



Da Afghanistan Bank

Non-Bank Financial Institutions Supervision Directorate General

Financial Leasing Regulation

Feb 2020

Table of Contents

Chapter 1: General Provisions.....	1
Article 1: Basis	1
Article 2: Purpose	1
Article 3: Scope	1
Article 4: Definition	1
Chapter 2: Licensing.....	3
Article 5: Issuance of License.....	3
Article 6: Licensing Requirements.....	4
Article 7: Requirements for the Shareholders, members of the board of Directors and board of Senior Executive Management	4
Article 8: Requirements for the Board of Directors	5
Article 9: Requirements for Senior Executive Management.....	5
Article 10: Application.....	6
Article 11: Documents to be attached to the application.....	6
Article 12: Verification of Information	7
Article 13: Processing of Application	7
Article 14: License Duration	8
Chapter Three: Supervision of Lessor’s Activities	8
Article 15: Reporting Requirements	8
Article 16: Matters Requiring the Approval of Da Afghanistan Bank	9
Article 17: Monitoring and supervision of Lessors.....	9
Article 18: Inspection Activities – on-site and off-site	9
Article 19: Revocation of License	10
Article 20: Annulment of License	10
Article 21: Notification of the annulment or revocation of the license	11
Article 22: Consequences of license annulment or revocation.....	11
Article 23: Penalties.....	11
Chapter Four: Classification and provisioning of Leased Asset.....	11
Article 24: Requirements for Lease classification process.....	11
Article 25: Lease classification category	12
Article 26: Re-negotiated financial lease	12
Article 27: Minimum provisioning requirement.....	12
Article 28: Charge-Off.....	13
Article 29: Income recognition requirement	13
Article 30: Repossession of asset in lieu of repayment of the financial lease	13

Article 31: Management information system and reporting requirement.....	14
Article 32: Financial Lease Classification Criteria.....	14
Chapter Five: Miscellaneous Provisions	16
Article 33: Compliance with Regulations.....	16
Article 34: Compliance with Reporting Requirements	16
Article 35: Risk management	16
Article 36: Requirements when entering to related person Transaction	17
Article 37: Reporting related person’s transaction to DAB.....	17
Article 38: Limitation on maximum size to related party exposure.....	17
Article 39: Large exposure and concentration of asset	17
Article 40: General Limitation on exposure to a single obligor or group of related obligors.....	18
Article 41: Enforcement.....	18

Chapter 1: General Provisions

Article 1: Basis

This regulation is designed pursuant to Article 27 of the Financial Leasing Law, official gazette number 1128 of 2014, for the purpose of regulating the process for licensing and supervision.

Article 2: Purpose

The purpose of this regulation is to:

- (1) Develop a transparent process for Da Afghanistan Bank to proceed with the licensing and conduct supervision of lessors and regulate leasing activities in the financial market of the country;
- (2) Ensure a more efficient implementation of the Financial Leasing Law;
- (3) Promote leasing as an instrument for the financing of fixed assets such as machinery, equipment, vehicles and/or properties; and
- (4) Promote competition in the financial market.

Article 3: Scope

- (1) This regulation shall apply to all local and foreign lessors who are qualified according to this regulation and operating in Afghanistan.
- (2) This regulation shall not apply to banking institutions that are licensed by Da Afghanistan Bank.
- (3) This regulation and financial leasing Law are not applied to the relationship between Lessor and Lessee which is governed by civil law in leasing affairs.

Article 4: Definition

Unless the context indicates otherwise, definitions provided for in the law on Financial Leasing shall apply to this regulation along with the following definitions:

- (1) **Law on leasing means:** The Law on Financial Leasing# 1128 fo4r 2014.
- (2) **Leasing activity means:** Activity practiced by lessors according to a definition of financial lease provided by the law on Leasing under the condition that the minimum lease term in not less than 12 months.
- (3) **Lessor:** Is a legal entity licensed by Da Afghanistan Bank who practices financial leasing activities as defined by Financial Leasing Law. According to the Law “A Lessor is a person who, under the financial lease contract transfers the right of possession and use of the asset to the Lessee. This terminology covers the sub-lease, unless otherwise stated in the Law”.
- (4) **Lessee:** Is the user of the leased assets as defined according to financial leasing law and this regulation. According to the Law “A lessee is a person who under a financial lease contract acquires the right of possession and use of the asset from the Lessor. This terminology covers the sub-lease, unless otherwise stated in this Law.”
- (5) **License Means:** A written permission issued by Da Afghanistan Bank to a lessor to practice financial leasing activity as defined by this regulation.
- (6) **Council means:** Supreme Council of Da Afghanistan Bank.
- (7) **Registry of Lessors means:** the central registry of licensed lessors created in accordance with this regulation.

