Article 1: Authority

This regulation (Regulation) on related persons of banks is issued pursuant of the authority granted to Da Afghanistan Banks by Chapter XV, article 177 of the Banking Law of Afghanistan.

Article 2: Banking Act and Regulation

This Regulation must be read in conjunction with the Banking Act, and more specifically articles 79-81 of the Banking Act.

Article 3: General goals and objectives

The Regulation seeks to prevent abuses arising in transactions with related parties by addressing the risk of conflict of interest and ensuring that related persons of banks licensed under the Banking Law do not benefit inappropriately from transactions with these institutions, usually to the detriment of the institution. The Regulation also seeks to ensure that transactions with related persons are concluded on an arm's length basis on terms and conditions that are the same as or similar to that with non-related persons; that these transactions are monitored; that appropriate steps are taken to control or mitigate the risks; and that exposures to related parties are written off in accordance with standard policies and processes.

Article 4: Definitions

In this Regulation, the following words and terms have the corresponding meanings indicated below, unless the context otherwise requires:

(1) **Close Relative:** As per article 2 (36) of Banking Law of Afghanistan.

(2) **Large Exposure:** As per article 2 (15) of Banking Law of Afghanistan.

(3) **Related Person:** As per article 2 (37) of Banking Law of Afghanistan. In further elaboration, a related person includes where the interests of two or more persons or a group of persons are so interrelated that they could be considered as a single unit, and one or more of these persons are a related person, then they are all considered related persons. The following also constitute related persons, namely members of formations within a bank or within enterprises that are members of the same group of enterprises as the bank, including

1. Audit committee members and their close relatives
2. Internal audit function and their close relatives
3. Independent audit function and their close relatives
4. Risk committee members and their close relatives
5. Credit committee members and their close relatives
6. Compliance function and their close relatives
7. Department heads and their close relatives
8. Other key personnel and their close relatives,
9. When any related person ceases to be a related person through resignation or otherwise, they continue to be considered a related person for one year.

(4) **Qualifying holding:** As per article 2(20) of Banking Law of Afghanistan.

(5) **Credit**: Means any asset or off-balance sheet item (contingent liability) that contains credit risk, including placements and term deposits with other financial institutions, domestic or foreign.

(6) **Related person transaction:** Transactions between a bank and an existing related person or a person who becomes a related person by reason of the conclusion of the transaction, where transaction includes on-balance sheet and off-balance sheet exposures and claims, as well as dealings such as service contracts, assets purchases and sales, construction contracts, lease agreements, derivative transactions, borrowings and write-offs.

(7) **Person:** Natural person and legal person.

(8) **Collateral:** Something pledged as security for repayment of a credit, to be forfeited in the event of default.

(9) **Regulatory capital (unimpaired capital):** As per article 2(42) of Banking Law of Afghanistan.

(10) **Benefit:** Means an advantage, privilege, profit or gain, whether or not in exchange for consideration.

(11) **Parent Company:** As per article 2(23) of Banking Law.

(12) **Arm's length basis:** a transaction in which the customer and bank act independently and have no relationship to each other; or a transaction where both parties in the deal are acting in their own self-interest and are not subject to any inappropriate pressure or duress from the other party.

(13) **Associated Enterprise:** Defined as per article 2(29) of Banking Law.

Article 5: Requirements when entering into a related person transaction

(1) A bank is prohibited from entering into a transaction with a related person except when the majority of Board of Supervisors approves the transaction in advance. A Board of Supervisors is prohibited from concluding a related person transaction unless it has received such necessary information as is reasonably required to come to a sound decision on the proposed related party transaction.

(2) Board of Supervisors is obliged, in meeting minutes, to

1. specify the key terms and conditions of a related party transaction
2. confirm that the related party transaction is entered into on an arm's length basis; and
3. affirm that it is in the reasonable best interest of the bank to enter into the related party transaction;

(3) A bank is obliged to maintain comprehensive records of all related party transactions concluded, including the information on which the approval of a related party transaction is based, as well as the names of Board of Supervisors' members who approved the transaction.

(4) A related person who has an interest in a related party transaction between the bank and itself or its related persons is obliged to abstain from the consideration, decision-making,

managing, controlling, monitoring and write-off of the relevant related party transaction.

(5) The followings are exceptions to paragraph (1) of this article pursuant to article 79(5) of Banking Law:

1. Deposits in the bank made by its Related Persons in the normal course of business.
2. Making deposits in a bank that is a member of the same group, in the ordinary course of correspondent business, subject to Asset Classification and Provisioning Regulation in any future directives issued by Da Afghanistan Bank.
3. Granting credit fully secured by a deposit account in the bank granting the credit and meeting conditions specified in the Asset Classification and Provisioning Regulation and in any future directives that may be issued by Da Afghanistan Bank.
4. Granting credit fully secured by obligations of, or guaranteed as to principal and interest by, a central government or central bank whose long-term rating is not lower than "A" or an equivalent level by an internationally-recognized rating agency whose ratings are approved for use by Da Afghanistan Bank.
5. Selling a loan to a related person of the bank without recourse.

