis of Conventional and Islamic Banking:

The Case of Bakhtar Bank Transforming into Islamic Bank of Afghanistan

This research investigates the financial performance of the Islamic Bank of Afghanistan after its transition from conventional banking as Bakhtar Bank to an Islamic Bank. To determine the presence of interesting variations in the financial performance of banks. The audited financial statements of the bank from 2009 to 2019 were subjected to financial ratio analysis. The financial ratio analysis revealed interesting enhancements in the bank's financial performance across various dimensions, including return on assets, return on equities, liquidity, solvency, and leverage ratios. Specifically, there was an increase of 0.005, 0.09, 1.69, 0.009, and 8.3 percent in each of these ratios, respectively. In summary, the Islamic Bank of Afghanistan's financial performance is deemed superior in comparison to that of Bakhtar Bank. Furthermore, Islamic banking is regarded as a favorable and successful alternative to traditional banking in Afghanistan (*Yönetim ve Ekonomi 27/3 (2020).*

Central Banks Rules and Regulations On the Commercial Banks and Islamic Banks

Article 6: Sources of Shariah Law

The primary sources of Shariah, which serve as the fundamental pillars of Islamic law, comprise the Qur'an, the sacred book of Islam that was revealed to the Prophet Muhammad (SAW), and the Sunnah, which encompasses the traditions and practices of the Prophet Muhammad (SAW). These primary sources form the bedrock of Islamic jurisprudence, offering guidance and principles for the Islamic way of life. In addition to these primary sources, secondary sources are employed to further elucidate and develop Islamic jurisprudence. These secondary sources involve a range of principles, including Ijma' (consensus among scholars regarding certain rules of Islamic law), Qiyas (juridical analogy based on clear injunctions from past incidents), Istihsan (the juridical preference for stronger evidence over analogy), Al Masalih al-Mursalah (considering actions that may not have a clear judgment in Shariah but are allowed when they benefit the community), and Ijtihad (the process of making legal decisions through independent interpretation of the primary sources). These secondary sources offer a structured framework for comprehending and applying Islamic law in various contexts (DAB).

Article 8: Compliance with Shariah Principles

According to Article 8 of the DAB, which explains the Compliance of the Shariah principles. Shariah means or translates as “Guided way”. This is the framework which outlined the islamic principles and islamic beliefs and it covers the basic principles how man should conduct social and Economic activities. Engaging in economic or business activities involves adhering to specific rules in Islamic finance. These rules prohibit certain elements like usury (Riba), gambling (Maisir), uncertainty (Gharar), and any actions that are considered impermissible

(Haram). For the validity of Islamic Financial Institutions (IFI), Islamic Windows, and Islamic Units, it's essential that none of their contracts or business practices go against these explicit or implied Shariah guidelines. Shariah, which provides divine guidance according to Allah Almighty, necessitates that all transactions conform to these divine rules and regulations. Any transaction that deviates from these principles becomes invalid. The Da Afghanistan Bank (DAB) places significant emphasis on ensuring that the Islamic financial system within Afghanistan operates in line with Shariah principles. This objective is pursued by adopting international best practices outlined by the Shariah Board. Furthermore, DAB mandates that all banks operating in Afghanistan must adhere to the highest ethical standards and delegates the responsibility for Shariah compliance to the respective bank's Shariah Board.

According to the Article 1 of the Da Afghanistan Bank,the Article 177 of Afghanistan's Banking law established regulations, which enabled Da Afghanistan Bank (DAB) to supervise, regulate and authorize the Banks to operate within Afghanistan and this means that when there are any future amendments made to the law, Da Afghanistan Bank has the authority to take action. Moreover, the objectives of the Article 2 of DAB as follows, the article aims to communicate the expectations of the DAB in regards to how banks should structure the Shariah day to day operations and also the Process of governance and ensuring the strict adherence to Shariah law. The purpose of this article is to provide all-inclusive guidance to the Board of Supervisors, Management Board of the Bank in order to help them accomplish their respective roles when it comes to Shariah.It also illustrates the obligations of the Bank with reference to Shariah compliance, underlining the significance of preserving these rules. On the other hand, the Article 3 regulations apply to all Islamic Banks and unless certain situational requirements demand otherwise, Da Afghanistan Bank-licensed banks including their Islamic subsidiaries. According to Article 4,The Shariah Governance principles created by Da Afghanistan Bank (DAB), also referred to as the "SG" or "the Framework," are outlined in this policy. It is one of the guiding principles for all fully-fledged Islamic Financial Institutions (referred to as "IFI") operating inside the Islamic Republic of Afghanistan. These principles apply to all Islamic finance-related papers that DAB issues, and for such documents, the stipulations herein apply to IFIs, also known as "the Bank." The SG must be interpreted according to the context of other essential rules, laws, and guidelines published by the Islamic Republic of Afghanistan and DAB. It is essential that everyone involved with DAB and the Bank understands the SG and their roles and responsibilities. To assist with any certain obstacles (al-mashaqqah), the DAB Shariah Supervisory Board may give exceptions within the SG. Any exception from the above rules must be properly requested by the Bank, after collaboration with its Shariah Board, and will only be approved when it provides the DAB Shariah Supervisory Board with good cause. This regulation lays the groundwork and defines the fundamental elements of Shariah governance for Islamic banks in Afghanistan. It highlights the significance of following Shariah principles and stresses the continuous requirement for improvement and enhancement as the country's Islamic banking sector progresses.[13]

This regulation applies to all Islamic banks and Islamic subsidiaries of banks licensed by Da Afghanistan Bank, except when specific situations require otherwise. This policy, outlined by Da Afghanistan Bank, sets out Shariah Governance principles (referred to as "SG" or "the Framework"). These principles act as guidelines for the structure of Shariah Governance Framework for every full-fledged Islamic Financial Institution (referred to as "IFI") operating within the Islamic Republic of Afghanistan. All the rules and provisions mentioned in this policy manual and other documents concerning Islamic finance issued by Da Afghanistan Bank are meant for IFIs, collectively referred to as "the Bank." It's crucial for all stakeholders in Da Afghanistan Bank and the Bank to be well-versed in the SG, understand their roles and responsibilities, and ensure compliance with the SG. While Islamic banking in Afghanistan is still in its early stages, this proposed SG serves as a basic reference document that will be further developed and refined by relevant stakeholders in the future. The Da Afghanistan Bank Shariah Supervisory Board (referred to as "the SSB") is expected to make some exceptions within the SG to address specific unavoidable or excessive difficulties (al-mashaqqah). Any exemption from the provided provisions can only be allowed through a formal application submitted by the Bank after consulting with its Shariah Board, explaining the reasons and justifications for such requests(DAB). Considering the early stage of Islamic Finance in the Islamic Republic of Afghanistan, Da Afghanistan Bank (DAB) has granted temporary authorization to banks to outsource various Shariah Governance and operational functions, including their Shariah Board. This means banks can seek the expertise of an external Shariah board, a third-party Shariah consultancy or service provider, or an approved Shariah scholar who also serves on the Shariah

[13] Da Afghanistan Bank Islamic Banking and Finance Department: Islamic Banking Regulations, December 19, 1399. https://dab.gov.af/sites/default/files/2022-04/IBFD%20all%20Regulation%28s%29.pdf.