- (8) **Senior Executives means:** The General Manger its Deputy, the Chief Financial Officer, and the Senior Department Managers.
- (9) **Minimum Lease term means:** A period during which a leased asset is provided to a lessee for temporary possession and use in accordance with a leasing agreement.
- (10) **Board of Director:** means the highest body of authority in a financial leasing institution responsible for strategically guiding the institution, effectively monitoring management and properly accounting to shareholders.
- (11) **Book value:** means the value of a leased asset as stated on the books of account of a financial leasing institution being the amount of the financial leasing institution's investment in that less any specific general provision for loss.
- (12) **Charge-off:** means the accounting process of expensing institution's income statement in view a facility being demand uncollectible, such that continuation as a recoverable advance is no longer warranted and being purely an accounting entry it does not forfeit the lessee's obligation to pay the outstanding payments due or the right of the financial leasing institution to institute legal action to enforce payment of the outstanding payments due under the financial lease.
- (13) **Regulatory capital:** means the sum of Tier1 capital and Tier 2 capital divided by risk weighted assets minus equity investment. The regulatory capital measurement will be introducing by DAB through separate circular or regulation.
- (14) **Collateral:** means the net realizable value of the following assets in which the interest of the financial leasing institution is fully enforceable.
- (15) **Readily marketable collateral:** the collateral must be salable under ordinary market conditions with reasonable promptness at a fair market value determined by quotations upon actual transactions on an auction or similarly available daily bid and ask price market. The types of the collateral that meets the characteristics of readily marketable collateral will be introduce through a separate guideline.
- (16) **Large exposure:** means an exposure to a customer, or group of closely-related customers, that meets or exceed 15 percent of Regulatory capital but does not exceed more than 25 percent of regulatory capital.
- (17) **Group of related obligor:** a group of related obligors is defined as two or more persons (natural, juridical or both) who are connected, directly or indirectly, in such a way that the financial soundness of any of them may affect the financial soundness of some or all of them.
- (18) **Financial lease concentration:** means an exposure to a customer, or group of closely-related customers that meets or exceeds 40 percent of the Regulatory capital.
- (19) **Related person:** includes where the interests of two or more persons or a group of persons are so interrelated that they could be considered as a single unite, and one or more of these persona are a related person, then they are all considered related persons. Including the management board and their close relatives, supervisory board and close relative, shareholder's close relatives, parent company top management and their close relatives.
- (20) **Arm's length basis:** a transaction in which customer and financial leasing institution act independently and have no relationship to each other; or a transaction where both parties in the deal are acting in their own self-interest and are not subject to any inappropriate pressure or duress from other party.
- (21) **Net financial lease balance:** means the outstanding principle of financial lease less the net realizable value of any eligible collateral.
- (22) **Net realizable value:** means the estimated selling price of an asset in the ordinary course of business less the estimated costs of recovery of the asset and the estimated costs necessary to sell the asset.

- (23) **Non-performing financial lease:** means a financial lease that is classified as sub-standard, doubtful, or loss in accordance with these regulations.
- (24) **Re-negotiated financial lease:** means a financial lease which has been refinanced, rescheduled, rolled over or otherwise modified because of weaknesses in the lessee's financial position or non-repayment of the outstanding facility according to the original terms.
- (25) **Standard Asset:** means any asset that can be easily resold and highly demanded in secondary market due to its wide scope of use.
- (26) **Specific Asset:** means any asset that is difficult to resell and has low demand in secondary market due to thin scope of use.
- (27) **Gearing:** means a measure of financial leverage demonstrating the degree to which the independent financial leasing company taking financial leasing operations are funded by owner's funds and various creditor funds.
- (28) **Gearing ratio:** means a ratio indicating the proportion of independent financial leasing company's debt to its equity.
- (29) **Limitation on gearing ratio**
Every financial leasing institution shall at all times ensure that the total debt of the company shall not be an amount greater than 7 times its equity capital that is a gearing ratio which does not exceed 7:1
- (30) **Interpretation:**
Debt means the sum of:
1. Loans and overdrafts;
 2. Bonds;
 3. Debenture;
 4. Amount due to related companies;
 5. Promissory notes;
 6. Commercial papers; and
 7. Any other dues and other form of borrowings as may be determined by the Da Afghanistan Bank (DAB).
- (31) **Equity means the sum of:**
1. Unimpaired ordinary paid up share capital or assigned capital;
 2. Unimpaired paid up non-cumulative perpetual preference shares;
 3. Share premium;
 4. General or other disclosed reserves;
 5. Retained profits or losses; and
 6. Current unaudited profits and losses since the first day of the current financial year.
 7. Every financial leasing institution shall submit a report to Da Afghanistan Bank on its calculation of gearing ratio and information on its borrowings on a monthly basis.

Chapter 2: Licensing

Article 5: Issuance of License

- (1) Any legal entity willing to undertake financial leasing activity in the country must apply to obtain a license from Da Afghanistan Bank in accordance with this regulation.
- (2) It is prohibited to undertake Financial Leasing activity without prior licensing in accordance with this regulation.

- (3) Any legal entity who has not obtained a license in accordance with the provisions of this regulation shall be prohibited from using the phrase “financial leasing” or any synonym thereof, whether in Dari or Pashto or any other language, as a part of its name, nor to use this phrase in its papers, documents or promotional materials.
- (4) Any entity who is undertaking financial leasing activities should apply to DAB for license within 4 months after the enactment of this regulation.

Article 6: Licensing Requirements

- (1) The followings are required to obtain a license from Da Afghanistan Bank to practice financial leasing activity:
 1. The applicant must be Shareholding Company duly registered in accordance with the laws of Afghanistan or foreign shareholding company duly registered in its country of origin, provided it registers a branch in Afghanistan;
 2. The number of shareholders could be one or more than persons. (natural or legal person);
 3. The applicant company’s paid in capital must not be less than Seven Hundred Thousand USD (\$ 700,000) or its equivalent in AFs;
 4. Non-refundable licensing fees are paid; and
 5. Members of the applicant company’s Board of Directors, shareholders, the representative of the foreign shareholding company branch, Senior Executive managers must fulfill the conditions, meet the qualifications and experience delineated below in articles 7 and 8 of this regulation.
- (2) The applicant is required to ensure compliance with all licensing requirements specified in this regulation. In case of failure to do so, Da Afghanistan Bank may, after mortifying the applicant, take action in accordance with this regulation.

