Da Afghanistan Bank

Corporate Governance Regulation

Financial Supervision Department

2016

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Part One- General Provisions

1.1 Authority

This regulation on corporate governance of banking organizations is pursuant to the authority granted to Da Afghanistan Bank by Article 177 and Chapter 5 of Banking Law of Afghanistan.

1.2 General Goals and Objectives

a) This regulation aims to clarify the Articles stated in the Banking Law regarding corporate governance of banks.

b) The objectives of this regulation are to:

1. Specify responsibilities that are common both to the Board of Supervisors and the Board of Management.
2. Provide detail regarding recommended makeup and qualifications for members of the Board of Supervisors, the Board of Management and other committees.
3. Detail the responsibilities of the Board of Supervisors and Board of Management and their appropriate places in the governance of a bank.

c) Good corporate governance practices help support and strengthen corporate decisions aimed at achieving the corporate objective, especially those decisions that have an important effect on the interest of shareholders.

1.3 Definitions

a) **Corporate Governance:** means a set of relationships amongst the Board of Management, Board of Supervisors, shareholders, Audit Committee and other stakeholders. These relationships, which involve various rules and incentives, provide the structure through which the objectives of the banks are set, and the means of attaining these objectives as well as monitoring performance are determined. Thus, the key aspects of good corporate governance include transparency of corporate structures and operations, accountability of Board of Management and Board of Supervisors to General Assembly of Shareholders, safeguarding interest of depositors, and meeting obligations toward shareholders after considering the interest of other recognized stakeholders.
b) **Annual Report:** means a document consisting of operational and financial information and legal requirements laid down in the applicable laws such as Corporations and Limited Liability Companies Law of Afghanistan of an entity normally for the period of one year.
c) **General Assembly:** as defined in Article 48 of Banking Law of Afghanistan.

d) **Charter:** means articles of incorporations developed as per Article 10 of Banking law of Afghanistan and defined under Corporations and Limited Liability Companies Law of Afghanistan.
e) **Internal Auditing:** means an independent, objective, assuring and consulting activity designed to add value and improve organization's operations. It helps an organization accomplish its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.
f) **Internal Control System:** means set of rules and controls governing the bank's organizational and operational structure, including reporting processes, and functions for risk management, compliance and internal audit.
g) **Stakeholder:** means a person natural or legal who has direct or indirect interest in the bank.
h) **Conflict of Interest (COI):** means any situation in which bank's management has an actual or potential interest that may influence the objective rendering of a financial service to a specific customer or group of customers; or prevent them from rendering an unbiased and fair financial service to that customer, or from acting in the interests of that customer
i) **Risk:** refers to the potential loss which happens in the future.
j) **Close Relatives:** as defined by Paragraph 36, Article 2 of Banking Law of Afghanistan.
k) **Bank Related Person:** as defined by Paragraph 37, Article 2 of Banking Law of Afghanistan.
l) **Code of conduct:** means a document setting out expected standards of behavior of members of an organization and the procedures in place if these standards are not met.
m) **Fit and Proper Person:** as predefined by Paragraph 16, Article 2 of Banking Law of Afghanistan and Fit and Proper Regulation.
n) **Shareholder:** means a person who owns at least one share in the bank.
o) **Qualifying Holding:** as defined by Paragraph 20, Article 2 of Banking Law of Afghanistan.
p) **Independent Member of Board of Supervisors**: as defined by Paragraph 35, Article 2 of Banking Law of Afghanistan.

Part Two- General Administrative and Governance Structure of Banks

2.1 Governance Structure

a) Each bank shall have the following governance structure:

1. General Assembly;
2. Board of Supervisors;
3. Audit Committee; and
4. Board of Management.

b) Before a bank appoints a person to serve on its Board of Supervisors or Board of Management, the bank must propose the issue to Da Afghanistan Bank as well as submit documents pursuant to Article 12 of Banking Law, during an application for a banking license or during subsequent appointments, and shall obtain Da Afghanistan Bank's authorization.

2.2 General Assembly

a) The General Assembly of a bank shall have the following duties and powers:

1. To adopt amendments to the charter of the bank;
2. To adopt the by-laws of the bank and amendments thereto, provided that the General Assembly may delegate authority to the Board of Supervisors to perform these functions, and may require that any adoption, amendment or repeal of a by-law be subject to approval of the General Assembly;
3. To appoint and to dismiss the members of the Board of Supervisors and determine remuneration of its members;
4. To adopt increases in the authorized capital of the bank and to determine the terms and conditions on which shares of the bank may be issued;
5. To approve the annual reports and financial statements of the bank, upon the recommendation of the Board of Supervisors of the bank;
6. To decide on the sale, merger, amalgamation, dissolution and closure of the bank;
7. To appoint bank's external audit firm which is authorized by DAB, taking into account the recommendation of the Board of Supervisors;
8. To establish and dissolve bank's subsidiaries, representative offices and branch offices.

b) Shareholders shall have voting rights corresponding to their holding of shares of capital stock of the bank. Each shareholder may exercise his or her voting rights at the General Assembly personally or through official agent which is introduced in writing.

c) At least one regular session of the General Assembly shall be held each year after the completion of the external audit of the balance sheet and financial statements of the bank for the preceding financial year, no later than 3 months after the end of that financial year.

d) Extraordinary sessions of the General Assembly may be convened at the request of the Board of Supervisors, the Board of Management, a shareholder or shareholders individually or together holding 20 percent or more of total voting rights, or Da Afghanistan Bank.

e) Written notice of the date, place and time of each session of the General Assembly, together with the agenda for that session, shall be sent to the shareholders at least one month in advance. In urgent cases such notice may be given seven days in advance.

However, no decisions shall be made on issues that are not on the agenda. In case of urgent matters, notice can be sent by electronic mode and voting can also take place through electronic mode. However in the subsequent session of the General Assembly the decisions taken by electronic mode should be confirmed.

f) Decisions of the General Assembly should be written and signed by shareholders and secretary only. However, in case of urgent matters voting can take place through postal ballot or electronic mode.

g) Shareholders should ensure that effective and appropriate secretarial functions exist.

2.3 Board of Supervisors:

2.3.1 Board of Supervisor's Structure

a. The Board of Supervisors should define appropriate governance structures and practices for its own work, and put in place the means for such practices to be followed and periodically reviewed for ongoing effectiveness.

b. The Board of Supervisors should structure itself in terms of leadership, size and the use of committees so as to effectively carry out its oversight role and other responsibilities. This includes ensuring that the Board has the time and means to cover all necessary subjects in sufficient depth and have a robust discussion of issues.

c. The chair of the Board of Supervisors plays a crucial role in the proper functioning of the Board of Supervisors. The chair provides leadership to the board and is responsible for its effective overall functioning, including maintaining a relationship of trust with board members. The chair should possess the requisite experience, competencies and personal qualities in order to fulfill these responsibilities. The chair should ensure that board decisions are taken on a sound and well informed basis. The chair should encourage and promote critical discussion and ensure that dissenting views can be freely expressed and discussed within the decision-making process. The chair should dedicate sufficient time to the exercise of his or her responsibilities.

d. To promote checks and balances, the chair of the Board of Supervisors should be an independent or non-executive board member.