Board of other banks in Afghanistan, referred to as "the Outsourced Scholar." However, this outsourcing must align with the requirements outlined in the Guidelines on Outsourcing of Islamic Banking Operations issued by DAB. DAB can also authorize the Outsourced Scholar to sit on multiple Shariah Boards in Afghanistan for a reasonable period. It is recommended that each bank appoint at least one competent Shariah expert to lead its Shariah Department and ensure Shariah compliance. The Shariah Board of the bank is to be an independent entity and should consist of qualified Shariah scholars chosen by the bank's management on behalf of the bank's board. These scholars should possess the appropriate qualifications and experience in Shariah to effectively deliberate on Islamic finance matters and provide sound Shariah decisions to the bank. The Shariah Supervisory Board (SSB) retains the authority to interview and assess proposed members of the Shariah Board and the proposed head of the bank's management (referred to as "the Proposed Person") to ensure their suitability for the appointment, with interviews conducted either in person or through acceptable electronic means, and the mode of interview communicated two weeks in advance to the bank (DAB). When a bank intends to appoint a new member to its Shariah Board or the Head of its Management, there are specific procedures to follow:

The bank must notify the Shariah Supervisory Board (SSB) at least ten weeks in advance of the proposed appointment. They must provide the SSB with the Curriculum Vitae of the Proposed Person and any other information requested in writing by the SSB. Once the SSB receives all the necessary information, they will issue a "Sufficient Information Letter" to the bank. However, receiving this letter does not prevent the SSB from asking the Proposed Person additional questions outside the provided information. The SSB will then conduct an interview, following the method described in clause 9 of the article. After the interview, the SSB can either confirm the Proposed Person as suitable for the bank to hire, or they can state that the person is not suitable. Their decision in this matter is final, and the Proposed Person cannot appeal to the courts of the Islamic Republic of Afghanistan. If the Proposed Person is found unsuitable, the SSB may, at its discretion, provide reasons for the decision and suggest personal development programs for the Proposed Person to undertake if they wish to apply.The bank can present a panel of Proposed Persons for consideration by the SSB, but it's important to note that the bank cannot submit more than three names for a vacant position. The final decision to hire a Proposed Person approved by the SSB is ultimately up to the bank. However, the SSB has the authority to waive the requirement outlined in clause 9 for individual Proposed Persons. They will inform the bank in writing if they grant such a waiver, and this waiver confirms that the Proposed Person is suitable, as per clause 11. If an application to confirm a Proposed Person remains with the SSB for more than three months after the issuance of the Sufficient Information Letter, the bank can consider the letter as acceptance of the Proposed Person and proceed to hire them at its own discretion (DAB).[14]

Article 9: Structure of the Shariah Governance

The structure of the Shariah Governance consists of six sections and each one has its own specific duties to govern.

Section 1: General Requirement of the Framework, this section will outline the general requirements of the framework and it explains each step or functions while implementing the Shariah governance at all the Banks.

Section 2: Rights, Duties and Accountabilities, this section highlights the extent of accountability and responsibility expected of the bank's Board, Bank's Shariah Board and the Management.

Section 3: Independence, this section works towards safeguarding the independence of the Shariah Board in order to have a clear and just Sharih decision making process and it stresses more on the role of the Board in recognizing the independence of the Board.

Section 4: Competency: This section works to ensure that essential functions are capable of implementing Shariah governance, this section addresses needs and required competencies.

Section 5: Confidentiality and Consistency: This section indicates the bare minimum of regulations that place a strong emphasis on maintaining and upholding confidentiality as well as increasing the Shariah Board's level of decision-making consistency.

Section 6: Internal Shariah Functions, This section deals with the internal Shariah functions.

Article 10: Requirements of the Bank Shariah Governance Structure

[14] Da Afghanistan Bank Islamic Banking and Finance Department: Islamic Banking Regulations, December 19, 1399. https://dab.gov.af/sites/default/files/2022-04/IBFD%20all%20Regulation%28s%29.pdf.

The bank is entrusted with the responsibility of establishing a strong and reliable internal Shariah Governance Framework (SG) for its Islamic banking operations. This framework must align with the principles provided by DAB's SG and emphasize the crucial roles of key functions in effectively adapting and implementing the SG. The bank is obligated to ensure that all its business activities conform to Shariah principles without exception. To achieve this, it must establish comprehensive control mechanisms throughout its operations to guarantee Shariah compliance. A robust SG is characterized by a responsible Board of Directors, competent and accountable Shariah Board, and strong Internal Islamic Banking Department. The end-to-end control mechanism for Shariah compliance encompasses four lines of defense, covering both pre-execution and post-execution phases of its operations(DAB).[15]

Article 10: General and Compliance Requirements

(1) Management of Funds: The funds of Islamic banking operations are classified into two categories i.e. restricted and unrestricted funds.'' *(Islamic Banking regulations, Page 21, Da Afghanistan Bank Islamic Banking and Finance Department)*.

(2) Income and Expenses: Income and expenses of the Islamic banking operation are categorized based on the management of funds in relation to the restricted and unrestricted funds. The classification of the Trading income, Fee-based income, and direct expenses will be guided by the general principles to be circulated by DAB. *(Islamic Banking regulations, Page 21, Da Afghanistan Bank Islamic Banking and Finance Department)*.

(3) Provisioning: The Banks are required to observe the relevant guidelines and circulars issued by DAB on the classification and provisioning of non-performing financing and securities. *(Islamic Banking regulations, Page 21, Da Afghanistan Bank Islamic Banking and Finance Department)*.

(4) Profit Sharing Ratio (PSR): PSR refers to the portion of profit distributable to depositors and the Banks. For example, PSR of 70:30 refers to 70% of profit distributable to the depositors and

[15] Da Afghanistan Bank Islamic Banking and Finance Department: Islamic Banking Regulations, December 19, 1399. https://dab.gov.af/sites/default/files/2022-04/IBFD%20all%20Regulation%28s%29.pdf.

the remaining 30% distributable to the Bank. *(Islamic Banking regulations, Page 21, Da Afghanistan Bank Islamic Banking and Finance Department)*.

(5) Dividend/Hibah – An accurate calculation of dividend/hibah is imperative to ensure that the mudharabah depositors receive a fair portion of their investment profit. The calculation based on the average rate of each investment deposit reflects the risk exposure of each deposit to the yield of the bank's assets. *(Islamic Banking regulations, Page 21, Da Afghanistan Bank Islamic Banking and Finance Department)*.[16]

Article 11: Islamic Banking Regulations

The Approved Islamic Business Activities:
The following activities are the Islamic business activities approved by DAB[17]:

(1) " Shariah compliant money placements/deposits: 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". *(Islamic Banking regulations Da Afghanistan Bank, Page 61).*
In accordance with the regulations of Wadi'ah / Qard, the organization is prepared to receive Shariah-compliant contributions or deposits of funds for the purpose of safeguarding. The cash must be given to the depositor without requiring collateral, either on request holder by agreement between them. It encompasses the ideas of Wadi'ah and Qard, which allow for the placement or depositing of money in a secure location without requiring any collateral, in accordance with Shariah. This implies that individuals or enterprises allocate funds in accordance with the principles of Islamic finance. The money is deposited into the bank without any safeguards implemented. The arrangement resembles a non-profit loan (Qard), where the funds deposited are intended to be secure and not utilized for risky or interest-driven activities.