Article 7: Requirements for the Shareholders, members of the board of Directors and board of Senior Executive Management

In addition to the requirements and conditions provided for in the relevant laws, the shareholders, members of the board of supervisors and management board must:

1. Be a “Fit and Proper Person” a person who in the judgment of Da Afghanistan Bank is honest, trustworthy, fair, displays integrity and has the ability to make sound and effective decisions in his personal, financial and business activities and possesses good skills and experience for conducting the intended activities of the leasing company.
2. A legal person is considered to be a fit and proper person if in the judgment of Da Afghanistan Bank all members of its board of supervisors, management board, or equivalent governing bodies, and persons with qualifying holding in such enterprise have these qualities.
3. No person shall be regarded as a fit and proper if he:
 - a. Has been convicted by an authorized court of an offense for which he was sentenced to imprisonment unless such sentence was motivated by its religious or political views or activities;
 - b. Has been declared bankrupt by an authorized court of law;
 - c. On grounds of personal or professional misconduct, has been disqualified or his authority in conducting financial affairs is under suspension by a competent authority;
 - d. Is an associate, a representative of a person which would not be regarded as a fit and proper person according to first, second and third sub-paragraph of this paragraph; and

- e. Has a beneficial owner which would not be regarded a fit and proper person according to the first, second and third sub-paragraph of this paragraph.

Article 8: Requirements for the Board of Directors

In addition to the requirements and conditions provided for in the relevant laws, the chairman and the members of the lessor's Board of Directors:

1. Must not be a board member or a member of a Senior Executive Management in another company practicing financial leasing activity in Afghanistan, unless the other company is a subsidiary of the lessor:
 - a. Must not be an Executive or Supervisory board member of the banking institution unless lessor is a subsidiary of such banking institution;
 - b. Shall be at least a college graduate with a business-related degree and have at least five (5) years of working experience in a business operating or in a relevant field; and
 - c. Shall be a "Fit and Proper Person" a person who in the judgment of Da Afghanistan Bank is honest, trustworthy, fair, displays integrity and has the ability to make sound and effective decisions in his personal, financial and business activities and possesses good skills and experience for conducting the intended activities of the leasing company.
2. The chairman of the board of directors, members of the board of directors, and their first degree relatives may not enter into any contracts, projects, or arrangements with the Lessor or for its accounts in which any of them has direct or indirect interests.
3. The first degree relatives of the management board and board of directors may enter into contracts, if the contract has been arranged on an Arm's length basis.
4. The board members may not receive any commission for any leasing transaction in which the Lessor is a party to it.
5. The Board of Directors (including the Chairman) must be maintained as an odd number
6. The finance leasing company must have at least one independent non-executive director as a member of the Board.
7. The Board may not have any Executive Directors.

Article 9: Requirements for Senior Executive Management

- (1) The conditions delineated in article 7 of this regulation shall apply to the lessor's Senior Executive Management members.
- (2) The CEO and CFO of the lessor, appointed by the Board, must:
 1. Work on a full-time basis for the duration of his employment by the lessor; and
 2. Have obtained a university degree from a recognized university and have practical experience of no less than 7 years in the field of financial, banking or finance business. The conditions above shall apply to all members of the Senior Executive Management when appointed by the Board.
- (3) The Board is responsible for creating a "Terms of Reference" (job description and associated responsibilities) for each member of the Senior Executive Management team which must be submitted for assessment and suitability to Da Afghanistan Bank.
- (4) The members of Senior Executive Management may not:
 1. Participate in the management of any similar or competing business with the Lessor, or conduct directly or indirectly a competing business.
 2. Receive any commission for any leasing transaction in which the Lessor is a party to it.

Article 10: Application

- (1) The application to obtain the license must be presented to Da Afghanistan Bank in accordance with the form developed by the DAB and it should be signed by the applicant company's authorized signatories with an undertaking subject to legal liability that the information contained therein and in the attachments are accurate.
- (2) The application must at least include the following:
 1. The name, type of entity, registration number, date of registration in the register of companies, the headquarters, and the number of branches of the applicant company;
 2. The names of all shareholders of the applicant company's capital, their nationalities, the nature of their activities, the amount and percentage of their ownership in the capital;
 3. The name, address, a full resume of each individual proposed to be appointed in Senior Executive Management position in the applicant company, including capacities and job titles;
 4. The name, address, a short resume of each individual proposed to be appointed to a Board position in the applicant company, including previous and current experience of being a board member and any association with any other company as a board member, shareholder or employee;
 5. The name and address of the applicant company's auditor;
 6. The capital of the applicant company; and
 7. The name of the person authorized to represent the company before Da Afghanistan Bank for the purpose of licensing procedures and his full address, including e-mail address.