2.3.2 Board of Supervisors' Appointment and Composition

a. Board of Supervisors is elected by the General Assembly of the institution, and majority of its members shall not be shareholders, management or employees of the Bank.

Shareholders, whether legal entities or natural persons, may appoint representatives to the Board but these representatives shall not constitute a majority of Board members.

b. The Board of Supervisors consists of minimum of three and maximum of nine members, elected by the General Assembly for the period of four years and they can be reappointed Board of Supervisors elects one of its members as the chairman.

c. At least two-third members along with chairman of Board of Supervisors should be independent members. Bank shareholders, their representatives and close relatives cannot constitute majority of the Board of Supervisors.

d. A member of the Board of Supervisors can have as much shares individually in his own name in a bank or in subsidiary of the bank that Da Afghanistan bank has determined. Members of Board of Supervisors who have such shares in the bank can get their remuneration or salary in conformity with policies and procedure of the Board of Supervisors and Article 49.3 of Banking Law of Afghanistan.

e. If a seat of Board of Supervisors becomes vacant, the remaining members should fill the vacant position by designating a temporary member until the next General Assembly of shareholders.

2.3.3 <u>Qualification of Board of Supervisors</u>

a. A person shall be eligible to serve as a member of the Board of Supervisors of a bank if:
    i. He/she is a Fit and Proper Person and meets conditions stipulated under Article 58 of the Banking Law of Afghanistan;
    ii. He/she is not a public (government) employee other than in a teaching capacity.
b. In addition to above requirements, every member of Board of Supervisors of a bank must have a suitable professional background via previous work in business, accounting, law, academia or supervision of financial institutions. At least one member of the Board of Supervisors shall have experience in banking, accounting or financial management in order to facilitate that person's membership on the Audit Committee;
c. Other requirements and details of the qualification of Board of Supervisors will be provided through circulars of Da Afghanistan Bank from time to time.

2.3.4 <u>Board of Supervisors' Role and Responsibilities</u>

a. The Board of Supervisors of a bank shall have the following duties and powers:

    1. Convene each session of the General Assembly and adopt the agenda for each session;
    2. Approve the bank's organizational structure;
    3. Make decisions regarding the establishment and dissolving of subsidiaries, branch offices and representative offices of the bank;

4. Appoint, dismiss and determine the remuneration of the members of Board of Management of the bank;
5. Oversee the performance of the bank's Board of Management;
6. Approve the bank's business strategy and annual budget;
7. Approve policies for the conduct of operation performance, including the bank's risk management policy, dealing with conflict of interest and issuance of guidance to Board of Management for implementation of those policies;
8. Determine the conditions under which credits may be granted by bank employees, and which credits require approval of the Board of Supervisors;
9. Ensure the establishment, functionality, appropriateness, adherence of DAB law and regulations and adequacy of internal controls and risk management for the bank;
10. Ensure the integrity of the bank's financial reporting, including financial reporting to Da Afghanistan Bank;
11. Ensure that appropriate Internal Audit function is established;
12. Make recommendations to the General Assembly on matters requiring shareholder approval;
13. Make recommendations to the General Assembly concerning appointment of the external audit firm for the bank;
14. Ensure execution of bank's annual external audit, which includes the auditor's opinion of the truth and accuracy of the bank's financial statements;
15. Make decisions concerning capital distributions, subject to requirements of Law and regulations of Da Afghanistan Bank, and what amount of the net profit of the bank shall be transferred to bank reserve;
16. Making decisions in accordance with the requirements of this law and related regulations regarding distribution of capital and net profit of bank which is determined as reserve fund.
17. Immediately inform Da Afghanistan Bank in writing, or require the Board of Management to do so, of any deterioration in the financial situation of the bank, or danger of such deterioration, and any other facts that may materially affect the financial situation of the bank, and in particular if the bank becomes undercapitalized;
18. Ensure implementations of directives and instructions of Da Afghanistan Bank;
19. Decide on other matters placed in the competence of the Board of Supervisors by the bank's charter or by-laws.
20. The chair person of Board of Supervisors is responsible to introduce members of Board of Management to DAB for approval in no more than three months after the positions becomes vacant.

b. The Board of Supervisors is ultimately responsible, and is accountable to all stakeholders (including the General Assembly, depositors, and DAB) for the conduct of the bank's affairs and condition. Although the board members cannot guarantee success, they are expected to supervise bank operations to ensure that they reflect sound planning, are effectively governed by comprehensive policies and internal control procedures, and are administered by competent management. While the Board of Supervisors may depend upon the Management Board's technical, industrial, and managerial expertise to run the bank's day-to-day operations, the board members remain responsible for ensuring that those operations are properly controlled, comply with the policies adopted by the Board of Supervisors and applicable laws and notifications, and are consistent with sound banking practices.

In meeting its overall commitment to the bank's General Assembly, depositors, and community, the Board of Supervisors must:

1. Ensure competent management;
2. Ensure that appropriate plans and policies are in place;
3. Monitor operations, ensure adequate internal controls and compliance with laws and decisions;
4. Oversee financial performance of the bank;
5. Prevent Conflicts of Interest;

2.3.4.1 Ensuring Competent Management

The Board of Supervisors hires the bank's executive officials, and must actively oversee the selection process. This includes developing strategies to attract and retain competent management and staff, such as appropriate compensation packages and training programs, developing a management succession policy to address possible vacancies, and determining the circumstances under which it is necessary to dismiss members of management for poor performance, dishonesty, conflicts of interest, or other reasons. The board should institute a formal performance appraisal process.

2.3.4.2 Ensuring Appropriate Policies and Procedures

a. The Board of Supervisors must adopt and approve written policies and procedures that direct management on all significant banking activities and the management of risk, including what banking practices and levels and types of risk are acceptable. All major areas of the institution's business should be covered by appropriate policies and procedures, which must be in place before any new activity begins. Each bank should have additional written guidelines in at least the following areas:

   1. Asset /Liability Management;
   2. Risk Management Policy;
   3. Code of Ethics
   4. Conflicts of Interest Policy;
   5. Credit Policy and its procedures;
   6. Operation Policy;
   7. Procurement Policy;
   8. Human Resources Policy;
   9. Corporate Governance;
   10. Internal Audit;

11. Information Technology;
12. Accounting Policy.

b. The policies should establish clear standards and responsiveness to changing business conditions. Associated procedures should detail how the policies will be implemented and include steps for getting appropriate approval of Board of Supervisors for exceptions.

2.3.4.3 <u>Monitoring Operations, Ensuring Adequate Internal Controls and Compliance with Laws and Regulations</u>

a. The Board of Supervisors must ensure that the Board of Management implements the policies and procedures, as well as any corrective actions required by the Da Afghanistan Bank. To achieve this goal, the Board of Supervisors should ensure that management incorporates a sound system of internal controls into the bank's day-today operating procedures.
b. The Board of Supervisors should require periodic briefings and written reports from the Board of Management regarding the financial condition and operation of the bank, and recommendations for maintenance or improvement. The Board of Supervisors should closely examine such reports and recommendations to verify their accuracy and feasibility.
c. The Board of Supervisors or its committees must review and, if necessary, revise policies and procedures at least annually to ensure that they remain adequate and consistent with the bank's goals.
d. The Board of Supervisors should hold frequent, regularly scheduled meetings (not less frequently than monthly) in order to properly monitor the bank's operations. Special meetings should also be held if circumstances warrant the board's immediate attention between regularly scheduled meetings. At all Board of Supervisors meetings, complete minutes should be taken to record significant decisions and discussions.