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[16] Da Afghanistan Bank Islamic Banking and Finance Department: Islamic Banking Regulations, December 19, 1399. https://dab.gov.af/sites/default/files/2022-04/IBFD%20all%20Regulation%28s%29.pdf.
[17] Da Afghanistan Bank Islamic Banking and Finance Department: Islamic Banking Regulations, December 19, 1399. https://dab.gov.af/sites/default/files/2022-04/IBFD%20all%20Regulation%28s%29.pdf.

(2) “Offering Shariah compliant financing products: Entering into or making arrangements 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’’. *(Islamic Banking regulations Da Afghanistan Bank, Page 61)*

The statement primarily discusses the provision of financial services in adherence to Islamic principles. The process entails the development or facilitation of agreements that comply with certain Islamic contracts and rules. The mentioned contracts, including Murabahah, Salam, Ijarah, and Istisna', represent distinct methods of structuring financial arrangements in accordance with Shariah principles. In order to enhance clarity, a comprehensive explanation of each principle will be provided.Murabahah is a financial contract commonly used in Islamic finance. This entails a financial institution engaging in the purchase of an item on behalf of an individual, thereafter reselling it for that individual at an increased price, thus enabling the individual to make payments in regular installments. Salam: A prepayment arrangement is established in which the purchaser pays payment in advance for the future delivery of products. Prepayment for future crop delivery is a commonly used practice in the agricultural sector. In contrast, Ijarah might be considered for a contract for leasing. The financial institution possesses a valuable property and enters into a leasing agreement with you, through which you make regular payments in exchange for the temporary use of that item. Lastly , Istisna It's a contract used for manufacturing or construction. You agree to buy something that will be made or built according to your specifications.

(3) “Managing unrestricted Shariah profit sharing investment accounts: Managing account, portfolio or fund, whereby a sum of money is placed with the service provider on terms that 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. *(Islamic Banking regulations Da Afghanistan Bank, Page 61).*

The Islamic financial principles of Mudarabah and Musharakah are applied to manage unrestricted Shariah profit-sharing investment accounts. These accounts involve individuals entrusting money to the Banks, ensuring returns are based on a pre-established profit-sharing framework. This approach allows service providers flexibility in making investment decisions within Shariah guidelines. The equity of those holding unrestricted investment accounts is meticulously documented, ensuring transparency and upholding the ethical and flexible nature of Shariah-compliant finance.

(4) Managing restricted Shariah profit sharing investment accounts: 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 holders shall be treated separately from the bank's assets and liabilities". *(Islamic Banking regulations Da Afghanistan Bank, Page 61).*

Managing restricted Shariah profit-sharing investment accounts involves overseeing accounts, portfolios, or funds where individuals deposit money with the Bank.Unlike unrestricted accounts, there are limitations set by the customers on the investment strategy.Importantly, the assets (funds and returns) and liabilities associated with the equity of those holding restricted investment accounts are treated separately from the overall assets and liabilities of the bank.This ensures the funds and returns from restricted accounts are managed distinctly.This to maintain transparency and adhere to the specific customer-imposed restrictions, making sure that the bank respects and follows the conditions set by the customers for the use and investment of their funds.

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

(11) Providing money exchange/remittance services between currencies and the provision of wire transfer or other remittance services. *(Islamic Banking regulations Da Afghanistan Bank, Page 61)*

Essentially, this financial service allows people or corporations to change one currency into another and effortlessly move cash across international borders. Money exchange services primarily facilitate the purchase and sale of other currencies at current exchange rates, specifically catering to the requirements of people or organizations involved in global transactions. Transfer services include the safe transfer of payments from one location to another, typically by wire transfers or other electronic methods, happening at the same time. This financial service is essential for enabling international trade and satisfying the financial requirements of persons with international responsibilities. It provides a dependable and effective system for exchanging currencies and transferring funds.

(12) Issuing/ administering means of payment: Dealing or issuing of payment instruments, or the selling or issuing of stored value (e.g credit cards, travelers' cheque etc).[18]*(Islamic Banking regulations Da Afghanistan Bank, Page 61)*

[18] Da Afghanistan Bank Islamic Banking and Finance Department: Islamic Banking Regulations, December 19, 1399. https://dab.gov.af/sites/default/files/2022-04/IBFD%20all%20Regulation%28s%29.pdf.

How Do Banks Make Profit Under the Umbrella of Islamic Law?

According to the article 4 of DAB the Banks make profit by the distribution of profit which is also called profit sharing and Loss bearing. To explain further, Islamic financial institutions generate a significant amount of their deposits, with the Bank raising the majority of this money for investments through mudharabah (profit-sharing and loss-bearing) contracts. Depositors (also known as investment account holders or IAH) agree to participate in the financial activities carried out by Islamic banking institutions (as mudharib) and share the profits made from financing and/or investment activities according to a predetermined profit-sharing ratio under the terms of the mudharabah contract. Except in cases of fraud, misconduct, carelessness, or violation of contract by the Banks, the IAH is responsible for losses resulting from assets funded under the mudharabah contract, also known as a profit-sharing investment account (PSIA). Therefore, the agreement calls for loss-sharing for one partner and profit-sharing for the other which in this case is Bank. Moreover, Managing risks specific to Islamic finance transactions is another important factor to consider Banks' capacity for risk management. The case of the mudharabah contract, a key contractual arrangement in Islamic banking, is an illustration of the specific risk in Islamic finance that would necessitate compliance to strict risk management regulations and a high level of transparency. The return of the mudharabah contract can only be determined at the conclusion of the 17 investing period, unlike traditional deposits where the interest rate is decided at the time the deposits are placed. As a result, the mudharabah contract exposes the Banks to the effects of the cycle of returns generated from assets backed by the IAH, the stability of the rates of return to the IAH, and the risk that the IAH's financial condition may worsen the Banks competitiveness in the islamic finance industry. To further explain what is the term “Mudarib’’ referred to as Net income Interest which refers to the specific islamic Finance. Mudarib: In Islamic finance, a Mudarib is a person or a party in a Mudarabah contract, this is a form of partnership. Mudarabah means a profit-sharing agreement where one person or party (the Rabb-ul-Mal) is going to provide capital, and the other party (the Mudarib) will be providing expertise and management to undertake a business or investment activity.The role of Mudarib’s that they will manage the investment or business and in the case of profit sharing, it will be shared according to the ratio agreed between these two parties initially. If there is a loss in the business then the other Party (Rabb-ul-Mal) will have to pay the losses and the Mudarib on the other hand will just lose the time and effort they invested in the business. Furthermore, to explain what is Net income interest, it is known as the share of net income or profit after deducting the expenses that an business or individual has the right to receive from a business or investment.The concept is common in the different type of investments like, the shareholder in the company or in other words the partners in partnership. Moreover, the Net income interest determines the actual income which can be distributed to an investor (In this case it is Banks) after deducting all the expenses and taxes and liabilities have been cleared. And if we further discuss the key difference in these concepts is primarily how it is applied or in other words it is their scope of application. Mudarib relates to a particular type of islamic finance contract which mainly deals with management and operational areas of the investment with the main goal of sharing profits. On the contrary, The Net Income interest which is a much broader financial concept which deals with the investor's share of the net earnings from the result of investment and this financial concept is not just limited to islamic finance but can also be applied in various kinds of investment.