Article 11: Documents to be attached to the application

- (1) The following documents must be attached to the license application form:
 1. A certificate of company's registration of the applicant, and a certificate including the names of its members of the board of management, its authorized signatories;
 2. A "No Objection Certificate" if any of the shareholders is a bank or financial institution, including a micro-finance company, and is registered in Afghanistan;
 3. The company's memorandum of association;
 4. A certificate issued by licensed bank certifying that the applicant company's capital has been fully paid-in;
 5. The organizational structure of the applicant company;
 6. Audited financial statements for the prior three years for legal entities who own more than 5% of the applicant company, if any;
 7. Proof of identify of the persons to be appointed in Senior Executive Management positions; and
 8. The Audit financial statements as follows:
 - a. If the applicant company has already been active for more than three years at the time of application - financial statements for the three years preceding the application.
 - b. If the applicant company has been active for three years or less at the time of application – financial statements for the period since applicant's registration.
 - c. The provision of this sub paragraph shall not be applicable to those applicant companies operating for less than 12 months or newly established companies.

9. A Business Plan related to the establishment of leasing operations covering a period of at least three years shall be specifying, as a minimum, the followings:
 - a. Source of current and future funding;
 - b. Projected financial statements
 - c. Organization chart for each year;
 - d. Projected cash flows;
 - e. Number and location of the company's branches to be established (if any)
 - f. Source(s) of new business activity;
 - g. Business activity sectors;
 - h. Geographical activity;
 - i. Customer profile (e.g. corporate, SME); and
 - j. If the financial leasing company is a subsidiary, their degree of independence from the parent company.
 10. Credit policy and risk management policy.
- (2) If the applicant company is a foreign shareholding company, all documents issued abroad submitted thereby must be duly certified by the country of origin.
 - (3) In addition to the document listed in a paragraphs 1-10 above, the following documents shall be attached to the application submitted by the foreign shareholding company:
 1. Written permission issued by the competent authorities in its country of origin allowing the foreign company to exercise financial leasing activity in the case it is registered in a country where financial leasing activity is required to be licensed;
 2. The duly signed regulation of the board of directors of the foreign company approving the opening a branch in Afghanistan and the appointment of the representative of the company in Afghanistan and specifying his/her authorities; and
 3. If any of the shareholders is a bank, then a "No Objection Certificate" from the bank's home regulator.
 - (4) Any information requirements, conditions or other documents deemed needed and necessary by Da Afghanistan Bank to decide on the application.

Article 12: Verification of Information

DAB shall take the necessary action to verify the accuracy of the information included in the application and documents attached thereto.

Article 13: Processing of Application

- (1) DAB shall charge the applicant an up-front and non-refundable fee.
- (2) DAB shall scrutinize the application and its attachments, and shall notify the applicant company's authorized representative within 7 days either that the application is complete or, that it is incomplete which precludes processing of the application.
- (3) DAB will grant the applicant company a period of 45 days as of the day of notification of the applicant's authorized representative to complete the file. This period may be extended by DAB once only for a period not exceeding 30 days. In such case, the application and its attachments shall be retained by DAB until the missing documents or the information is furnished.

- (4) Failure by the applicant company to furnish the required missing items within the authorized time period shall render the application cancelled. However, the applicant company may submit a new application.
- (5) In all cases, DAB shall notify the applicant company's authorized representative once the application is complete.
- (6) The DAB shall issue a reasoned decision regarding the granting or declining of the license within a period of 60 days from the date of receipt of the full application file and attachments with reasons for the decline, if relevant and shall notify the application company's authorized representative accordingly.
- (7) No license granted by DAB may be transferred at any time by any entity to any other entity regardless of any situation which may occur.

Article 14: License Duration

The license is issued for the indefinite term subject to revocation and annulment in accordance with this regulation and is not transferable.

Chapter Three: Supervision of Lessor's Activities

Article 15: Reporting Requirements

- (1) Every Lessor must provide DAB with the following information:
 - 1- Audited financial statement, within 90 days of the end of each fiscal year;
 - 2- Notification of any significant changes to the membership of the Lessor's board of directors or Senior Executive Management within 7 days as of the date of the occurrence of such change. DAB will assess the eligibility of all new board members and Senior Executive Management team members using the same criteria authorized during the license application procedure;
 - 3- Notifications related to closure of any branches, establishment of new branches, or moving of branches within 7 working days of its occurrence;
 - 4- Any amendment of the Lessor's capital, Memorandum of Association not relating to its objectives within two weeks of the date of passing the general assembly resolution in connection therewith;
 - 5- Monthly financial reports (unaudited); and
 - 6- A report on Lessor's leasing activities in a form provided by DAB and prepared on a monthly basis within 15 days after the end of each month which should include information on the leasing portfolio including:
 - a) Number and volume of leases (including subleases);
 - b) Number and volume of non- performing leases;
 - c) General lease loss provision and Specific provisions;
 - d) The number and value of contracts terminated;
 - e) Repossession cases filed;
 - f) Number of rescheduled leases;
 - g) Large exposures;
 - h) business sector concentration and closed related customer;
 - i) Any other data and information demanded by DAB.
- (2) Under Article 107 of Da Afghanistan Bank Law the Lessor has the right to appeal to DAB if the Lessor believes its rights were violated by the actions of DAB's representatives or that

DAB's representatives have performed their supervisory and monitoring functions in violation of Leasing Law, this regulation or other laws of Afghanistan.

- (3) If the Lessor is not satisfied with the decision of DAB pursuant to paragraph 2 of this Article, it can refer the matter to the Financial Dispute Commission, and, if not resolved, file a lawsuit in competent court.