2.3.4.4 <u>Overseeing Financial Performance</u>

a. The Board of Supervisors should regularly review and evaluate the bank's financial statements and certain key financial ratios, including:

1. Return on Assets;
2. Return on Equity;
3. Net Interest Margin;
4. Non-Interest Expense to Average Assets;
5. Capital to Average Assets;
6. Non-Performing Loans to Total Loans;
7. Write-offs to Average Total Loans.
8. Credit Deposit Ratio
9. Capital Adequacy Ratio
10. Leverage Ratio

b. The Board of Supervisors responsibilities to supervise the financial operations of bank are not diminished by the examiners of DAB. The Board of Supervisors is independently responsible for the bank's financial condition and may not rely on DAB examiners to identify or correct problems. The Board of Supervisors should expect its auditors and the Board of Management to assist it in identifying any problems the bank may be experiencing.

2.3.4.5 <u>Prevention of Conflicts of Interest</u>

a. To achieve the goal of ensuring that the personal interests of members of the Board of Supervisors and Board of Management do not conflict with the best interests of the bank, the Board of Supervisors should:

   i. Establish and adhere to a written policy on salaries, fees, loans, and expenses granted to insiders of the institution, especially members of the Board of Supervisors and Board of Management;
   ii. Consult with the bank's legal advisors before entering into or approving transactions involving the bank with members of the Board of Supervisors or Board of Management, except transactions that are allowed as per bank's policies approved by the Board of Supervisors;
   iii. Disclose all real or potential conflicts of interest to the entire Board of Supervisors, and possibly to the General Assembly, before the Board of Supervisors makes a decision on the matter;
   iv. Ensure that the Board of Supervisors fully documents the action it takes in approving all transactions between the bank with any member of the Board of Supervisors or Board of Management, except transactions which are required to be allowed as per bank's approved policies;
   v. Ensure that a member of Board of Supervisors with a potential conflict of interest in any matter refrains from discussion, voting, or any other involvement in the matter and that this action is documented in the minutes;
   vi. Ensure that the bank's interests are paramount in any transaction involving an insider or a related legal person of the bank.

2.4 <u>Meetings of Board of Supervisors</u>

a. Board of Supervisors shall meet regularly, at least once a month. Special meetings may be held as necessary. A special meeting shall be called if:

   1. The bank becomes undercapitalized;
   2. It is requested by the Audit Committee or external auditor of the bank; or
   3. It is instructed by Da Afghanistan Bank.

b. Da Afghanistan Bank may require a bank to hold a special meeting of its Board of Supervisors if it deems it necessary, and to consider the matters set forth in a written notice of Da Afghanistan Bank;
c. Board of Supervisors may hold its meetings online (web conference); however, at least one meeting should be held face-to-face in a quarter;
d. The quorum of Board of Supervisors completes by presence of its two-third members. Board of Supervisors may take valid decisions by a simple majority of the votes of its members who are present. Members may not abstain from voting except as permitted or required by Banking Law of Afghanistan. In case of a tie vote, the Chairman shall cast the deciding vote in cases predicted in the Banking Law of Afghanistan. In case of urgent matters, decisions can be taken by voting via electronic mode.
e. Any member of Board of Supervisors who fails to attend three consecutive meetings or five meetings in a calendar year without an acceptable excuse, will lose his or her membership.
f. The Board of Supervisors should maintain appropriate records (e.g. meeting's minutes or summaries of matters reviewed, recommendations made, decisions taken and dissenting opinions) of its deliberations and decisions. These should be made available to the Board of Supervisor whenever required.
g. The Board of Supervisors shall designate an employee of the bank who is not a member of the Board of Supervisors as secretary. Minutes of each meeting of the Board of Supervisors shall be signed by members of Board of Supervisors, its chairman and secretary.

2.5 <u>Relationships between Shareholders and Board of Supervisors</u>

a. Member of Board of Supervisors shall be appointed by the General Assembly or in any extraordinary meeting of the General Assembly according to the Article 49 of Banking Law of Afghanistan.
b. The General Assembly shall be chaired by the chairperson of the Board of Supervisors. The chair is responsible for the proper conduct of business at such meetings so as to facilitate discussion during those meetings.
c. The Board of Supervisors should ensure that, within the framework of the statutory rules, Shareholders are properly provided with information. There may be no contact between individual members of the Board of Supervisors and Shareholders regarding bank's conduct of affairs, except with the approval of the chair of the Board of Supervisors.
d. Board of Supervisors directly reports to Shareholders and advises on related matters.

2.6 <u>Committees under Board of Supervisors</u>

a. Board of Supervisors may establish certain specialized Board committees. The committees should be created and mandated by the full Board. The number and nature of committees shall depend on many factors, including the size of the bank and its Board, the nature of the business areas of the bank, and its risk profile.

b. Each committee should have a charter or other instrument that sets out its mandate, scope and working procedures. This includes how the committee will report to the full Board, what is expected of committee members and any tenure limits for serving on the committee. The Board should consider the occasional rotation of members and of the chair of such committees.

2.6.1 Audit Committee

a. Audit Committee could be separate from Board of Supervisors or could be a sub-committee of the Board of Supervisors with necessary expertise and independence.
b. Bank's Board of Supervisors may create Audit Committee from its majority independent members or such other eligible persons who are composed of odd numbers that have not less than 3 and more than 9 members after seeking necessary DAB approval before its creation. At least one member of this committee must have knowledge and skill of banking, accounting or financial management.
c. In case the Audit Committee is separate from Board of Supervisors, before a bank appoints a person to serve on its Audit Committee, the bank must propose the issue to Da Afghanistan Bank as well as submit documents pursuant to Article 12 of Banking Law of Afghanistan, during an application for a banking license and/or during subsequent reappointment, and shall obtain Da Afghanistan Bank's authorization.
d. The Board of Supervisors of each bank must nominate chairman and members of the Audit Committee to DAB for approval.
e. None of the members of the Audit Committee may be members of the Management Board or employees of the bank or an enterprise in the same group as the bank.
f. The Audit Committee of a bank shall:

    1. Review the annual financial statements of the bank before the statements are approved by the Board of Supervisors;
    2. Review such other financial reports of the bank as the Audit Committee deems necessary;
    3. Review and evaluate the bank's policies regarding internal controls, and make recommendations to the Board of Supervisors regarding their approval;
    4. Oversee the implementation and maintenance of the bank's internal controls by the bank's Board of Management;
    5. Periodically review the effectiveness of the bank's internal controls with the head of the bank's internal audit function and Board of Management;
    6. Periodically evaluate the effectiveness of the bank's internal control systems report, its findings to the Board of Supervisors, and recommend any changes it deems necessary;
    7. Recommend to the Board of Supervisors an audit firm to conduct the bank's external audit;

8. Meet with the bank's external auditors to discuss the annual audit of the bank's financial statements; and
9. Perform other tasks, related or incidental to the above, as determined by the Board of Supervisors.

