



**Islamic Republic of Afghanistan
Da Afghanistan Bank**

Article Six: Asset Risk Diversification and Limitations on large exposures of banking organizations

Part A — General

§ 6.1.1 Authority

This regulation imposes requirements on a bank to observe sufficient and effective risk controls that ensure their assets are diversified as to risk of loss; and establishes limitations on large exposures pursuant to the authority granted to DAB by Article 32.2, 32.5, 35.4, 35.5, and 35.6 of the Decree Law of Banking in Afghanistan (Banking Law).

§ 6.1.2 Definitions

A) Asset Concentration - An asset concentration exists when extensions of credit or other bank assets posing similar risk characteristics to a bank aggregate 40% or more of a bank's primary capital. For domestic branches of foreign banks, the concentration threshold is 12% of total assets. Asset concentrations consist of direct, indirect or contingent funding obligations which may be due to the bank as described by legally binding contract. Asset groupings should include all types of loans, including overdrafts; cash items; suspense resources; securities (including derivatives and mutual fund investments); leases; acceptances; advances; letters of credit; all other obligations due to the bank; loans endorsed, guaranteed or cosigned by related individuals. Asset concentrations should also consist of due from banks time and demand accounts other assets carried on the books of a bank where payment is dependent on one financial institution or affiliated group, e.g., counterparty risk... Asset concentrations also include assets centered in a particular industry, product line, and geographic location including a cross-border country or businesses that derive 50% or more of their income from cross-border country activities, and various types of collateral that may be vulnerable to market risk revaluation.

B) Attribution – for regulatory purposes, the act of considering a loan granted to one obligor as being simultaneously granted to one or more additional obligors, and therefore counted in calculating the total amount of credit extended to each of the additional obligors. A loan is considered attributed to the initial obligor and also to another obligor or obligors, if the proceeds of the loan are to be used for the direct benefit of the other obligor or obligors. Attribution is also required when the other obligor or obligors are related directly or indirectly to the initial obligor through common control, including where the other obligor or obligors are directly or indirectly controlled by the initial obligor. Finally, attribution is also required when substantial financial

interdependence (as defined in 6.1.2 H) 3.) exists between the initial obligor and other obligor or obligors.

C) Control – a natural or juridical person is said to control a juridical person if the first person directly or indirectly owns more than 50 percent of the voting rights of the second person, or through some other means exercises an influence over the second person that cannot be offset by the collective actions of the other shareholders.

D) Credit – any disbursement or commitment to make a disbursement of a sum of money in exchange for a promise to repay the amount disbursed and to pay interest or other charges on such amount, whether secured or unsecured; any extension of the due date of a debt; any guarantee issued; and any purchase of a debt security or other promise to pay a sum of money and to pay interest either directly or by a discounted purchase price. For the purposes of this regulation, “guarantees” include financial and performance-based standby letters of credit as well as other guarantees. “Credits” also include: accounts receivable, wherein not money, but goods or services of monetary value are advanced by the bank in exchange for a promise to pay by the obligor, whether this promise to pay has a definite fulfillment date or not, and whether interest is chargeable on the outstanding balance or not; purchase of securities under agreements to resell at a later date; overdrafts, whether or not prearranged, but not an intra-day overdraft for which payment is received before the close of business of the bank that makes the funds available; and loans or extensions of credit that have been charged off on the books of the bank in whole or in part, unless the loan or extension of credit is no longer legally enforceable.

E) Direct benefit – the proceeds of a loan or extension of credit to an obligor will be deemed to be used for the direct benefit of another person when the proceeds, or assets purchased with the proceeds, are transferred to the other person, other than in a genuine transaction with economic substance where the proceeds are used to acquire property, goods, or services.

F) Exposure – the aggregate outstanding principal amount of credits to a single obligor or group of related obligors. Exposure includes not only credits made directly to the obligor or group of obligors, but also credits attributed to them. Exposures are to be calculated on a gross basis; that is, reserves for losses, premiums, discounts, and other adjustments to the carrying amount of the assets on the balance sheet are disregarded in the calculation.