Central Bank (Da Afghanistan Bank)

The central bank of Afghanistan is the Da Afghanistan bank, Da Afghanistan Bank is like a legal person that can do many things, like making contracts, buying and selling things, issuing securities (like bonds or shares), borrowing money, and being involved in legal matters. Its main office is in Kabul, but it can also set up smaller offices or appoint agents in different places, both in Afghanistan and in other countries, for different purposes (Article 1 DAB).The main goal of Da Afghanistan Bank is to maintain stable prices within the country. It also aims to ensure the smooth and secure functioning of the financial system and support a reliable payment system. While focusing on these goals, Da Afghanistan Bank will also help the government's economic policies and promote sustainable economic growth. Its key responsibilities include making and implementing monetary and foreign exchange policies, managing Afghanistan's foreign exchange reserves, issuing the country's banknotes and coins, assisting the government as a financial advisor, regulating various financial entities, and establishing efficient payment and securities systems (*Article 2 Da Afghanistan Bank*).

Da Afghanistan Bank has significant legal powers to regulate electronic transactions between itself, banks, and their customers. It will maintain a public record of these regulations. The bank can also inspect the records of various financial entities and gather necessary information to fulfill its supervisory duties. Da Afghanistan Bank operates independently, and no one should unduly influence its decision-makers or interfere with its activities. Those associated with the bank must uphold its reputation as a fair and impartial central bank, refraining from incompatible activities. Members of the bank's supreme council should avoid engaging in political activities while in their positions (*Article 3 DAB*). Furthermore, Da Afghanistan Bank will act as Afghanistan's representative in international meetings, councils, and organizations related to monetary policy, bank regulation, and other areas under its jurisdiction. It can offer banking services to foreign governments, central banks, and international bodies that Afghanistan is part of. Through international financial cooperation, it can join organizations focused on economic stability. In its role as Afghanistan's agent, Da Afghanistan Bank may handle responsibilities and transactions related to Afghanistan's involvement in international organizations (*Article 4 DAB*).

The Da Afghanistan Bank acts as a lender of last resort, like in the case of Kabul Bank in September 2010, a crisis ensued when depositors of Kabul Bank sought to withdraw their funds upon discovering substantial fraud within the bank. Kabul Bank was in a financially unstable state during this period, marked by a high loan-to-deposit ratio of 70 percent, signifying that over $900 million of its deposits were allocated to loans, many of which were fraudulent.

The Afghan government introduced an $825 million lender of last resort facility to safeguard deposits and prevent a larger financial crisis. This facility was financed using Afghanistan's central bank reserves, and the terms of repayment were agreed upon by the Ministry of Finance and DAB, as outlined in a promissory note signed by both parties. The repayment schedule spanned eight years, concluding in 2019. Over half of the borrowed amount has been repaid since 2010, with DAB revealing an outstanding balance of $388 million as of October 20, 2016. These repayments included $205.2 million from cash recoveries, with the rest sourced from the Afghan government's budget. Repayments have dwindled notably during President Ghani's tenure, with only $30 million recovered since he took office and reduced budget repayments in 2015 and 2016. The Ghani government is committed to clearing the lender of last resort balance by the end of 2019, and the 2017 budget currently being reviewed in the

National Assembly sets aside approximately $145 million for repayment, nearing the amount required to meet this 2019 goal. (*Responding to corruption of Kabul bank collapse, 2016*).

Supreme Council

According to the Article 6 of the Da Afghanistan Bank, The DAB should have a Supreme Council as its highest policy and decision making body and a Governor charged with the management of Da Afghanistan Bank, a Comptroller General responsible for the internal control and audit of the operations of Da Afghanistan Bank, and other related staff. The supreme court consists of seven members which as follows,

- Governor as Chairman of the supreme Council.
- First Deputy Governor as Vice Chairman of the Supreme Council
- Five other members (*According to the Article 7 of the DAB*)

According to Article 7, all the members should be selected by the President Of the Republic of Afghanistan with the permission of the Parliament of Afghanistan.Moreover, In order to allocate the end dates of first term appointments throughout that time, members of the Supreme Council will be appointed to five-year terms. Unless there are grounds to remove them as outlined in Article 12, these members may be reappointed. Furthermore, the Supreme Council is responsible for setting the main policies of Da Afghanistan Bank and overseeing its operations. To fulfill its duties, the Council regularly evaluates the country's economic and monetary situation. The Executive Board reports to the Council at least once every quarter on topics such as the Bank's operations, monetary and regulatory policies, the stability of the financial system, money and capital markets, and any significant events affecting the Bank's operations or the financial system. The Comptroller General provides the Council with requested reports and studies for supervising the Bank's operations, and the Governor ensures the Council receives all necessary information in a timely manner(Article 8 DAB).

The Supreme Council holds several important powers, including the formulation and adoption of Afghanistan's monetary policy, the foreign exchange policy, and the approval of reports and recommendations made by Da Afghanistan Bank to the government or parliament. It also decides on the banknotes and coins' face value and design, debt securities, foreign exchange reserves investment categories, and the approval of certain financial instruments. Furthermore, it establishes rules for the administration and operation of the central bank, determines the bank's budget and employee terms, proposes increases in its authorized capital, and decides on financial risk management. The Council also approves annual reports and financial statements, handles asset depreciation, and has any additional powers granted by the law.(DAB).

The Law on Money and Banking of the Islamic State of Afghanistan

In this section, I will highlight some of the important roles of the Afghan Bank and the outdated laws that the Central Bank had to follow. According to Chapter 6 of Reconstructing Afghanistan by the IMF, I found out that the legislation on money and banks that was passed in Afghanistan in 1994 was a mixture of legislation governing the central bank and a law governing banks comprising essential parts taken together. For instance, the legal tender, the Afghani, as well as its value, were established under Part I of the legislation. It also established the minimum reserves that the DAB, the central bank, had to retain against issued banknotes. The second section of the law outlined DAB's objectives, responsibilities, authorities, and organizational structure. DAB was given the mandate to carry out the government's monetary and credit policies and protect the value of the Afghani currency. Additionally, DAB was given the authority to monitor financial institutions such as banks and credit institutions, to regulate activities involving foreign exchange, and to determine interest rates and fees for commercial banks. However, these regulations were not well defined and did not adhere to the standards of practice used internationally. There were no standards for loan categorization or provisioning, and there was no mention of regulatory enforcement. Additionally, DAB was expected to handle government accounts, provide financing for any gaps in the government's budget, and provide loans to other government agencies by virtue of Part II's mandates. The last portion of Part II outlined the structure of DAB's several organs, such as the Supreme Council, the Monetary and Credit Committee, the Executive Board, the Board of Supervisors, and the Banknote Reserves Supervision Board. It also outlined the functions of each of these bodies. The Supreme Council was the highest institution and had the authority to make key decisions and adopt rules. It was comprised of ministries and the governor of DAB. The make-up of the Council as well as the Monetary and Credit Committee was problematic since it politicized decisions that ought to have been taken on technical grounds, putting DAB's independence in jeopardy. The Board of Supervisors was in charge of monitoring the banking activities of DAB and presenting reports, while the Executive Board was made up of the governor and his deputies. Nevertheless, this control function had been neglected for a considerable amount of time. The banking system was the subject of the law's third section, which defined what constitutes a bank and outlined the steps necessary to launch a new financial institution. The adoption of the double-entry accounting technique as well as the submission of yearly financial statements to DAB were mandatory for banks. If a bank violated the legislation, the Supreme Council had the authority to either hand over the control of the bank to DAB, take measures to improve the bank's management, or close the bank entirely. The law allowed for the inclusion of officials from the bankrupt bank in the case of liquidation, which might be problematic in situations of fraud since it allowed for the presence of officials from the failing bank. In the event that a government bank were to be shut down, it would be the responsibility of the government to pay any outstanding deposits, wages, and claims from other creditors.[19]