g. Audit Committee must convene at least once every three months. Audit committee quorum completes by presence of two-third of all members and, valid decisions are taken by majority of present members. Members cannot abstain from voting except in case of Conflict of Interest.
h. Audit Committee can request Board of Supervisors meeting only to consider any matter of disquiet to the committee.
i. Audit Committee can hire its legal specialists and auditors related to its field.
j. In addition, Audit Committee should:
    1. Supervise the work of internal auditors and oversee their relationship with external auditors;
    2. Ensure independence, objectivity and qualifications of internal and external auditors;
    3. Review periodically the remuneration and performance of the external auditors and ensure a periodic change of senior audit partner;
    4. Ensure appropriate functionality of internal audit function;
    5. Receive and review internal audit reports and draw attention of the Board of Management and Board of Supervisors to any material matters;
    6. Engage external advice as required.
    7. Review the external auditor's letter to bank's management (containing recommendations on internal control issues) and consider the adequacy of the Board of Management's response.
    8. Ensure compliance with regulatory requirements and internal procedures through reviewing reports from the Board of Management and internal and external auditors. Due attention must be paid to breaches of regulations, related party transactions and litigations.

2.6.2 <u>Nomination Committee</u>

a. Bank incorporated in Afghanistan shall have a Nomination Committee. Every member of the Nomination Committee shall be appointed to hold office until the next annual General Assembly, following that member's appointment, and shall be eligible for reappointment.

b. If a member of the Nomination Committee resigns, ceases to be a director or for any other reason ceases to be a member of the Nomination Committee and this results in a breach of any requirement prescribed under paragraph (a) above, the Board of Supervisors shall, within 3 months of that event, appoint such number of new members as may be necessary to certify the composition of the Nomination Committee in accordance with that requirement.

2.6.2.1 Responsibilities of Nomination Committee

a. The Nomination Committee of a bank incorporated in Afghanistan shall identify the candidates and review all nominations for the appointment of:

   1. Member of Board of Supervisors;
   2. Member of each committee of Board of Supervisors;
   3. The Chief Executive Officer, Deputy Chief Executive Officer and members of the Board of Management;
   4. Heads of Risk Management and Compliance Departments, and Chief Internal Audit.

b. Nomination Committee shall determine the criteria to be applied in identifying a candidate or reviewing a nomination;

c. The criteria to be applied in identifying a candidate or reviewing a nomination shall include the following:

   1. The candidate or nominee is a Fit and Proper Person for the office;
   2. The candidate or nominee is qualified to hold the office, taking into account the candidate's or nominee's track record, age, experience, capability and such other relevant factors as may be determined by the Nomination Committee.

d. The Nomination Committee shall maintain records of all its meetings.

2.6.2.2 Composition of Nomination Committee

The Nomination Committee consists of three members including chairman of the Board of Supervisors, an independent member of Board of Supervisors, and a dependent member of Board of Supervisors if one exists.

2.6.3 Risk Management Function

2.6.3.1 Risk Management Committee

a. The Board of Supervisors of each bank shall establish a risk management committee, the majority of which shall consist of independent members of the Board of Supervisors. At least one member of the risk management committee shall have expertise in risk management and banking.

b. The Risk Management Committee commonly focuses on:

1. Credit Risk
2. Operational Risk
3. Market Risk
4. Interest Rate Risk and
5. Liquidity Risk

c. The Risk Management Committee assists the Board of Supervisors in developing, approving, and monitoring the implementation of the bank's risk management policies. In particular, the Committee shall:

1. Review and evaluate the bank's proposed policies, strategies, limits and procedures for risk management, and make recommendations to the Board of Supervisors regarding their approval;
2. Ensure that bank's risk management policies, strategies and limits are appropriate for the bank's business strategy as approved by the Board of Supervisors;
3. Assist the Board of Supervisors to ensure that the bank's risk management program is conducted in accordance with the policies, strategies and limits approved by the Board of Supervisors and with relevant laws and regulations of Da Afghanistan Bank;
4. Monitor the implementation of those policies, strategies and limits through receipt of reports from senior management and/or the bank's risk management function;
5. Submit reports to Board of Supervisors on the effectiveness of the bank's risk management process;
6. Periodically review the bank's risk management policies, strategies and limits, and recommend to the Board of Supervisors any changes that the Committee deems necessary; and
7. Perform other tasks assigned to it by the Board of Supervisors relative to the bank's risk management program.
8. The Board of Supervisors of a bank may assign some or all of the functions referred to in this Article to the Audit Committee.

2.6.3.2 <u>Risk Management Department</u>

a) Banks should have an effective independent risk management function, under the direction of a Chief Risk Officer (CRO), with sufficient stature, resources and access to the Board of Supervisors.
b) The risk management function should be sufficiently independent of the business units and should not be involved in revenue generation.

c) The risk management function should have a sufficient number of employees who possess the requisite experience and qualifications, including market and product knowledge as well as command of risk disciplines. Staff should have access to regular training.
d) The Chief Risk Officer (CRO) should report and have direct access to the Board of Supervisors or its risk committee without impediment.
e) The CRO should have the ability to interpret and articulate risk in a clear and understandable manner and to effectively engage the board and management in constructive dialogue on key risk issues. Interaction between the CRO and the board and/or risk committee should occur regularly, and the CRO should have the ability to meet with the board or risk committee without executive directors being present.
f) Risks should be identified, monitored and controlled on an ongoing bank-wide and individual entity basis. The sophistication of the bank's risk management and internal control infrastructure should keep pace with changes to the bank's risk profile, to the external risk landscape and in industry practice.
g) Risk identification should encompass all material risks to the bank, on- and off-balance sheet and on a group-wide, portfolio-wise and business-line level. In order to perform effective risk assessments, the Board and senior management, including the CRO, should, regularly and on an ad hoc basis, evaluate the risks faced by the bank and its overall risk profile. The risk assessment process should include ongoing analysis of existing risks as well as the identification of new or emerging risks. Risks should be captured from all organizational units. Concentrations associated with material risks should likewise be factored into the risk assessment.
h) Risk identification and measurement should include both quantitative and qualitative elements. Risk measurements should also include qualitative, bank-wide views of risk relative to the bank's external operating environment. Banks should also consider and evaluate harder-to-quantify risks, such as reputation risk.
i) Information should be communicated to the Board of Supervisors and Board of Management in a timely, accurate and understandable manner so that they are equipped to take informed decisions. While ensuring that Board of Supervisors and Board of Management are sufficiently informed, management and those responsible for the risk management function should avoid voluminous information that can make it difficult to identify key issues. Rather, information should be prioritized and presented in a concise, fully contextualized manner. The board should assess the relevance and the process for maintaining the accuracy of the information it receives and determine if additional or less information is needed.
j) Risk reporting systems should be dynamic, comprehensive and accurate, and should draw on a range of underlying assumptions.
k) Banks should avoid organizational "silos" that can impede effective sharing of information across an organization and can result in decisions being taken in isolation

from the rest of the bank. Overcoming these information-sharing obstacles may require the Board of Supervisors, Board of Management and control functions to re-evaluate established practices in order to encourage greater communication.