G) Fully secured – a certain principal amount of credit is considered fully secured if all of the following characteristics are met and documented: the initial market value of the collateral is ascertained and recorded; the debtor has rights in the collateral; the debtor has authenticated a security agreement that contains a description of the collateral or the bank has possession of the collateral; a financing statement that contains the name of the debtor, the name of the bank, and the collateral to be covered has been filed in the appropriate jurisdiction according to the applicable laws of Afghanistan; no other secured creditor has a prior claim to the same collateral; and the collateral has a current market value equal to 100 percent or more of the principal amount of credit in question.

H) Group of related obligors -- 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 the other or others, or the same factors may affect the financial soundness of some or all of them, or if as a result of the structure of their relationship the other person is in fact ultimately responsible for the credit outstanding. More specifically, individual obligors of a bank are considered a group of related obligors:

1. When the expected source of repayment for each loan is the same for each obligor, and neither obligor has another source of income from which the loan (together with the obligor's other obligations) may be fully repaid.
2. When loans are made to obligors 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 obligors. Substantial financial interdependence is deemed to exist when 50 percent or more of one obligor's gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other obligor. Gross receipts and expenditures include gross revenues/expenses, inter-company loans, dividends, capital contributions, and similar receipts or payments.
4. When separate obligors borrow from a bank to acquire a business enterprise of which those obligors will, collectively, own more than 50 percent of the voting securities or voting interests.
5. In other cases, when DAB determines, based on an evaluation of the facts and circumstances of particular transactions, that the financial soundness of any obligor may affect the financial soundness of any other.

I) Large loans that have credit risks – for the purposes of this regulation, a “large loan that ha(s) credit risks” (also known as a large exposure) is defined as the sum of credits to a single obligor or group of related obligors, if such sum exceeds 10 percent of the regulatory capital of the bank.¹ For an Afghanistan branch of a foreign bank, a large exposure is defined as an exposure that exceeds 3 percent of the total assets of the branch.

J) Nonconforming exposure – an exposure that was within the legal limitation when incurred, but has subsequently fallen out of compliance because of a decline in regulatory capital, a subsequent link among obligors that results in their forming a group of related obligors with total exposure above the limitation, or a decline in the value of readily-marketable collateral. Nonconforming exposures are not considered to be regulatory violations, unless the bank has not taken action within the required timeframes to eliminate the nonconformity.

K) Readily marketable collateral – to be considered readily marketable, the collateral must be salable under ordinary market conditions with reasonable promptness at a fair market value determined by quotations based upon actual transactions on an auction or similarly available daily bid and ask price market. Only the following types of collateral that meet the above characteristics are eligible to be considered readily marketable for the purposes of this regulation:

1. Currency, if it is in the possession of the lending bank and provided that the currency is either Afghani or another currency that is denominated in the same currency as the principal amount of credit in question and freely convertible to Afghani and issued by the monetary authority of a Category A country;
2. Deposits by the obligor in the lending bank, if the deposit is denominated in the same currency as the principal amount of credit in question and, when the deposit is eligible for withdrawal

¹ The term “large loans that have credit risks” is used in the Banking Law but is not defined. This regulation uses the more common term “large exposure” instead.

before the secured amount matures, the bank has established internal procedures to prevent release of the security.