A New Legal Framework: Modernizing the Financial Sector of Afghanistan

The new central bank law gives the Da Afghanistan Bank (DAB) complete freedom from outside influences. This means that it can fully fulfill its duties and goals without any help from the government or other authorities. This independence is accompanied by a critical necessity for accountability, emphasizing DAB's obligation to account for its activities. In order to maintain consistency and coherence within the legal framework of the financial system, the law also mandates that the government consult DAB on any legislative or administrative matters within DAB's jurisdiction. In addition, this law brings together a number of financial issues that would normally require their own laws. These include currency, cash payments, payment systems, and trading services. DAB is also tasked with regulating hawala dealers, those who operate outside of the conventional banking system, to facilitate the exchange of currency and the processing of payments. The banking law, on the other hand, gives banks clear rules, processes, and

[19] Schaetzen, Bruno de, Louis Dicks-Mireaux, Felix Fisher, Thierry Kalfon, and Ron van Rooden. Edited by Adam Benett. Reconstructing Afghanistan, 2005. https://www.imf.org/external/pubs/nft/2005/AFG/ENG/REAF.pdf.

requirements. It suggests that a bank is a business that takes deposits from people and uses those savings to give money or make investments. The process of asking for a banking license is simplified into two steps. In the first step, only the most important information is needed. Furthermore, the new law also mandates DAB to maintain price stability and entrusts DAB with adopting, defining, and implementing the country's monetary policy and foreign exchange policy. Moreover, it issues banknotes and coins, manages foreign exchange reserves, licensing, monitoring, regulation, and supervision on any institution involved in the financial sector, and acts as a fiscal agent of the government and lender of last resort. However, the law prevents financing the government budget deficit, and lending money to commercial banks is against the law. The only circumstances in which they can be performed are as a lender of last resort and to provide stable but short-term liquidity for financial institutions(banks), particularly during a systemic liquidity crisis. The DAB is in charge of laying out the exact requirements for getting these licenses. The law states what kinds of banking activities are legal and upholds modern banking standards, putting an emphasis on good management, responsible risk-taking, and clear accounts. It also talks about changes in ownership, credit documentation, risk management, and making sure that foreign financial standards are followed. Additionally, it establishes the criteria for conducting audits and enhances the regulatory oversight of the DAB by implementing on-site inspections. The concluding section of the legislation highlights the specific measures that the Da Afghanistan Bank (DAB) would undertake in order to address instances of bank infractions and financial challenges. By incorporating these rules, the DAB will be authorized to suspend licenses and initiate bankruptcy proceedings, all of which will be conducted under the supervision of a financial services judiciary.[20]

Profitability of Banks

It is important to explain that in the case of Fully-fledged Islamic Banks, in the Income statement, there is Income interest, which does not really mean that the Banks are charging interest despite following Islamic laws and regulations. The interest income, which is known as Mudaribah(Interest income), is the percentage of profit shared between two parties at the agreed rate. From the annual income statement, one can observe that it is translatable where it

[20] Schaetzen, Bruno de, Louis Dicks-Mireaux, Felix Fisher, Thierry Kalfon, and Ron van Rooden. Edited by Adam Benett. Reconstructing Afghanistan, 2005. https://www.imf.org/external/pubs/nft/2005/AFG/ENG/REAF.pdf.

says income interest is not interest charge, but it is the % of distributable profit resulting from the profit sharing rule of the Islamic Banking system. It is to gain from profits.

Refer to Appendix 1:

For Bank e milli Afghanistan(BMA), we can see from the table that for the year 2015, the sources of Income were Net interest income AFN 804,664,908, Net fees and commission AFN 113,795,959, other incomes 264795959, foreign exchange gain AFN 83067894 and Gain from securities/loss was AFN 0 and Gain from investment was AFN 3436838772. Although it is important to mention there were fluctuations in these above-mentioned incomes over the years, the Bank was overall earning Income. The primary source of Income for this Bank is the Net interest income, Net fees and Commissions, other incomes, and foreign exchange. The Bank was involved in investment in the year 2015, amounting to AFN 3,436,838,772, and in 2019, amounting to AFN 302,579,899, and it can be observed that over the years, there was a significant decline in investment gain, and this Bank never had Gain/ loss from Securities.

Pashtany Bank

It can be observed that Pashtany Bank, just like BMA, had sources of Income from, Net interest income AFN 114879373, Net fees and commission AFN172,063,183, other income 594106598, foreign exchange gain AFN 46470145 but there was AFN 0 Gain from securities/loss was AFN 0 and Gain from investment. From the data, it can be seen that the main sources of Income vary over the years. For example, in 2016, the Net interest income was AFN 317,970,597, which was greater than in 2015, and Net Fees and Commissions AFN 53,999,556, Other Income was AFN 413133364, and there was a loss in Foreign exchange AFN -17307387. So, the primary Income was from these four categories mentioned above.

New Kabul Bank

By looking at the table for the year 2015, the sources of Income for New Kabul Bank are Net Interest income AFN 196,140,075, Fees and Commissions AFN 1,076,666,066, and Other

Income AFN 1390569840. This Bank has AFN 0 from foreign exchange, Gains from securities, and Gains from investments. Moreover, by observing the table, the main and important source of Income for New Kabul Bank is the Net fees and Commissions and Other incomes because it shows a significant amount of Income over the period of years.

Azizi Bank

In the case of this Bank, there were only four years of data due to a lack of access to more years of data available on the Bank's website. The sources of Income for Azizi Bank for the year 2015 are net income interest AFG 546569000, net fees and commissions 442784000, other incomes AFG 22119000, and foreign exchange AFN175440000. And AFN 0 gain/loss of securities and AFN 0 Gain from Investment. But for 2016, 2017, and 2018, it shows gains from investment.

Afghanistan International Bank(AIB)

The sources of Income for this Bank are all the six categories: Net interest income, Net fees and Commissions, Other incomes, Foreign exchange, Gain/loss from Securities, and Gain from Investment. From Appendix 1, if we observe the year 2015, Net interest income AFN 1080742, Net fees and Commissions AFN 662,876,000, Other incomes AFG -1205000, Foreign Exchange AFN 193633000, Gain/loss from Securities AFN 3659000 and Gain from Investment AFN -13555000. We can see that there was a Loss in other incomes in 2015 and a loss in investments in 2015,2016 and 2018. From Appendix 1, we can conclude that the most important source of Income for AIB Bank is Income interest because it shows an increase from 2016 AFN1,057,925,000 to 2019 AFN 1,346,271,000.

Maiwand Bank

The sources of Income for Maiwand Bank are Net interest income, Net Fees and Commissions, Other incomes, Foreign exchange, Gain from Securities, and Gain from Investments. According to Appendix 1, the most important source of Income for Maiwand Bank is Net Interest Income And Fees and Commissions. The Bank has AFN 0 Gain/loss from Security and Gain from investment. If we look at the year 2016, the Net Interest income is AFN 732,571,000, Net Fees and Commissions AFN 111,240,000, Other income AFN 4,781,000, and Foreign Exchange AFN -21312000, which is a loss on Foreign exchange. It can be concluded that Net Interest income and Fees and Commissions are the main sources of Income.