2.7 Compensation and Remuneration Committee

(a) The bank should have Compensation and Remuneration Committee as an integral part of its governance structure and organization to oversee the compensation system's design and operation on behalf of the Board of Supervisors. The Committee should:

1. Be constituted in way that it exercises competent and independent judgment on compensation policies and practices and incentives.
2. Demonstrate that its decisions are consistent with an assessment of the bank's financial conditions and future prospects.
3. Work closely with the bank's Risk Committee in the evaluation of the incentives created by the compensation system.
4. Ensure that the bank's compensation policy complies with the guidance of the Basel committee.
5. Ensure that compensation policy is reviewed, if appropriate externally commissioned, and is conducted independently of management.

(b) For employees in the risk and compliance function:

1. Remuneration should be determined independently of other business areas and be adequate to attract qualified and experienced staff.
2. Performance measures should be based principally on the achievement of the objectives of their functions.

(c) In the event of exceptional DAB intervention to stabilize or rescue the bank:

1. DAB may restructure compensation in a manner aligned with sound risk management and long-term growth.

(d) Guaranteed bonuses that are not related to performance cannot be part of prospective compensation plan.

(e) An annual report on compensation should be disclosed to the public on a timely basis and should include the following information:

1. The decision-making process used to determine the bank's compensation policy;
2. The most important design characteristics of the compensation system, including criteria used for performance measurement and risk adjustment, the linkage between pay and performance, deferral policy, and the parameters used for allocating cash versus other forms of compensation;

3. Aggregate quantitative information on compensation, broken down by senior executive officers and employees whose actions have material impact on the risk exposure of the bank.

f) The Board of Supervisor must actively oversee the compensation system's design and operation. The compensation system should not be primarily controlled by the Board of Management.

2.8 Exception to establishing committees:

a. In case Board of Supervisors of a bank is composed of five members or more and performs all tasks of risk management and audit committees, creation of separate Audit Committee and Risk Management Committee is not compulsory.
b. Banks must seek DAB's approval for creation of such sub-committee when Board of Supervisors performs all tasks of Risk Management and Audit Committee.

c. The requirements to establish an Audit Committee does not apply to banks that are subsidiaries of bank holding companies, provided that:

1. The bank-holding company is established under the laws of Afghanistan;
2. The bank-holding company beneficially owns all of the voting shares of the bank;
3. The bank-holding company has an Audit Committee that performs, on behalf of the bank, all of the functions that would otherwise be required to be performed by the Audit Committee of the bank under Article 52 of Banking Law; and
4. The bank holding company has a written policy guaranteeing that the Board of Supervisors of the bank has full and timely access to all submissions, deliberations, and reports of the Audit Committee that pertains to the bank.

2.9 Establishment of Other committees

a. The Board of Supervisors may establish other committees as it deems appropriate. Minutes of each meeting of each committee of the Board of Supervisors shall be kept and shall be signed by the person chairing the meeting.

2.10 Board of Management's Roles, Responsibilities, and Qualifications

2.10.1 General Principles

a) Under the direction and oversight of the Board of Supervisors, the Board of Management shall carry out and manage the bank's activities in a manner consistent with the business strategy, risk appetite, and other policies approved by the Board of Supervisors.

b) Board of Management shall consist of a core group of individuals responsible and accountable to the Board of Supervisors for the sound and prudent day-to-day management of the bank.

c) The organization, procedures and decision-making of Board of Management should be clear and transparent and designed to promote effective management of the bank. This includes clarity on the role, authority and responsibility of the various positions within Board of Management, including that of the CEO.

2.10.2 <u>Appointment and Membership</u>

a. The Board of Management of a bank consists of at least five members, and shall include:

1. Chief Executive Officer,
2. Deputy Chief Executive Officer;
3. Chief Operating Officer, Chief Finance Officer and Chief Credit Officer;
4. Such other officials as may be specified in the bank's charter or by-laws or deemed appropriate by the Board of Supervisors.

b. Before a bank appoints a person to serve on its Board of Management, the bank must propose the issue to Da Afghanistan Bank as well as submit documents pursuant to Article 12 of Banking Law, during an application for a banking license or during subsequent appointments, and shall obtain Da Afghanistan Bank's approval.

c. Members of the Board of Management of a bank are eligible to serve for four consecutive years and shall be eligible for reappointment.

d. Members of Board of Management shall be full-time administrators or employees of the bank. Each member of the Board of Management does not necessarily need to have expert knowledge or expertise in every area of bank management, but should be generally familiar with each relevant area, in addition to having detailed knowledge of their own area of responsibility, so that the members of the Board of Management can work together effectively and professionally.
e. Remunerations, stipends, appointment and dismissals of CEO and members of the Board of Management are decided by Board of Supervisors.
f. No member of the Board of Management shall have any Qualifying Holding in the bank of which he/she is a member.
g. Shareholders of a bank, their representatives, and close relatives cannot serve on the Board of Management of the respective bank or banking group.

2.10.3 <u>Board of Management's Qualifications and Eligibility</u>

a) A person shall be eligible to serve as a member of the Board of Management of the bank if he or she:
   i. Is a Fit and Proper Person;
   ii. Meets conditions stipulated under Article 58 of the Banking Law of Afghanistan

2.10.4 Board of Management's Roles and Responsibilities

a. Board of Management and Board of Supervisors contribute substantially to a bank's sound corporate governance through personal conduct.

b. Board of Management is responsible for delegating duties to staff and should establish a management structure that promotes accountability and transparency throughout the bank.

c. Board of Management should provide the Board of Supervisors with the information it needs to carry out its responsibilities, supervise Board of Management and assess the quality of senior management's performance. In this regard, Board of Management should keep the Board of Supervisors regularly and adequately informed of material matters, including:

    1. Preparation and developing of business strategy, risk strategy/risk appetite;
    2. The bank's performance and financial condition;
    3. Breaches of risk limits or compliance rules;
    4. Internal control failures;
    5. Legal or regulatory concerns; and
    6. Issues raised as a result of bank's whistle blowing procedures.

d. Board of Management of a bank shall:

    1. Organize the work and direct the day-to-day business operation of the bank, pursuant to the strategies and policies approved by the Board of Supervisors, and monitor the day-to-day activities of the bank's employees;
    2. Implement the business strategy and policies of the bank approved by the Board of Supervisors. Consistent with the direction given by the Board of Supervisors, senior management should implement business strategies, risk management systems, risk culture, processes and controls for managing the risks both financial and non-financial.
    3. Identify and assess regularly all serious risks involved in the activities of the bank and ensure the monitoring and control such risks in accordance with the policies approved by the Board of Supervisors;
    4. Develop the organizational structure of the bank and its branches that is suitable for the bank's overall strategy as determined by the Board of Supervisors, and submit the proposed structure for approval to the Board of Supervisors;
    5. Develop and implement systems for monitoring the activities of the bank, ensure adherence to such systems, assess the sufficiency thereof regularly and improve them if necessary in accordance with the policies established by the Board of Supervisors;

6. Ensure that all employees of the bank are aware of the provisions of legislation relating to their duties of employment and of the principles approved by the Board of Supervisors;
7. Ensure monitoring of the compliance of the activities of the bank and its employees with legislation and the policies approved by Board of Supervisors;
8. Ensure the existence and functioning of systems to guarantee that information necessary for employees of the bank to perform their duties is communicated to them in a timely manner;
9. Ensure the safety and regular monitoring of information technology systems used by the bank and systems used for the safekeeping of assets of clients;
10. Inform the Board of Supervisors of all discovered violations of legislation, internal rules or other rules established or approved by Board of Supervisors;
11. Present periodic overviews of the activities and financial situation of the bank to the Board of Supervisors.
12. Immediately inform the Board of Supervisors and Da Afghanistan Bank in writing of any deterioration in the financial situation of the bank, or danger of such deterioration, and any other facts that may materially affect the financial situation of the bank, and in particular if the bank becomes undercapitalized.