3. Securities issued or unconditionally guaranteed by central governments or central banks;
4. Securities issued by or guaranteed by multilateral lending institutions or global or regional development institutions subject to the prior approval of DAB.
5. Securities and other financial instruments issued by other parties that carry an investment grade rating by at least two internationally-recognized rating agencies.
6. An unconditional guarantee, in writing, of the principal amount of the credit plus accrued interest, if any, by a bank licensed by a financial sector regulatory authority in a Category A country. In the case of an Afghanistan branch of a foreign bank, the home office may provide the guarantee, even if it is not licensed in a Category A country. In the case of an Afghanistan subsidiary of a foreign bank, the parent bank may provide the guarantee, even if it is not licensed in a Category A country. If the guarantee is provided by the home office or the parent bank, the guarantee must provide, in the event of default by the obligor, for the contribution of assets to the banking organization in Afghanistan that are considered by DAB to be assets resulting from transactions involving unrelated parties and related non-depository institutions. That is, the assets contributed must increase (in the case of a foreign branch) the net due to the home office and other branches of the same bank, or (in the case of a subsidiary) the capital of the subsidiary. The assets to be contributed must be assets that are permissible for a banking organization licensed or permitted in Afghanistan to hold.

L) Total assets – in reference to an Afghanistan branch of a foreign bank, the sum of assets resulting from transactions involving unrelated parties and related non depository institutions, plus the net due from the home office and other branches of the same bank (if any).

M) Unimpaired capital and reserves – for the purposes of this regulation, unimpaired capital and reserves is defined as the regulatory capital of the bank, calculated in accordance with the regulation on capital.²

§ 6.1.3 General Goals and Objectives

A) This regulation aims at the following:

1. To prevent the possibility that default by one obligor or a group of related obligors will have a significant, negative effect on the bank’s profitability or capital. Credits to a single obligor or group of related obligors that are fully secured by readily marketable collateral are excluded from the calculation of the general limitation described in § 6.2.1, subject to the following limitations:

- a) The aggregate amount of such credits that are excluded from the calculation is limited to 15 percent of the bank’s regulatory capital. In the case of an Afghanistan branch of a foreign bank, the limitation is 4 percent of the total assets of the branch.

² The term “unimpaired capital and reserves” is used in the Banking Law but is not defined. This regulation declares that “unimpaired capital and reserves” is equivalent to “regulatory capital,” and the latter term will be used throughout.

b) Such credits that are in excess of 15 percent of the bank's regulatory capital (4 percent of the total assets of an Afghanistan branch of foreign bank) are included in the calculation of the general limitation, as if they did not meet the definition of "fully secured by readily marketable collateral."

2. To encourage banks to have a diversified credit portfolio by limiting the number of allowable large exposures and to develop appropriate policies, strategies, controls and risk monitoring processes to manage asset concentrations that may have a significant, negative effect on a bank's profitability or capital.

B) The objectives of this regulation:

1. Banks that are corporations registered in Afghanistan are required to limit exposures to a single obligor or group of related obligors to 15 percent of regulatory capital, with additional amounts allowed for secured credits. The corresponding limitation for an Afghanistan branch of a foreign bank is 4 percent of the total assets of the branch.

2. Banks that are corporations registered in Afghanistan are required to limit the aggregate amount of large exposures, where a large exposure is defined as an exposure exceeding 10 percent of regulatory capital, to 200 percent of regulatory capital. For an Afghanistan branch of a foreign bank, a large exposure is defined as an exposure exceeding 3 percent of the total assets of the branch, and the aggregate amount of large exposures is limited to 60 percent of the total assets of the branch.

3. DAB may grant an Afghanistan branch of a foreign bank exemption from these limitations, if the home office unconditionally guarantees the full and timely payment of all of the Afghanistan branch's liabilities arising from transactions with unrelated parties.

4. Banks that are corporations registered in Afghanistan are to observe sufficient and effective risk controls and ensure that their assets are diversified as to risk of loss.

Part B — Risk Management of Asset Concentrations

§ 6.2.1 General Guidance

A) Institutions with asset concentrations are expected to have in place effective policies, systems, and internal controls to monitor and manage this risk. The DAB has established uniform risk thresholds for banks to identify, monitor and control asset concentrations. For banks licensed in Afghanistan, the threshold is 40% of regulatory capital. For branches of foreign banks, the threshold is 12% of total assets. Additionally, the bank's Board of Supervisors is responsible for establishing appropriate risk parameters or limits on asset concentrations and for monitoring exposure, as well as for evaluating the methods used by management to administer, control and stress-test asset concentration risk. Asset concentrations that involve excessive or undue risks require close scrutiny by the bank and should be reduced over a reasonable period of time. Banks with a need to reduce asset concentrations are expected to develop a plan that is realistic, prudent, and achievable in view of their particular circumstances and market conditions.