Afghan United Bank (AUB)

Using Appendix 1, AUB Bank's sources of Income are Net Interest Income, Fees and Commissions, and Other incomes. This Bank does not have any income from Foreign Exchange, Gain/Loss from Securities, or Gain from Investments. If we look at the data from 2015, Net Interest income is AFN 765,950,000, Net Fees and Commissions AFN 222,422,000, and Other Incomes AFN 126,359,000. We can say that the main source of Income for AUB Bank is Interest Income.

The First Microfinance Bank

The sources of Income for micro-finance banks are net interest income, net fees and commissions, other incomes, and foreign exchanges, which are only in 2017 and 2018. If we look at Appendix 1 for the year 2018, Net Interest Income AFN 1219225000 declined compared to 2017 but not a significant decline, Net Fees and Commissions AFN 78595000, which increased from the previous year, Other Income AFN 49333000, Foreign Exchange AFN 130121000. We can say that the main source of Income for this Bank is Net Interest Income.

Ghazanfar Bank

If we look at Appendix 1, we can observe using the data from 2018 that the Net Interest income AFN 409,175,000, Net Fees and Commissions AFN 175,697,000, Other Income AFN 113,721,000, Foreign Exchange AFN 5696000 Which only gain in the year of 2018. This Bank did not have any income from gains/Losses from securities or Gains from investments. To conclude, we can say the main source of Income is Net Interest Income.

National Bank of Pakistan

Looking at the appendix and using 2016 data, Net interest income was AFN 96,184,000, Net fees and Commissions AFN 27,190,000, Other incomes AFN 0, and Foreign Exchange loss was -34701000. This Bank does not have gain/loss from securities or gain from investments. So, one can say that the Net interest income is the Main source of Income for this Bank.

Bank Alfalah Bank

The sources of Income for this Bank are net interest income, net fees and commissions, other incomes, and foreign exchange, but it does not get any income from gains/losses from securities or gains from investments. Let's use the data from Appendix 1 for the year 2019: net interest income AFN 239,001,000, net fees and commissions AFN 100,286,000, other incomes AFN 20598000, and foreign exchange AFN 1208600. From this observation, we can say that the main source of Income is Net interest income.

To conclude, Analyzing financial data from various Afghan banks provides valuable insights into their operational dynamics. Bank e Milli Afghanistan (BMA) consistently relies on Net Interest Income, Net Fees and Commissions, Other Incomes, and Foreign Exchange gains, with notable investments in 2015 and 2019. Despite fluctuations, BMA has maintained an overall positive income trend. Similarly, Pashtany Bank showcases variability in income sources over the years, emphasizing the importance of Net Interest Income, Net Fees, Commissions, Other Incomes, and Foreign Exchange. New Kabul Bank, focusing on Net Fees and Commissions and Other Incomes, highlights the strategic significance of these sources. Azizi Bank's limited data reveals gains from investments in 2016, 2017, and 2018. Afghanistan International Bank (AIB) has a diversified income portfolio, prominently featuring Net Interest Income. Maiwand Bank prioritizes Net Interest Income and Fees/Commissions, while Afghan United Bank emphasizes Interest Income. The First Microfinance Bank underscores the central role of Net Interest Income. Ghazanfar Bank's 2018 data indicates Net Interest Income as the primary source. The National Bank of Pakistan relies on Net Interest Income, while Bank Alfalah Bank highlights Net Interest Income as its primary source. In conclusion, the similarities lie in the pivotal role of Net

Interest Income and Fees/Commissions, showcasing their universal importance across Afghan banks' operations and revenue generation strategies.

Refer to Appendix 2:

Appendix 2 illustrates that there are four categories: big banks, small banks, non-Islamic banks, and fully-fledged Islamic banks. To start with, the Big Bank, Afghanistan International Bank (AIB), operated under a conventional banking system but had a window open for Islamic Banking activities. AIB Bank's Islamic activities fully comply with Shariah compliance laws, and they observe all the Islamic laws while operating on the Islamic side of the business. As we can observe from Appendix 2, this Bank is involved in all the areas and has income from Net interest, Net Fees and Commissions, Other Incomes, Foreign Exchange, Gain/Loss from Securities, and Gain/Loss from Investments. Looking at the number in Appendix 2, one can observe that the main source of income for this Bank is the Net Interest Income, which keeps increasing from 2015 AFN 1,080,74,0002 and 2019 AFN 1,346,271,000. However, it is important to mention that AIB is gaining income from other sources like Net fees and Commissions AFN 662,876,000 and 2019 AFN 1,066,596,000 with steady increase over the years and also Other incomes there was a loss in 2015 AFN -1205000 but over the period of years it shows improvement for instance, in 2019 it increases to AFN 46414000. Also, Foreign exchange from 2015 was AFN 193633000 to 2016 AFN 144023000, and in 2019, it was increasing to AFN 2649623000. Lastly, from Gian/Loss of Securities from 2016 AFN -477000 and 2018 AFN -1732,000, there was a loss, but the income increased in 2019 to AFN 105221000. Gain/Loss from investments: there was a loss for three years, 2015 AFN -13555000, 2016 AFN -1788000, and 2017 AFN -6436600.

The small Bank, which is the National Bank Of Pakistan, has only a few branches in Kabul. If we look at Appendix 2, we can see that this Bank was also involved with all kinds of activities and had income from Interest Income, Net Fees and Commissions, Other incomes, Foreign exchange, Gain/Loss from Securities, and Gain/Loss from Investments. If we describe the data for the period of 5 years, we can see that the net interest income in 2015 was AFN 94,411,000, and there was a significant decrease in 2018, AFN 21,417,000, but it increased in 2019 to AFN 56389000. On the other hand, in Other incomes from 2017 AFN 26696000 to 2019 AFN

-1184000, the Bank had a loss. They only had gain/loss from securities for the year AFN 1273000 and gain/loss from investments; there was a loss in 2017 AFN -3640000 and a gain in 2018 AFN 3528000. It can be concluded that the Main source of income for this Bank was the Net interest income.

Azizi Bank, which is a commercial bank and is involved in all types of banking activities, has sources of income from net interest income, fees and commissions, other incomes, foreign exchange, and Gains from investments. Using Appendix 2, we can observe that the Net interest income from 2015 AFN 546569000 to 2019 AFN 598031000 shows an increase, and also from Net fees and commissions from 2015 AFN 442784000 to 2019 AFN1184120000 shows a significant gain. Other incomes also show a significant increase from 2015 AFN 22119000 to 2019 AFN 828407000. Moreover, Foreign exchange gain shows a Significant decrease in income from 2015 AFN 175440000 to 2016 AFN 42440000, but it increased in 2018 AFN 140227000. Lastly, Azizi Bank also shows investment gain from 2016 AFN 2394000, And a decrease in 2017 AFN 1216000 but also shows an increase in 2018 AFN 4633000. From this, we can conclude that the main source of income is Net interest income and Fees and Commissions.