Part Three- Responsibilities Common to the Board of Supervisors and Board of Management

3.1 General Provisions

a. It is the duty of the Board of Supervisors to oversee the management of the bank's activities, and the duty of the Board of Management to carry out the policies established by the Board of Supervisors. Members of the Board of Supervisors and Board of Management must exercise reasonable care in governing the institution's affairs and must consider the institution's well-being ahead of their own.
b. The same person may not serve on more than one board: the Board of Supervisors and Board of Management. The Chief Executive Officer may attend meetings of the Board of Supervisors, but only as a non-voting member.
c. Members of the Board of Supervisors, Board of Management and Audit Committee are similarly obliged to protect the interest of bank.
d. Members of the Board of Supervisors and Board of Management must ensure that their own business and personal relationships with the institution, as well as the institution's ties to other Board members and Board of Management, are always on terms consistent with those the bank grants to persons who are not Board members or members of the Board of Management. They should take appropriate precautions in structuring their business and personal ties to the bank to avoid even the appearance of a Conflict of Interest.
e. While it is impossible to specifically define every practice or condition which would fall under the category of Conflicts of Interest, the following are examples of objectionable practices:

1. Engaging in transactions that would not be in compliance with DAB regulation on Related Persons issued pursuant to the Banking Law;
2. A Board member or management official taking advantage of a business opportunity for his or her own personal benefit when that opportunity is within the lawful powers of the institution and would be beneficial to the institution given its financial, managerial and technical capabilities; and
3. Payment of excessive compensation or dividends to institution insiders given the bank's size or level of capital or earnings.

f. Members of the Board of Supervisors and Board of Management must make decisions within the areas of responsibility of their respective boards on an informed basis. In the case of the Board of Supervisors, this does not mean that the members need to have expert knowledge of the banking or financial sector. However, they must possess basic understanding of banking, the financial services industry generally, and the laws, DAB regulations and policies that affect their activities. They must also stay informed of their bank's condition through regular attendance at meetings of their boards and review of reports and materials provided there, and must exercise independent judgment in decision-making.

3.2 <u>Fiduciary Duties</u>

a. Members of the Board of Supervisors and Board of Management must:

   1. Perform their duties honestly and in good faith with a view to the best interests of the bank;
   2. Exercise such care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances; and
   3. Avoid Conflicts of Interest between the bank's interests and their own personal or business interests.

b. Members of the Board of Supervisors and Board of Management are liable for any damage caused to the bank for violations of the duties referred to in paragraph (a) of this Article.
c. In the event of violations of the duties referred to in paragraph (a) of this Article by members of the Board of Supervisors and Board of Management resulting in losses to the bank, shareholders of the bank shall have the right to bring legal action on behalf of the bank against such persons seeking compensation for such losses to the bank in accordance with the procedures set forth in Article 48 of the Law on Corporations and Limited Liability Companies.

3.3 <u>Disclosure of Commercial Interests</u>

a. Each member of the Board of Supervisors and the Board of Management shall disclose in full to the Board of Supervisors, or a committee designated by the Board of Supervisors, the significant commercial interests that he or she, or members of his household have, directly or indirectly. Such disclosures shall be made annually in accordance with guidelines adopted by the Board of Supervisors.

b. Whenever any matter related to business interests of a member of the Board of Supervisors or the Board of Management, or any committee with decision making authority, comes up for discussion, the member concerned shall provide complete information at the beginning of the discussion, shall not participate in the discussion, and his presence shall not be counted as necessary for the purpose of constituting a quorum.

3.4 <u>Secrecy Obligations</u>

a) Present and past members of the Board of Supervisors and Board of Management and employees of a bank shall be required to keep confidential, not to use for personal gain and not to permit to be examined by others unless required by law, any information that they obtain in the course of their services to the bank. Such information may be disclosed to:

    1. The officers, staff and agents of Da Afghanistan Bank, including supervisors, inspectors, auditors, conservators and experts appointed by Da Afghanistan Bank in accordance with the Banking Law of Afghanistan;
    2. Other state authorities, and judicial and justice departments assigned in accordance with the law or by a court of competent jurisdiction; and
    3. A private credit bureau or public credit registry, if such bureau or registry has been duly authorized by Da Afghanistan Bank to receive such information.

<u>Part Four- Foreign bank's branch's Governance and Administrative Structure</u>

<u>4.1 General Provisions</u>

a. Each foreign bank's branch shall have head office or regional office and Management Committee who shall be responsible for day-to-day operations of the branch.

b. Before a foreign bank's branch appoints a person to serve on its Management Committee, or Internal Audit Department, the bank must propose the issue to Da Afghanistan Bank as well as submit documents pursuant to Article 12 of Banking Law, during an application for a banking license or during subsequent appointments, and shall obtain Da Afghanistan Bank's authorization.

c. The Management Committee of a foreign bank's branch is elected by head office for a term of four years which can be renewed for another term.

d. In meeting its overall commitment to the bank's stakeholders, head office or regional office must:

    1. Ensure competent management;
    2. Ensure that appropriate plans and policies are in place;

3. Monitor operations, ensure adequate internal controls and compliance with laws and regulations;
4. Oversee financial performance of the bank;
5. Prevent Conflicts of Interest;

e. Head office or regional office is responsible for oversight of the branch operations and performance.

f. Foreign bank branches are obliged to follow both parent's and Afghanistan's banking laws and regulations. In case of contradiction, the laws and regulations of Afghanistan shall prevail.

4.2 <u>Management Committee</u>

a) Under the direction and oversight of the head office or regional office, the Management Committee shall carry out and manage the bank's activities in a manner consistent with the business strategy, risk appetite, and other policies approved by the head office or regional office.

b) Management Committee shall consist of a core group of individuals responsible and accountable to the head office or regional office for the sound and prudent day-to-day management of the bank.

c) The organization and procedures and decision-making of Management Committee should be clear and transparent and designed to promote effective management of the bank. This includes clarity on the role, authority and responsibility of the various positions within Management Committee, including that of the Country Manager (CM).

d) The Management Committee of a foreign bank's branch shall be responsible for the management and execution of the bank's activities. The Management Committee of a foreign bank's branch consists of at least five members, and shall include:

1. Country Manager, with overall responsibility for overseeing the day-to-day operations of the bank;
2. Country Operation Manager, Country Financial Manager and Country Credit Manager;
3. Such other officials that are appointed in the organizational chart, statute and procedures or it deemed necessary by head office or regional office;

e) To increase efficiency and allow deeper focus in specific areas, Management Committee may establish certain specialized sub-committees. The committees should be created and mandated. The number and nature of committees shall depend on many factors, including the size of the bank and its Management Committee, the nature of the business areas of the bank, and its risk profile. Each committee should have a charter or other instrument that sets out its mandate, scope and working procedures.