B) The purpose of an institution's policies is to improve the overall quality of its portfolio through risk diversification. Institutions that have effective internal controls to manage and reduce excessive asset concentrations over a reasonable period of time need not automatically

refuse credit to sound borrowers because of their particular industry or geographic location. Furthermore, a bank may be able to reduce the risks associated with concentrations through the strengthening of individual credits. For example, the bank may be able to obtain additional collateral or guarantees. In the event of deterioration, the bank's position would be improved because the additional collateral or guarantees may provide a cushion against losses. When asset concentration levels have been built up over an extended period, it may take an extended period to achieve a more balanced and diversified portfolio mix. Given the institution's trade area, lack of economic diversity, or geographic location, reducing the existing asset concentration in the near term may be impossible. If a loan concentration exists, the banking organization should have strong credit policies and loan administration standards in place to provide adequate control for the risks associated with both existing exposures and new exposures. The Board of Supervisors must also maintain adequate capital to protect the institution while its portfolio is being restructured. This may require additional capital and reserves to off-set inherent risk in the bank. For identified asset concentrations and appropriate capital risk allocations, bank management should be aware of not only the particular company's or industry's recent trends, but also its future prospects.

§ 6.2.2 Alternatives for Reducing Concentrations

A) Some alternatives for institutions whose asset concentrations are not likely to be reduced in the near term are described below:

1. *Increased Holdings of Capital* – To compensate for the additional risk that may be associated with an asset concentration, a bank may elect to maintain a higher capital ratio than would be required under risk-based capital guidelines. This additional capital would provide support in the event the concentration adversely affects the organization's financial position.

2. *Increased Allowance for Loan Losses* – The banking organization may choose to factor a cushion for loan concentrations into its determination of an adequate allowance for loan losses in determining the minimum level. This cushion would be available to absorb some deterioration in loan concentrations.

3. *Loan Participations* – If a banking institution has a concentration, it may be possible to sell a portion of the loan portfolio in the secondary market to reduce its dependency on an asset group. If the institution is not large enough to participate in the secondary market, an alternative might be to sell loans, without recourse, to a correspondent bank that is also attempting to diversify its loan portfolio.

B) DAB capital Regulation 2.1.3 requires all banks licensed in Afghanistan to maintain a capital ratio that is adequate for the types of activities that it undertakes. In determining the adequacy of a bank's capital, DAB will take into account a number of factors to ensure that required capital is broadly proportional to the bank's risk profile. These factors include credit risk concentrations, concentration of particular types of assets or liabilities and the effectiveness of the bank's management systems for monitoring and controlling risk. DAB capital Regulation 2.3.2 provides that upon notification by DAB of a capital deficiency, the bank will have 60 days to remedy the deficiency or DAB will apply enforcement action against the bank.

Part C — Limitations on exposures to a single obligor or group of related obligors

§ 6.3.1 General limitation

A). No bank is permitted to grant credit to a single obligor or group of related obligors, if as a result of that action the exposure to that obligor or group exceeds 15 percent of regulatory capital, or increases the amount by which the exposure already exceeds 15 percent of regulatory capital. The corresponding limitation for an Afghanistan branch of a foreign bank is 4 percent of the total assets of the branch.

B). In calculating compliance with this limitation, exposures to each of the obligors in a group of related obligors are aggregated and considered as an exposure to a single obligor. When the aggregation is performed, each individual credit is counted only once, even though it may be attributed to more than one obligor in the group.