Article 16: Matters Requiring the Approval of Da Afghanistan Bank

- (1) The Lessor must obtain Da Afghanistan Bank's prior written approval for any of the following:
 1. Amendments of any of its Articles of Association;
 2. Merging with another company; and
 3. Issuing resolution for voluntary liquidation.

Article 17: Monitoring and supervision of Lessors

- (1) Lessors are subject to DAB's monitoring and supervision.
- (2) The lessor must provide data, information, and forms of documents and contracts used thereby as specified by DAB from time to time whenever requested by DAB for monitoring and supervision purposes. All data and information submitted by the Lessor to Da Afghanistan Bank must be in written/printed form and duly signed by the authorized signatory on behalf of the Lessor.

Article 18: Inspection Activities – on-site and off-site

- (1) The DAB shall be authorized to conduct an inspection of the licensed Lessors to ensure compliance by the Lessors with relevant Law, Regulations and circulars by any means necessary and appropriate.
- (2) The DAB's authorities referred to paragraph 1 of this Article include access to the Lessor's entire entries, books, files, relevant documents and forms, and may enlist the aid of a certified auditor at the expense of the Lessor.
- (3) Upon completion of the inspection, the DAB shall issue a written report to the Lessor clearly identifying any area of non-compliance with the financial leasing law, Regulations and circulars by the Lessor and the specific corrective actions necessary for it to become compliant if there are instances of non-compliance.
- (4) If the Lessor commits any breach of the provision of the leasing law, this Regulation, or orders issued in accordance thereto, or it came to Da Afghanistan Bank's attention that the Lessor does not comply with the applicable laws in the course of conducting its business, even if no judicial decisions indicating them are issued, DAB may take any of the following measures against the Lessor:
 1. Addressing a written notification to request:
 - a. The Lessor to stop the breach and take corrective actions to remove the effects of the breach;
 - b. DAB will communicate in writing with the Lessor detailing the actions deemed necessary to be implemented which may be both mandatory and advisory; and
 - c. The Lessor to suspend part or all of its operations until the breach is rectified.
 2. Suspending the license for the period it deems appropriate provided it does not exceed 30 days.

3. Revocation of the License granted to the Lessor.
- (5) Da Afghanistan Bank shall always ensure that the measure taken thereby are commensurate to the breach committed by the Lessor.
- (6) Da Afghanistan Bank shall notify the relevant parties of its decision to suspend or revoke the license, and publish the decision, as the case may be, on Da Afghanistan Bank website.
- (7) The measure taken in accordance with this Article shall not prevent civil or criminal liability in accordance with any other legislation.

Article 19: Revocation of License

- (1) In addition to the other cases delineated in this regulation, the Da Afghanistan Bank shall notify the Lessor of its intention to suspend, immediately or within a stated time period, or revoke the license granted to the Lessor:
 1. If it transpires that the Lessor has provided Da Afghanistan Bank with incorrect information or intentionally omitted to disclose the information that should have been disclosed for the purposes of obtaining a license; and
 2. If a final criminal judicial decision is obtained against a shareholder (if a private individual), member of its Board of Director, or member of Senior Executive Management in relation to crimes committed in the course of conducting Lessor's business activities.
- (2) DAB shall take the proper decision concerning the revocation of the license
Within 30 Days of receiving the Lessor's response.
- (3) The DAB revokes the license granted to the Lessor without notification in accordance with paragraph (1) of this Article in any of the following cases:
 1. Upon the Lessor's request following a Broad of Director's resolution; and
 2. If the Lessor has been declared bankrupt or placed under compulsory liquidation or Lessor's parent company has been declared bankrupt or is under liquidation.
- (4) In the event that the Lessor does not have a valid license, the Lessor's company may still exist as a legal Afghan business entity but will be unable to enter into any new finance leasing contracts. DAB will retain its right of supervision and monitoring of the company for a period of time of its sole choosing as though the company remained an active Lessor.

Article 20: Annulment of License

- (1) If it comes to DAB's attention that a Lessor has not commenced finance leasing activities after obtaining the License or ceased operations for a period exceeding 6 months, DAB may require the Lessor to provide justification for ceasing or not commencing operations within 7 days of notifying it.
- (2) If the Lessor responds to DAB's notice and DAB is convinced of the reasons for not commencing or ceasing operations, DAB may grant an extension not exceeding 6 months to commence or recommence operations.
- (3) If the Lessor does not respond within the specified period or responded within the specified period but DAB was not convinced of the response that it commenced operations or did not cease operations or did not resume operations after the lapse of the period granted, DAB may annul the license granted to the Lessor.

Article 21: Notification of the annulment or revocation of the license

- 1) The DAB will issue a decision to annual or revoke the license, the DAB shall notify the board of director of the lessor decision indicating its grounds.
- 2) The decision shall be in the Da Afghanistan bank website within 2 working days of issuance and within seven working days from the date of issuance in a local newspaper.
- 3) The measures taken in accordance with this paragraph shall not prevent civil or criminal liability in accordance with any other legislation.

Article 22: Consequences of license annulment or revocation

- 1) If the license is annulled or revoked in accordance to the provision of this Regulation or Financial Leasing Law or other DAB's legislative documents, the lessor shall not practice financial leasing.
- 2) All leasing contracts that the lessor entered into before license annulment or revocation, remain valid within duration.