4.3 <u>Mandatory Departments or Functions</u>

a) Each foreign bank's branch should have the following managerial structure:

1. Human Resources Management Department;
2. Information Technology Department;
3. Risk Management Department/Section;
4. Compliance Department/Section;
5. Operations Department;
6. Internal Audit Department/Section;
7. Credit Department;
8. Islamic Banking Division or Department (If licensed to have an Islamic Banking Window);
9. Finance Department; and
10. Legal Advisor or Department.

b) Internal Audit Department, Compliance Department and Risk Management Department should have independence and should directly report to Audit Committee or Board of Supervisors or a similar body at the head office/regional office.

Part Five-Internal Control and Risk Management Function

5.1 Internal Control Requirement

a) Each bank or branch of foreign bank must have a comprehensive and adequate system for identification, measurement, monitoring and control of all risks to which the bank is exposed. The system shall be approved by the Board of Supervisors, or a similar body at headquarter.

b) Each bank, or branch of a foreign bank, shall have internal controls and information systems that are appropriate for the size of the bank and the nature, scope, and risk of its activities. Such controls and systems shall include at a minimum:

1. An organizational structure that establishes clear lines of authority and responsibility for committing the bank to enter into transactions, disbursing funds on behalf of the bank, and monitoring compliance with the policies established by the bank's Board of Supervisors, or similar body at headquarter;
2. Clear guidelines for delegation of authority and responsibility;
3. Guidelines to evaluate the adherence of the bank to its risk management policies and procedures;
4. Provisions to ensure timely and accurate financial, operational and regulatory reports;
5. Procedures to safeguard and manage assets;
6. Provisions to ensure compliance with applicable laws and regulations of Da Afghanistan Bank;

7. Review by the bank's internal audit function, Audit Committee and full Board of Supervisors, or similar body at headquarter, the effectiveness of the internal control systems.

c. The bank's system of internal controls shall be approved by the Board of Supervisors, and shall be subject to periodic assessment by the bank's internal audit function.

5.2 Compliance Function

a) Banks are required to establish a compliance function department/section in order to ensure the routine monitoring of compliance with this law, other legislations, corporate governance rules, codes and policies applicable to the bank and to ensure that deviations are reported to the competent authorities.

b) In case of material deviations, the head of the compliance function department/section referred to in Paragraph one of this Article, shall report such material deviations directly to the Board of Supervisors.

c) The bank's Board of Supervisors is responsible for overseeing the management of the bank's compliance risk. The board should establish a compliance function and approve the bank's policies and processes for identifying, assessing, monitoring and reporting and advising on compliance risk.

d) An independent compliance function is a key component of the bank's second line of defense. This function is responsible for, among other things, ensuring that the bank operates with integrity and in compliance with applicable laws, regulations and internal policies.

e) The bank's Board of Management is responsible for establishing a compliance policy that contains the basic principles to be approved by the Board of Supervisors and explains the main processes by which compliance risks are to be identified and managed through all levels of the organization.

f) The compliance function should advise the Board of Supervisors and Board of Management on the bank's compliance with applicable laws, rules and standards and keep them informed of developments in the area. It should also help educate staff about compliance issues, act as a contact point within the bank for compliance queries from staff members, and provide guidance to staff on the appropriate implementation of applicable laws, rules and standards in the form of policies and procedures and other documents such as compliance manuals, internal codes of conduct and practice guidelines.

g) To be effective, the compliance function must have sufficient authority, stature, independence, resources and access to the Board of Supervisors. Board of Management should respect the independent duties of the compliance function and not interfere with their fulfillment.

5.3 <u>Internal Audit Function And Requirements</u>

5.3.1 <u>Internal Audit Function</u>

a) An effective and efficient internal audit function constitutes the third line of defense in the system of internal control. It provides an independent assurance to the board of Supervisors and senior management on the quality and effectiveness of a bank's internal control, risk management and governance systems and processes, thereby helping the Board of Supervisors and senior management to protect their organization and its reputation.

b) The internal audit function should have a clear mandate, be accountable to the Board of Supervisors and be independent of the audited activities. It should have sufficient standing, skills, resources and authority within the bank to enable the auditors to carry out their assignments effectively and objectively.

c) Each bank shall establish an independent internal audit function, which shall:

1. Assess the suitability and sufficiency of the bank's internal controls for its activities, in accordance with Article 60 of Banking Law;
2. Regularly monitor compliance with the requirements, rules of procedure, limitations and other rules established by the Board of Supervisors or the Board of Management;
3. Monitor compliance with relevant legislation and regulations of Da Afghanistan Bank;
4. Analyze the deficiencies discovered in the activities of the bank and the employees thereof, cases of failure to perform duties and excess of authority;
5. Prepare proposals for the elimination of such deficiencies inserted in subparagraph 4 above of this paragraph and for measures to prevent errors;
6. Meet with the bank's Board of Supervisors, Audit Committee and/or Management regarding subparagraphs (1) through (5) of this paragraph.
7. Prepare reviews of the activities of the unit on a regular basis and submit the reviews to the Board of Supervisors and Board of Management of the bank pursuant to the procedure prescribed or approved by the Board of Supervisors; and
8. Perform other tasks related to the above as determined by the Audit Committee or Board of Supervisors.

d) The Internal Audit reports to the Board of Supervisors, either directly or through the Audit Committee.

5.3.2 Requirements for Employees of Internal Audit Function

a) The director and employees of the internal audit function must be fit and proper persons, and have the education, professional experience and qualifications necessary for the work of the internal audit department.

b) The director of internal audit function shall be appointed to and removed from office by the Board of Supervisors of the bank and the Board of Supervisors shall introduce the Chief of Internal Audit Department to Da Afghanistan Bank for approval.

c) The number of employees of the internal audit function shall be sufficient for the performance of the duties assigned thereto.

Part Six-Responsibilities Towards Disclosure and Transparency

6.1 General Disclosure and Transparency

a. The bank should be adequately transparent to its shareholders, depositors, and other relevant stakeholders.
b. The bank should provide these parties with key information necessary to enable them to assess the effectiveness of the Board of Supervisors and the Board of Management in governing the bank.
c. Disclosure should include, but not limited to, material information on:
    1. The bank's objectives, organizational and governance structures and policies (in part the content of any corporate governance code or policy and the process by which it is implemented), major share ownership and voting rights and related parties transactions.
    2. The bank should disclose its incentive and compensation policy.
    3. The annual reports of the bank should be printed in a public magazine, and should be uploaded to its website no later than 3 months of the end of financial year.
    4. Banks should regularly update their websites and the websites should have adequate information regarding the services and financial condition of the bank..
    5. The bank should disclose adequate information, when involved in complex structures, the purpose, strategies, structures, risks and controls around such activities.
    6. Disclosure should be accurate and clear, and present information in an understandable manner and in such a way that shareholders, depositors, other relevant stakeholders and market participants can understand it easily.