Lastly, Ghazanfar Bank is a fully-fledged Islamic Bank and has sources of income from Net Interest, Fees and Commissions, Other income, and Foreign exchange. If we observe Appendix 2, we can see that there are Fluctuations throughout the incomes. From 2015, the net interest income of AFN394,781,000 to 2018 AFN 409,175,000 Showed an increase but a slight decrease in 2019 AFN 385,397,000. On the other hand, net fees and commissions show a rise from 2015 AFG 151,368,000 to 2019 AFN 178,889,000. Also, Other incomes show an increase from 2015 AFN 59,301,000 until 2018 113,721,000 but show a significant decline in 2019 AFN 68258000. Lastly, there was only Gain from Foreign exchange in 2018 AFN 5696000. To conclude, this Bank's primary source of income is the Net interest income(Distributable Profit based on Profit sharing law of Islamic Banking).

In conclusion the analysis of Appendix 2 reveals distinct categories among Afghan Banks - Big Banks, Small banks, Non Islamic Banks and Fully-Fledged Islamic Banks.There are limitations to certain banks like Ghazanfar Bank operating like AIB Bank because Ghazanfar Bank has to follow Shariah law and adhere to Islamic Banking laws. Whereas AIB also, to some extent, follows Shariah laws, it is not fully-fledged Islamic Banking. We can see that AIB Bank has a bigger portion of income compared to the other 3 Banks, which could possibly be the result of the activities that the Bank undertakes in both Islamic and Conventional banking systems. Moreover, the size of the Bank could be another reason. For instance, the National Bank of Pakistan is the smallest Bank according to income, which is a possibility because it is a foreign Bank and has few franchises overseas, has limitations, and has to follow the rules and laws of Da Afghanistan Bank, which limits their activities lastly if we look at the Azizi Bank, which is a commercial Bank and is involved in Transactions and activities and does not have to follow Islamic laws and operates like any other commercial bank around the world.From this it becomes evident that the nature of Banks operations, compliance with Islamic Laws limits the Activities of Banks who fully comply with the Islamic banking laws.

Current Situation of Banking Sector in Afghanistan Under Taliban Government

There is a report, although not substantiated by concrete evidence, suggesting a potential shift in Afghanistan's banking sector, particularly within commercial banking. It is speculated that the Taliban may be contemplating a transition from conventional banking to an Islamic banking system.

"The Taliban-led Central Bank of Afghanistan has established a committee to review and amend the Central Bank Law and the Banking Law of Afghanistan. According to the Central Bank, a seven-member committee is set up to study and propose amendments to the Central Bank Law."Staff, "Afghanistan Dispatch: The Taliban Want to Replace the Conventional Banking System with Islamic Banking."[21]

After the rise of the Taliban in Afghanistan, the Central Bank has established a committee with the specific purpose of conducting a comprehensive analysis and possible amendment of both the Central Bank Law and the Banking Law of the nation. This initiative is primarily aimed at reconciling the legal structure with the principles of Islamic banking, thereby indicating a shift away from traditional banking methods. The current Central Bank Law, which is about sixty years old, does not provide regulations for the establishment of an Islamic banking system. The committee's objective is to fill this gap. The existing Banking Law effectively serves both

[21] Staff, Jurist. "Afghanistan Dispatch: The Taliban Want to Replace the Conventional Banking System with Islamic Banking." JURIST, March 20, 2022. https://www.jurist.org/news/2022/03/afghanistan-dispatch-the-taliban-want-to-replace-the-conventional-banking-system-with-islamic-banking/.

Islamic and conventional banking systems, enabling commercial banks to function with dedicated windows for Islamic banking. This is done under the supervision of the Central Bank, which provides a regulatory framework.

The Afghan banking industry has been crucial in driving the country's economic progress in the last twenty years. Islamic banking, in particular, has experienced rapid growth, not just in Afghanistan but also in other parts of the world too. Although Islamic banking has gained significance in recent years, it is important to emphasize that the committee responsible for modifying the Banking Law and the Central Bank Law lacks competence in the field of Islamic banking. Every member of the committee lacks significant expertise or background in this industry.

Since the Taliban's takeover of power in August 2021, the legal environment has been characterized by a lack of new laws or rules, which has contributed to increased complexity. Hence, the path of the committee's suggestions and their potential endorsement, if at all, remains ambiguous. All commercial banks have been instructed by the Central Bank to adopt the Islamic banking system. Financial institutions are obligated to provide the Central Bank with comprehensive proposals that outline the schedule and essential modifications for this transition. The First Microfinance Banking Bank of Afghanistan has already commenced the process of conversion and has included other organizations to reorganize its operations in accordance with Islamic banking principles.

Nevertheless, a significant obstacle in this ambitious shift is the ability of the Central Bank and the Taliban-led government to effectively enforce and supervise the implementation of the Islamic banking system nationwide. Aside from the complex nature of banking legislation, there are additional concerns over the expansion of the recently formed Advancement of Virtue and Prevention of Vice division inside the Central Bank. According to certain sources, authorities from this department are allegedly directing Central Bank staff to follow particular personal routines, such as growing beards and praying five times a day. Non-compliance with these practices may result in wage consequences. This raises significant questions regarding the convergence of religion and financial administration within the developing Afghan banking environment.

Summary and Conclusion

By carefully reviewing the Appendix 1 and Appendix 2 , and the distinct categories, it is clear and indisputable that Islamic banks in Afghanistan fully adhere to Islamic rules and regulations. The Islamic banks in the region completely comply with the requirements of Islamic law, assuring strict adherence to the regulations set by the Shariah board. The compliance criteria are formulated based on the particular regulations outlined in Shariah Law, as adopted by Da Afghanistan Bank (DAB). The flexibility of DAB in adhering to Islamic rules is crucial in determining the operating structure of these institutions. Commercial banks in Afghanistan function similarly to conventional banks globally, such as those in the United States. These entities are involved in typical banking operations, which include earning interest income, charging fees and commissions, and making earnings from foreign currency transactions. In addition, commercial banks enhance the diversification of their investment portfolios by allocating funds to specific financial instruments and distributing the resulting profits or losses among their stakeholders. Therefore, Afghanistan accommodates two separate categories of banks: fully-fledged Islamic banks and commercial banks. The distinction between these two categories of banks often depends on the depositor's preference for safety and uncertainty. Due to their strict adherence to Islamic regulations, Islamic banks provide a perceived reduced level of risk, ensuring the safety of deposited cash, even if the returns may not be as profitable.

On the other hand, depositors who are willing to accept certain risks typically choose to use commercial banks. The latter individuals participate in a more active investment approach, which has the potential to generate profits but also comes with an equivalent amount of risk. The banking sector in Afghanistan offers a selection between risk and security. Islamic banks serve those who are cautious about taking risks and prioritize financial stability. On the other hand, commercial banks appeal to those who are prepared to accept a certain degree of financial risk in exchange for the possibility of more significant profits.