Article 23: Penalties

- 1) The entity shall be penalized, if it conducts leasing activities without obtaining a license from DAB.
- 2) The lessor shall be penalized if it fails to provide information with the established timeframe in according with the sub paragraphs 1- and 2- of the paragraph 1 of the Article 15 of this regulation.
- 3) The amount of fines referred to in this Article shall be published in a DAB Circular from time to time.
- 4) The proposed penalties stated in paragraph 1, 2 and 3 of this article shall be imposed by Da Afghanistan Bank.

Chapter Four: Classification and provisioning of Leased Asset

Article 24: Requirements for Lease classification process

1. For the purpose of Lease classification, the Lessor shall review on a monthly basis in accordance with this regulation and the internal policy and guidelines of the financial leasing companies.
2. The lease portfolio review shall be made by a person who is independent form the lease origination function of the Lessor.
3. The financial leasing company or Lessor may develop internal risk grading system to indicate various level of risk exposure in financial leases which shall be reconciled to the 5 classification categories under this regulation for the purpose of reporting to DAB.
4. While small homogenous financial lease may be reviewed on a group-wise basis, the following financial lease must be reviewed on an individual basis.
 - a) Large exposure;
 - b) Lease concentrations;
 - c) Non-performing financial leases; and
 - d) Financial lease that have been charged off.
5. The remaining of the financial lease portfolio may be divided into groups of leases with similar credit risk characteristics (such as type of facility) for review on collective basis.

6. Where a financial leasing company has more than one financial lease extended to a single customer or group of closely-related customers and one such facility is non-performing, the financial lease company shall review all other facilities to that customer or group of closely-related customer for the purpose of classification and shall document such review.
7. The financial leasing company or Lessor shall, based on the financial lease portfolio review, assign each facility to the classification categories on the basis of credit risk.

Article 25: Lease classification category

A financial leasing institution’s facility are to be classified on the basis credit risk into the 5 categories as provided schedule under this regulation.

Article 26: Re-negotiated financial lease

- 1) A non-performing financial lease, once re-negotiated, shall be classified as a sub-standard asset, or continue to remain in the same category in which it was, prior to its re-negotiation.
- 2) The classification of a facility which has been re-negotiated to modify one or more of its terms shall be improved unless repayment of principle and interest, in accordance with the new payment schedule under the financial lease, has been made for 6 instalment periods or for a period of not less than 6 months, which ever period is greater.
- 3) On the expiry of the period reference in above point (2) the re-negotiated may be classified no more favorably than “watch” until repayment of principle and interest has been made for 6 additional instalment periods or for an additional period of not less than 6 months, which ever period is greater.

Article 27: Minimum provisioning requirement

1. Any impairment to the value of a financial lease or group of financial lease shall, at least monthly and based on the financial leasing review and classification process, be recognized by reducing the book value of the financial lease and charging the income statement in the period in which the impaired occurred.
2. All lease assets that are Non-performing shall be provisioned by multiplying the outstanding balance of the investment in a financial lease by applicable provision rate less cash collateral and value of the asset.
3. The financial institution may not set provision for lease portfolio which are secured by readily marketable collateral as mentioned under article 4.

The applicable provision rates shall be as follows

Classification	Provision Rate
Standard	1% (Optional)
Watch	5%
Sub-standard	25%
Doubtful	50%
Loss	100%

4. The value of the asset shall be determined based on the unamortized amount for each of the following asset categories.

Asset category	Amortization
Standard equipment	Shall be amortized over five years.
Specific equipment	Shall be amortized over three years 40% in years in one and two each and 20% in the third year.

5. The DAB may direct a financial leasing company or Lessor to increase its level of provisions where reliable information indicates that losses are likely to be more than the minimum amounts as specified in the above table.
6. The financial leasing company shall apply provisions of this regulation in reporting under the International Financial Reporting Standard 39 and this regulation.

Article 28: Charge-Off

- (1) A financial lease which is uncollectible and that continuation as a recoverable advance is no longer warranted shall be charged off.
- (2) A financial lease or any portion thereof shall be charged off within 12 months of being classified as loss.
- (3) A charge-off shall be made against the specific financial lease loss reserve account and if the amount of the financial lease to be charged off exceeds the balance of the specific financial lease loss reserves account, additional reserves shall be established to cover the shortfall through charges to income or through transfers from the general financial lease loss reserves account.
- (4) The recovery on a financial lease previously charged off shall be recorded as income in the financial period during which such recovery occurs.

Article 29: Income recognition requirement

- (1) A non-performing financial lease shall be placed on a non-accrual basis, and interest due but uncollected shall not be accrued as income but instead be shown as interest in suspense.
- (2) Notwithstanding with paragraph (1) above interest on a financial lease to the Government of Afghanistan and leased asset guaranteed by the Government of Afghanistan which becomes non-performing shall continue to accrue interest up to the limit of the guarantee.
- (3) Any interest on any non-performing financial lease previously accrued as income but uncollected shall be reversed and credited into interest in suspense account until paid in cash by the lessee.

Article 30: Repossession of asset in lieu of repayment of the financial lease

- (1) Where a financial leasing institution repossession an asset in lieu of repayment of a facility, the book value of the repossessed asset shall be the unpaid balance of the financial lease or the net realizable value of the asset, whichever is lower.

- (2) Where the net realizable value of the asset is less than the book value of the financial lease, the difference shall be charged off through the provisions for bad and doubtful account when the asset is added to the book of account of the financial leasing institution.