§ 6.3.2 Special rules for credits fully secured by readily marketable collateral

Credits to a single obligor or group of related obligors that are fully secured by readily marketable collateral are excluded from the calculation of the general limitation described in § 6.2.1, subject to the following limitations:

A) The aggregate amount of such credits that are excluded from the calculation is limited to 15 percent of the bank's regulatory capital. In the case of an Afghanistan branch of a foreign bank, the limitation is 4 percent of the total assets of the branch.

B) Such credits that are in excess of 15 percent of the bank's regulatory capital (4 percent of the total assets of an Afghanistan branch of foreign bank) are included in the calculation of the general limitation, as if they did not meet the definition of "fully secured by readily marketable collateral."

Part D — Limitations on aggregate large exposures

§ 6.4.1 General limitation

A) No bank is permitted to grant credit that has the effect of creating or increasing a large exposure, if as a result of that action the aggregate amount of large exposures of the bank exceeds 200 percent of regulatory capital, or increases the amount by which aggregate large exposures already exceed 200 percent of capital. For an Afghanistan branch of a foreign bank, a large exposure is defined as an exposure exceeding 3 percent of the total assets of the branch, and the aggregate amount of large exposures is limited to 60 percent of the total assets of the branch.

B) In calculating compliance with this limitation, exposures to each of the obligors in a group of related obligors are aggregated and considered as an exposure to a single obligor. When the aggregation is performed, each individual credit is counted only once, even though it may be attributed to more than one obligor in the group.

If the bank falls out of compliance with the limitation on aggregate large exposures for any reason, it is required to take action to eliminate the nonconformity within 60 days. Action to reduce any large exposure may be taken, not necessarily to reduce the specific exposure whose increase caused the bank to fall out of compliance.

§ 6.4.2 Special rules for credits fully secured by readily-marketable collateral

Credits to a single obligor or group of related obligors that are fully secured by readily marketable collateral are excluded from the calculation of “large exposure” in § 6.3.1, subject to the following limitations:

A) The aggregate amount of such credits that are excluded from the calculation is limited to 15 percent of the bank’s regulatory capital. In the case of an Afghanistan branch of a foreign bank, the limitation is 4 percent of the total assets of the branch.

B) Such credits that are in excess of 15 percent of the bank’s regulatory capital (4 percent of the total assets of an Afghanistan branch of a foreign bank) are included in the calculation of large exposures, as if they did not meet the definition of “fully secured by readily marketable collateral.”

Part E — Nonconforming exposures

§ 6.5.1 Nonconforming exposures resulting from declines in regulatory capital (or total assets of an Afghanistan branch of a foreign bank) or subsequent links among obligors

If an exposure becomes nonconforming because of a decline in regulatory capital (or total assets of an Afghanistan branch of a foreign bank) or subsequent links among obligors that result in their individual exposures being combined, banks are required to take reasonably prompt action (as soon as possible, but no later than six months after the event) to bring the exposure back into conformance. Such action may require selling a loan or security to another financial institution, obtaining readily-marketable collateral from the obligor, or increasing regulatory capital (or total assets of an Afghanistan branch of a foreign bank).

§ 6.5.2 Nonconforming exposures resulting from declines in value of readily marketable collateral

If an exposure becomes nonconforming because of a decline in the value of readily marketable collateral, banks are required to take action to eliminate the nonconformity within 60 days.

§ 6.5.3 Special case of large exposures not conforming with aggregate limitation

If the bank falls out of compliance with the limitation on aggregate large exposures for any reason, it is required to take action to eliminate the nonconformity within 60 days. Action to reduce any large exposure may be taken, not necessarily to reduce the specific exposure whose increase caused the bank to fall out of compliance.

Part F – Recordkeeping and Reporting

§ 6.6.1 Recordkeeping

Banks must keep records that completely and accurately list all defined asset concentrations and large exposures, including the identity of the obligor or obligors, the magnitude of the exposure, whether or not the obligor or obligors are related parties, and the classification status of each exposure. These records must be updated at least quarterly and summarized in a report by the Board of Management to the Board of Supervisors.