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Appendices

Appendix 1: Commercial Banks Dataset

Name of the Bank	Year	Net Interest Income	Net Fees and Commission	Other Incomes	Foreign exchange	Gain from securities/loss	Gain from Investment
Bank-e-Millie Afghanistan	2015	804,664,908	113,795,959	264,795,959	83,067,894	0	3,436,838,772
Bank-e-Mili Afghanistan	2016	860,843,042	103,156,385	350,651,397	81,448,076	0	0
Bank-e-Millie Afghanistan	2017	945,719,132	194,311,138	332,945,706	37,429,892	0	0
Bank-e-Millie Afghanistan	2018	695,108,536	695,108,536	437,880,042	123,282,587	0	0
Bank-e-Millie Afghanistan	2019	913,115,377	172,063,183	594,106,598	46,470,145	0	302,579,899
Pashtany Bank	2015	114,879,373	17,710,907	150,981,270	4,767,309	0	0
Pashtany Bank	2016	317,970,597	53,999,556	413,133,364	-17,307,387	0	0
Pashtany Bank	2017	225,112,014	46,141,432	397,218,982	35,878,749	0	0
Pashtany Bank	2018	59,690,905	54,809,694	401,502,306	53,049,682	0	0
Pashtany Bank	2019	30,198,952	13,932,411	48,003,620	3,876,242	0	0
New Kabul Bank	2015	196,140,075	1,076,666,066	1,390,569,840	0	0	0
New Kabul Bank	2016	107,519,406	1,158,299,742	1,420,344,019	0	0	0
New Kabul Bank	2017	342,861,918	1,147,367,147	1,661,357,348	0	0	0
New Kabul Bank	2018	44,440,386	1,250,932,083	1,440,287,667	0	0	0
New Kabul Bank	2019	105,283,644	1,154,549,302	1,398,927,722	0	0	0
Azizi Bank	2015	546,569,000	442,784,000	22,119,000	175,440,000	0	0
Azizi Bank	2016	575,625,000	789,625,000	41,015,000	42,440,000	0	2,394,000
Azizi Bank	2017	347,093,000	1,320,817,000	81,589,000	104,673,000	0	1,216,000
Azizi Bank	2018	598,031,000	1,184,120,000	828,407,000	140,227,000	0	4,633,000
Afghanistan International Bank	2015	1,080,742,000	662,876,000	-1205000	193,633,000	3,659,000	-13,555,000
Afghanistan International Bank	2016	1,057,925,000	756,857,000	55,717,000	144,023,000	-477,000	-1,788,000

Afghanistan International Bank	2017	1,081,866,000	923,866,000	55,964,000	172,609,000	36,472,000	-64,366,000
Afghanistan International Bank	2018	1,240,457,000	888,311,000	64,750,000	231,055,000	-1,732,000	0
Afghanistan International Bank	2019	1,346,271,000	1,066,596,000	46,414,000	2,649,623,000	105,221,000	0
Maiwand Bank	2015	617,533,000	149,437,000	168,234,000	106,309,000	0	0
Maiwand Bank	2016	732,571,000	111,240,000	4,781,000	-21,312,000	0	0
Maiwand Bank	2017	588,742,000	104,231,000	87,019,000	-12,714,00	0	0
Maiwand Bank	2018	539,368,000	123,474,000	80,948,000	15,470,000	0	0
Maiwand Bank	2019	242,250,000	202,213,000	8,482,000	30,689,000	0	0
Afghan United Bank	2015	765,950,000	222,422,000	126,359,000	0	0	0
Afghan United Bank	2016	912,200,000	314,393,000	53,736,000	0	0	0
Afghan United Bank	2017	815,259,000	249,182,000	97,589,000	0	0	0
Afghan United Bank	2018	796,962,000	262,514,000	188,062,000	0	0	0
Afghan United Bank	2019	675,563,000	370,200,000	38,936,000	0	0	0
The First Micro- Finance Bank	2015	872,127,000	45,273,000	30,781,000	0	0	0
The First Micro- Finance Bank	2016	1,029,963,000	57,819,000	16,438,000	0	0	0
The First Micro-Finance Bank	2017	1,263,446,000	53,734,000	17,430,000	0	0	0
The First Micro-Finance Bank	2018	1,219,225,000	78,595,000	49,333,000	130,121,000	0	0
The First Micro-Finance Bank	2019	1,254,202,000	67,099,000	198,127,000	149,502,000	0	0
Ghazanfar Bank	2015	394,781,000	151,368,000	59,301,000	0	0	0
Ghazanfar Bank	2016	396,268,000	115,678,000	63,693,000	0	0	0
Ghazanfar Bank	2017	400,150,000	126,544,000	111,134,000	0	0	0
Ghazanfar Bank	2018	409,175,000	175,697,000	113,721,000	5,696,000	0	0

Ghazanfar Bank	2019	385,397,000	178,889,000	68,258,000			
National Bank of Pakistan	2015	94,411,000	27,132,000	0	83,071,000	0	0
National Bank of Pakistan	2016	96,184,000	27,190,000	0	-34,701,000	0	0
National Bank of Pakistan	2017	79,394,000	79,394,000	26,696,000	36,147,000	0	-3,640,000
National Bank of Pakistan	2018	21,417,000	108,897,000	9,618,000	22,724,000	0	3,528,000
National Bank of Pakistan	2019	56,389,000	19,508,000	-1,184,000	0	1,273,000	0
Bank Alfalah Bank	2015	270,209,000	169,658,000	54,204,000	27,338,000	0	0
Bank Alfalah Bank	2016	291,237,000	144,864,000	48,546,000	12,344,000	0	0
Bank Alfalah Bank	2017	384,809,000	82,904,000	133,066,000	13,721,000	0	0
Bank Alfalah Bank	2018	207,012,000	82,499,000	304,668,000	9,820,000	0	0
Bank Alfalah Bank	2019	239,001,000	100,286,000	20,598,000	12,086,000	0	0

Appendix 2: 4 categories, Big Bank,Small Bank, Non-Islamic Bank and Fully fledged Islamic Bank

Banks	Year	Net Interest Income	Net Fees and Commissions	Other Incomes	Foreign Exchange	Gain/Loss from Securities	Gain or Loss from Investments
Afghanistan International Bank	2015	1,080,74,0002	662,876,000	-1,205,000	193,633,000	3,659,000	-13,555,000
Afghanistan International Bank	2016	1,057,925,000	756,857,000	55,717,000	144,023,000	-477,000	-1,788,000
Afghanistan International Bank	2017	1,081,866,000	923,866,000	55,964,000	172,609,000	36,472,000	-64,366,000
Afghanistan International Bank	2018	1,240,457,000	888,311,000	64,750,000	231,055,000	-1,732,000	0
Afghanistan International Bank	2019	1,346,271,000	1,066,596,000	46,414,000	2,649,623,000	105,221,000	0
National Bank of Pakistan	2015	94,411,000	27,132,000	0	83,071,000	0	0
National Bank of Pakistan	2016	96,184,000	27,190,000	0	-34,701,000	0	0
National Bank of Pakistan	2017	79,394,000	79,394,000	26,696,000	36,147,000	0	-3,640,000
National Bank of Pakistan	2018	21,417,000	108,897,000	9,618,000	22,724,000	0	3,528,000
National Bank of Pakistan	2019	56,389,000	19,508,000	-1,184,000	0	1,273,000	0

Azizi Bank	2015	546,569,000	442,784,000	22,119,000	175,440,000	0	0
Azizi Bank	2016	575,625,000	789,625,000	41,015,000	42,440,000	0	2,394,000
Azizi Bank	2017	347,093,000	1,320,817,000	81,589,000	104,673,000	0	1,216,000
Azizi Bank	2018	598,031,000	1,184,120,000	828,407,000	140,227,000	0	4,633,000
Ghazanfar Bank	2015	394,781,000	151,368,000	59,301,000	0	0	0
Ghazanfar Bank	2016	396,268,000	115,678,000	63,693,000	0	0	0
Ghazanfar Bank	2017	400,150,000	126,544,000	111,134,000	0	0	0
Ghazanfar Bank	2018	409,175,000	175,697,000	113,721,000	5,696,000	0	0
Ghazanfar Bank	2019	385,397,000	178,889,000	68,258,000	0	0	0