Article 31: Management information system and reporting requirement

- (1) When a lease is classified doubtful or loss, the financial leasing institution shall obtain a current and reliable written indication of the net realizable value of the asset and obtain regular updates thereafter.
- (2) Every financial leasing institution shall maintain a management information system adequate to identify and track-
 1. The features of individual financial lease, groups of leases, and the financial lease portfolio;
 2. The evolving condition of a facility or leased asset such as-
 - a) Regularity of payments;
 - b) The financial condition of the obligor;
 - c) The status and value of collateral; and
 - d) All other attributes of the leased asset;
 3. The characteristics of obligors and groups of related customer;
 4. Sectors in it which the financial leasing institution has credit exposures.
- (3) Every financial leasing company shall maintain, and make available to an authorized examiner of the Da Afghanistan Bank, adequate written records and reports in support of-
 1. Financial lease review and classification functions;
 2. Evaluation and calculation of potential loss exposure in the financial lease portfolio;
 3. The entries made to the provisions for bad and doubtful accounts; and
 4. Actions taken to ensure that the amount of the provisions for bad and doubtful accounts is adequate to cover the identified potential loss exposure in the financial lease portfolio.
- (4) The Board of Directors shall require regular written reports showing that-
 1. The lending activities of the Lessor are in compliance with the financial lease policies approved by the Board of Directors, and this regulation;
 2. The risks and potential loss exposure in the financial leasing company's financial lease portfolio have been identified;
 3. The problem or deteriorating facilities have been identified, classified, placed on non-accrual status, and the action taken by management to reduce the risk of loss on such facilities;
 4. The amount of accrued, but uncollected interest on the books of account of the financial leasing institution is appropriate;
 5. Adequate provisions for potential financial lease losses have been made to the proper account; and
 6. Losses have been identified and written off.
- (5) Every financial leasing company shall, within 15 days after the end of the month, submit to DAB reports in such form provided by DAB showing an analysis and classification of its leases, provisions, and interest in suspense account.

Article 32: Financial Lease Classification Criteria

Standard: Must meet all of the following conditions:

- (1) Facility is performing and expected to continue to perform in accordance with the financial lease agreement;
- (2) Past due period less than 30 days past due and despite any fluctuations, can at least service the interest applied/charged;
- (3) Sufficient documentation to support the outstanding facility, evidence the financial leasing institution's perfected interest in eligible collateral (if any), or permit the financial leasing institution to properly supervise the financial lease or any collateral held (if any);
- (4) Financial condition of the obligor is sound and expected to remain sound; and
- (5) If a lease asset in respect of which, no default in payment of interest or repayment of principal has occurred, or payment thereof has not been past due and which does not carry more than normal risk attached to the business and does not disclose any problem.

Watch: Meets one or more of the following criteria.

- (1) Despite the facilities may be currently performing and/or secured by unimpaired collateral, certain factors are known which could, in the future impinge on the performance of the facility or impair the value of the asset or eligible collateral (if any) including deteriorating general economic or sector conditions and adverse trends in the obligor's financial condition;
- (2) 31-60 days past due or is not in compliance with any other term or condition of the financial lease;
- (3) Insufficient documentation to support the outstanding facility, evidence that financial leasing institution's perfected interest in eligible collateral (if any) or permit the financial leasing institution to properly supervise the facility or any additional collateral held (if any); and
- (4) The financial leasing company asset based lending officer's inability to properly supervise them due to lack of expertise.

Substandard; has one or more of the following deficiencies.

- (1) Primary source of repayment of the facility is insufficient to service the facility and the financial leasing institution is relying on one or more secondary of repayment (such as sale of fixed assets or restructuring of the facility);
- (2) 61-90 days past due or is not in compliance with any other term or condition of the financial lease agreement;
- (3) Display well defined credit weakness that jeopardize that payment of the rentals;
- (4) Inadequate liquidity and cash flow less than repayment of principle and interest;
- (5) Is not protected by the current (sound) net-worth and payment capacity of the Lessee;
- (6) Terms regarding interest and/or principle have been re-negotiated/ re-scheduled after commencement of operations; and
- (7) If default occurs to "initial conditions amended asset" the asset should be classified at least in sub-standard class.

Doubtful: has one or more of the following deficiencies;

- (1) Collection of the facility in full is highly questionable or unlikely;
- (2) 91-180 days past due;
- (3) Operational losses, including the necessity to sell assets to meet operating expenses;
- (4) Illiquidity and cash flow less than required interest rate;
- (5) Complete absence of faith in financial statement;
- (6) Likelihood of loss on the facility; however, the situation could improve due to near-term important and reasonably specific pending factors such as a proposed merger, acquisition, liquidation, perfection of liens, additional collateral, or other arrangement; and

- (7) Exhibits all the weaknesses inherent in sub-standard assets with the added characteristics that the credit is not well secured and the weaknesses make collection or liquidation of the debt in full improbable- on the basis of currently existing facts.

Loss: has one or more of the following deficiencies.

- (1) Facility is regarded as uncollectable such that its continuation on the financial leasing institution's books of account is not warranted;
- (2) 181 days past due;
- (3) The obligor seeks new loans to finance operational losses;
- (4) Location in an industry that is disappearing;
- (5) Very high losses;
- (6) Total revenue less than production cost;
- (7) No repayment source except liquidation;
- (8) Presence of money laundering, fraud, embezzlement or other criminal activity;
- (9) Facility may have some recovery value; however, the financial leasing institution deems it to be neither, sensible nor desirable to postpone removing the facility from its books pursues long-term recovery efforts; and
- (10) Is considered uncollectible and of such little value that its continuation as a recoverable advance is not warranted.