§ 6.6.2 Reporting

DAB may require banks to report at least quarterly to DAB on all defined asset concentrations and large exposures in a similar manner as the exposures are reported to the Board of Supervisors. DAB may create a standard reporting format for this purpose.

Part G – Exemption from limitations for Afghanistan branches of foreign banks

§ 6.7.1 Application required for exemption from limitation

An Afghanistan branch of a foreign bank may apply to DAB to become exempt from both the limitation on exposures to a single obligor or group of related obligors and the limitation on aggregate large exposures. The application must be accompanied by the following documents:

A) A statement from the foreign bank’s Board of Directors (or equivalent body) that the foreign bank (as a whole) is in compliance with asset concentration and large exposure limitations imposed by its home country regulatory authority. This statement must be updated on an annual basis.

B) A letter of no objection from the foreign bank’s home country regulatory authority to the exemption and to the required guarantee.

C) A letter of guarantee, signed by each member of the foreign bank’s Board of Directors (or equivalent body) that the home office unconditionally guarantees the full and timely payment of all of the Afghanistan branch’s liabilities arising from transactions with unrelated parties.

- a) D) A copy of the most recent version of the lending policy of the branch that contains a reasonable, internally-defined threshold for “asset concentrations and large exposure” and subjects proposed large exposures to a higher level of management review and approval at the time of origination.

§ 6.7.2 Criteria for DAB approval of exemption

In judging the application for the exemption on its merits, DAB will take into account the foreign branch’s overall record of compliance with laws, regulations, and policy statements and enforcement actions of DAB; its overall asset quality, including its level and trend of non-performing assets and adversely-classified assets and the accuracy of its loan classifications as determined by DAB on-site examinations; and the assessment by

DAB of the branch's loan origination function for adherence to the branch's loan policy and to general principles of prudent lending.

Appendix Sample Large Exposures Calculations

Bank 1 has AF 500,000,000 of regulatory capital.

The limit for a single obligor or a group of related obligors is 15 percent of regulatory capital = AF 75,000,000.

With regard to the aggregate amount of large exposures, assume there are 16 exposures at Bank 1. The amount of a large exposure for Bank 1 is AF 50,000,000 (10 percent of regulatory capital) or above.

The limit for the aggregate amount of large exposures is 200 percent of regulatory capital = AF 1,000,000,000.

Borrower A exposure	=	AF 60,000,000	(13 percent of regulatory capital)
Borrower B exposure	=	AF 75,000,000	(15 percent of regulatory capital)
Borrower C exposure	=	AF 65,000,000	(13 percent of regulatory capital)
Borrower D exposure	=	AF 55,000,000	(11 percent of regulatory capital)
Borrower E exposure	=	AF 70,000,000	(14 percent of regulatory capital)
Borrower F exposure	=	AF 75,000,000	(15 percent of regulatory capital)
Borrower G exposure	=	AF 65,000,000	(13 percent of regulatory capital)
Borrower H exposure	=	AF 55,000,000	(11 percent of regulatory capital)
Borrower I exposure	=	AF 60,000,000	(13 percent of regulatory capital)
Borrower J exposure	=	AF 40,000,000	(08 percent of regulatory capital)
Borrower K exposure	=	AF 75,000,000	(15 percent of regulatory capital)
Borrower L exposure	=	AF 70,000,000	(14 percent of regulatory capital)
Borrower M exposure	=	AF 65,000,000	(13 percent of regulatory capital)
Borrower N exposure	=	AF 60,000,000	(13 percent of regulatory capital)
Borrower O exposure	=	AF 70,000,000	(14 percent of regulatory capital)
Borrower P exposure	=	AF 55,000,000	(11 percent of regulatory capital)
Total exposure	=	AF 1,015,000,000.	

However, total amount of large exposures = AF 975,000,000 as Borrower J is not considered a "large exposure" at 8 percent of regulatory capital and thus is not included for the purposes of calculation of "aggregate amount of large exposures."