7. Disclosure could be published on the bank's website, in its annual and periodic financial reports or by other appropriate forms.

d. Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure.
e. An annual audit should be conducted by an independent, competent and qualified auditor in order to provide an external and objective assurance to the Board of Supervisors and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.
f. External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.
g. External auditors should report directly to Board of Supervisors.
h. Channels of disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.
i. The corporate governance framework should be complemented by an effective approach that addresses and promotes the provision of analysis of advice by analysts, rating agencies and others, that is relevant to decisions by investors, free from material Conflicts of Interest that might compromise the integrity of their analysis or advice.

6.2 Board of Supervisors' Responsibility for Disclosure

a. The Board of Supervisors must adopt written corporate governance guidelines covering all the bank's corporate governance matters.
b. The Board of Supervisors must oversee the process of disclosures to internal and external stakeholders.
c. The Board of Supervisors must ensure that disclosures made by the bank are fair, transparent, comprehensive and timely and reflect the character of the bank and the nature and risks inherent in the bank's activities.
d. Disclosure policies should be reviewed for compliance with the DAB's disclosure requirements.

Part Seven-Code of Conduct, Competence and Ethical Behavior

7.1 Code of Conduct

a. The bank should develop its own code of conduct commensurate with its structure, size and business operations.
b. The code of conduct should be comprehensive covering all legal, regulatory and ethical issues.

c. The code of conduct should contain a set of ethical values that the bank expects its staff to follow in conducting business. Core ethical values would normally include honesty, integrity, diligence, fairness, and accountability. Such values should be consistent to avoid confusion to staff.
d. Code of conduct should specify the name or title of the officer who is responsible for:

    1. Handling queries from staff regarding the contents of the code of conduct and any related matters.
    2. Approving requests by staff to accept personal benefits exceeding limits imposed, or otherwise outside acceptable limits, in the code of conduct.
    3. Taking appropriate actions to follow up on cases reported by the staff.

e. All staff should avoid situations that may lead to or involve a Conflict of Interest, actual or potential and, in case of doubt, should seek the advice of the code of conduct officer.
f. All staff with lending authority should have specified limits that are commensurate with their rank or function as laid down in the bank's credit policy.
g. Staff member should not use the power or authority deriving from their position to gain, or to influence other staff to take any action in order to gain a personal benefit or an indirect benefit.
h. Staff members should discourage customers from offering personal benefit of any kind, including any type of gift, favor, service, loan, fee or anything of monetary value.
i. No staff member should solicit, accept and retain personal benefits from any customer of the bank or any individual or organization doing or seeking to do business with it.
j. The officer responsible for approving the acceptance of personal benefits should have authority to:

    1. Permit a staff member to accept a personal benefit unconditionally or subject to such conditions as office may specify.
    2. Require a staff to refuse the offer of a personal benefit or to return a personal benefit to its donor.
    3. Require a staff member to give a personal benefit which he has received to a charitable organization nominated by the staff member and acceptable to the officer, or
    4. Require a staff member to dispose of a personal benefit which he has received in such manner as the officer may direct.

k. The staff member should handle carefully information to third party without written consent from the customer.
l. Staff member should not use information to obtain financial gain in any way.

m. Staff member should not take up any employment or part-time commercial duties outside the bank without prior written approval of the management.
n. The Board of Supervisors is responsible for:

    1. Establishing bank's ethical standards and promoting them to all levels of staff;
    2. Approving the code of conduct;
    3. Ensuring that the bank has adequate systems to enforce the code;
    4. Resolving complex ethical issue;
    5. Ensuring that the reputation risk of the bank is carefully managed.

o. The Board of Management and senior management should demonstrate their support forthe code of conduct.
p. The code of conduct should be reviewed periodically by the Board of Supervisors and updated to keep abreast of changes in the banking industry and regulatory requirements.
q. Staff members should not be assigned conflicting responsibilities that may make them susceptible to abuses which may result in undetected errors.
r. Access rights to confidential information should only be granted to staff on legitimate business purposes on a need to know basis.

7.2 <u>Competence</u>

a. The bank should engage and deploy personnel with sufficient skills, knowledge, experience and soundness of judgment for the discharge of the particular duties and responsibilities allocated to them.
b. The requirements regarding competence and ethical behavior extend to personnel at all levels within the bank's organizational structure.
c. The bank's Board of Supervisors is responsible for ensuring that the bank's business is conducted with integrity, prudence and the appropriate professional competence.
d. The Board of Supervisors should act to ensure that a culture of competence and ethical behavior is embedded within the bank, at both the institution and individual staff levels. Staff recruitment and appraisal systems should be designed so as to include competence, professionalism and integrity as key assessment factors.
e. As it is in the bank's long term commercial interest for its staff to be competent and behave ethically, senior management should ensure that appropriate procedures are put in place:

    1. To assess the competence of newly recruited individuals or individuals being transferred between posts within the bank;
    2. To monitor and review the knowledge, skills and performance of each individual member staff to ensure their continuing competence on an ongoing basis;
    3. To provide adequate levels of supervision to staff;

4. To provide relevant and timely training to staff members to develop their skills and ensure they remain competent for their roles;
5. To address and identify competence failing or gaps in a timely fashion.

f. The bank should maintain adequate systems of control to monitor and review regularly and frequently the competence of their staff so as to ensure that its staff members remain competent for their role, taking into account changing circumstances including market developments, product innovation and changes in the regulatory landscape.
g. The bank should take appropriate remedial action in case if there are competence gaps. This could range from arranging suitable training, increasing the level of supervision, or, in extreme cases, suspending staff from the performance of their duties or posting staff to more suitable position. In serious cases, where incidence of incompetence of the bank's staff have caused significant losses to the bank or are likely to result in significant adverse publicity with consequent reputation risk for the bank, the bank should notify the DAB on a timely basis and discuss the remedial actions which the bank proposes to take to avoid recurrence of similar incidents in the future.
h. Staff members with the previous responsibilities should clearly communicate and provide constructive feedback on competence issues to staff members under their supervision, with a view to motivating them to maintain or improve their competence levels.
i. The bank's policies and procedures for staff performance appraisal should ensure that staffs are aware that their competence will be assessed as an integral part of their performance measurement and will be taken in to account in the determination of any performance related variable remuneration which may be payable to them.

7.3 <u>Ethical Behavior</u>

a. Good ethical behavior should be required for all levels of staff member within the bank, staff members of the bank should act with integrity, due skills, care and diligence in carrying out their role and responsibilities. The bank should take steps to ensure that employees fully recognize their personal accountability in this respect.
b. The bank should ensure that integrity and professional ethics are integrated into its corporate culture. The bank is expected to include training on professional ethics as part of the induction course provided for all newly recruited staff members.
c. The adherence by staff to acceptable ethical standards of behavior should be monitored during the course of their work and should be reviewed in the regular performance appraisal. There should be clearly defined procedures for investigation any apparent instances of unethical behavior on the part of employees, whether the subject of customer complaints or otherwise.
d. To reinforce staff members' level of awareness of the legal, regulatory and ethical issues, the bank should regularly communicate to its staff members the standards and

requirements of their own code of conduct and other codes issued by the DAB. Staff members of the bank should also keep themselves abreast of the standards and requirements of the codes issued by the professional bodies (such as the banking association), of which they are members.

e. In the event of non-compliance by any staff members with applicable codes, the bank should review the situation leading to the breach and assess if this is reflective of any deficiencies in its risk management or control systems that necessitate remedial action.

7.4 Effective Date of Regulation

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