Chapter Five: Miscellaneous Provisions

Article 33: Compliance with Regulations

- 1) Any legal entity, currently conducting finance leasing activities, must fully comply with the provisions and requirements of financial leasing Law and Regulations on Financial Leasing within 6 months from the date the Regulations come into force. DAB may grant any lessor an extension to this period for a maximum of one year but reserves its full rights of supervision and monitoring during this period of time.
- 2) If any entity does not comply with the requirements of Clause 1 of this Article, it shall be prohibited by DAB from conducting finance leasing activities. However, all leasing contracts that the entity entered into before the date of this prohibition remain valid within their duration.
- 3) Any legal entity which is established as a merger with an existing finance leasing company must comply with Clauses 1) and 2) above and with Article 13 Clause 7) of these Regulations.

Article 34: Compliance with Reporting Requirements

DAB shall grant new finance leasing license holders a grace period of 4 (four) months before being required to submit reports.

Article 35: Risk management

- 1) A Lessor shall design, adopt and put in place system and processes to identify, manage and mitigate risks.
- 2) A Lessor shall identify, measure, control and monitor all risks involved in a financial lease service. The following categories of risk shall follow the best practices of risk management.
 1. Credit risk;
 2. Residual risk;
 3. Liquidity risks or Asset and Liability management;

4. Market risks;
5. Operational risks;
6. Legal risk;
7. Reputational risk;
8. Strategic risks; and
9. Any other risk that financial leasing company may determine.

Article 36: Requirements when entering to related person Transaction

- (1) A financial leasing company or Lessor is prohibited from entering to transaction with a related person except when the majority of the Board of Director approves the transaction in advance. A board of Director is prohibited from concluding a related person transaction unless it has received such necessary information as in reasonably required to come to a sound decision on the proposed related party transaction.
- (2) Board of Director is obliged, in meeting minutes, to
 1. Specify the key term and conditions of the related party transaction;
 2. Confirm that the related party transaction is entered in to in arm's length basis; and
 3. Affirm that it is in the reasonable best interest of the lessor to enter into the related party transaction.
- (3) A Lessor is obliged to maintain comprehensive record of all related party transaction, including the information on which the approval of related party transaction is based, as well as the name of Board of Director's member who approved the transaction.

Article 37: Reporting related person's transaction to DAB

- (1) The Lessor or financial leasing company must report on a monthly basis information on related person transactions and exposure to DAB. The report must contain the following:
 1. Related person lease transaction, to which the Lessor is committed and extended during the lasted quarter.
 2. Total number of related person lease contracts and the outstanding lease receivables or outstanding amount. Along with related person name, lease term.
 3. Related person individual lease or asset classification, provisioning and write-off.

Article 38: Limitation on maximum size to related party exposure

- (1) A Lessor is obliged to observe the following maximum limits in relation to exposures to an individual related person, group of connected related persons or all related persons:
 1. A Lessor total exposure to an individual related person or group of connected individual related persons may not under any circumstances exceed 25 percent of financial leasing Regulatory capital; and
 2. A Lessor total exposure to all related persons may not under any circumstances exceed 40 percent of the institution's Regulatory capital.

Article 39: Large exposure and concentration of asset

This Article aims at the following:

- (1) To prevent the possibility that the default by one obligor or Lessee or group of related obligors will have a significant effect on the financial leasing institution's profitability or capital. More

specifically the, individual obligors of a financial leasing institution are considered a group of related obligors:

1. When the expected source of repayment for each financial lease is the same for each obligor, and neither obligor has another source of income from which the financial lease may be fully paid;
2. When financial lease made to obligor who are related directly or indirectly through common control, including where one obligor is directly or indirectly controlled by another obligor;
3. When substantial financial interdependence exists between or among the lessee or obligors. Substantial financial interdependence is deemed to exist when 50 percent or more of one obligor's gross receipts or gross expenditure (on annual basis) are derived from transactions with the other obligor; and
4. When DAB determines, based on evaluation of the facts and circumstances of particular transactions, that the financial soundness of any obligor may affect the financial soundness of other.

Article 40: General Limitation on exposure to a single obligor or group of related obligors

- (1) No financial leasing company or Lessor to grant financial lease to single obligor or group of related obligors exceeds 25 percent of regulatory capital or increases the financial lease by which the exposure already exceeds 25 percent of regulatory capital;
- (2) In calculating compliance with this limitation, exposure to each of the obligors in a group of related obligors are aggregated and considered as an exposure to single obligor;
- (3) No financial leasing institution is permitted to grant financial lease on aggregate large exposures that exceeds 200 percent of the regulatory capital.
- (4) Financial lease to single obligor or group of related obligor that are fully secured by readily marketable collateral are excluded from the calculation of general limitation paragraph (1) above under this article;
- (5) If the financial leasing institution falls out of compliance with limitation on aggregate large exposure or single exposure for any reason, it is required to take action to eliminate the non-conformity within 90 days;
- (6) A financial leasing institution can take the following action within the time frame to eliminate the non-conformity:
 1. Demand the additional down payments;
 2. Increase the instalment payments;
 3. Ask for additional collateral; and
 4. Inject the paid in capital.

Article 41: Enforcement

This regulation shall be effective upon adoption by supreme council of Da Afghanistan bank.