(6) A bank is not permitted to extend credit to a related person on an unsecured basis. A bank is obliged, when granting credit to a related person, to do so only against Collateral, which must provide the following level of prescribed coverage:

1. In the case referred to in article 5(5)(3) and 5(5)(4), above, the liquid market value or liquidation value of the collateral must be a minimum of 100 % of the credit amount;
2. If all other cases, the liquid market value or liquidation value of the collateral must be a minimum 120% of the credit amount;

(7) A bank is required to deduct from its regulatory capital the full amount of any unsecured credit exposure to a related person.

(8) Bank is obliged to report promptly a concluded related person transaction to the Board of Supervisors. However, in order to monitor related party transactions on regular basis, Transactions referred to in article 5(5) should be reported to the board on a quarterly basis.

(9) If credit has been disbursed to a related person in breach of this article 5 or article 82 of the Banking Law, such credits must be repaid immediately.

(10) Supervisory board members and management board members who approved a related party transaction which breached this Regulation are liable to criminal prosecution for fraud perpetrated on the bank and responsible individually for refunding the full amount of principal, interest and other related charges of credit extended.

Article 6: Prohibition against doing business with related person on certain terms

(1) A bank is prohibited from entering into a transaction with a related person on terms which are more advantageous (e.g., in credit assessment, tenor, interest rates, fees, amortization schedules and requirement for collateral) than a corresponding transaction it enters into with a non-related person. A bank is prohibited from selling an asset for less than its liquid market value or fair value to a related person.

(2) A bank is prohibited from purchasing sub-standard quality goods or assets from a related

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person; or accepts as collateral assets which are sub-standard quality goods or assets and do not constitute qualifying collateral.

The followings are deemed to be low-quality assets:

1. Assets which are classified Sub-standard, Doubtful and Loss pursuant to bank's standards or Da Afghanistan Bank's regulation and recent supervisory report;
2. Assets which do not generate a consistent and regular income or benefit for the bank;
3. Assets which are overdue more than thirty days;
4. Assets in relation to which the expiry date has been extended and/or repayment conditions have been re-scheduled on more favorable terms to the client, due to unfavorable financial condition of the debtor.

(3) A bank is prohibited from granting credit in cases where the credit is used for the following purposes:

1. In order to pay bank related person's debt or obligation;
2. In order to purchase bank related person's assets;
3. In order to invest in bank related person's trade;

Article 7: Reporting related person's transactions to Da Afghanistan Bank

(1) Bank must report on monthly basis information on related person transactions and exposures to Da Afghanistan Bank. The report must contain the following:

1. Regarding related person credits – a listing of individual
   a. Related person credits to which the bank is committed as at the end of the latest month
   b. Related person credits which the bank extended during the latest month
   c. Related party credits outstanding as at the end of the latest month
   d. Related party credits classification (individually) (Watch; Sub-standard; Doubtful; and Loss)
   e. Related party credits provisions (Provisions raised in respect of each of the related person credits)
   f. Related party credits write-offs (individually; with full explanation of motivation of write off)
2. Related person's name, outstanding amount, maturity date, and other important debt deal's terms and conditions must be reported.

(2) Da Afghanistan Bank is empowered to require a bank, a group of banks or all banks to submit such related person information, related party transaction information and related party exposure information as it deems necessary and when it deems it necessary.

(3) A bank is obliged to maintain comprehensive and complete information on related persons, related person transactions and related person exposures. The bank is required to ensure that appropriate control framework is developed and applied to such information.

Article 8: Restrictions on banks facing breaches of regulatory capital adequacy requirements

A bank is prohibited from entering into related party transactions

1. While it is in beach of the regulatory capital adequacy requirements.
2. In the event that a related party transaction would result in a breach of the regulatory capital adequacy requirements.

Article 9: Limitations on maximum size of related party exposures

(1) A bank is obliged to observe the following maximum limits in relation to exposures to an individual related person, group of connected related persons or all related persons;

1. A bank's total exposure to an individual related person or group of connected individual related persons may not under any circumstances exceed 5 percent of bank's regulatory capital.
2. A bank's total exposures to all related persons may not under any circumstances exceed 25 percent of the bank's regulatory capital.

Where a bank is in breach of these limits, the bank is required to impair its qualifying regulatory capital to the extent of such breach, by deducting from its qualifying regulatory capital an amount equivalent to the amount by which an individual exposure or aggregate of total exposures exceed the relevant limit.

(2) Da Afghanistan Bank has the authority to exclude the following transactions from paragraph (1) of this article subject to the:

1. Transactions related to Da Afghanistan Bank.
2. Transactions that are going to be contracted with a government or guaranteed by a government;
3. When maturity date of interbank transactions is one year or less than one year.

(3) A bank is obliged to have obtained prior supervisory approval for any large exposure (an exposure in excess of 10 percent of its regulatory capital) which it wishes to undertake.

Article 10: Transparency of group structure

(1) A group that contains a bank must develop its group, governance, business, control and organizational structures in such a way that Da Afghanistan Bank could recognize the following:

1. The ultimate controlling shareholder/s of the group and of the bank
2. The ultimate controlling bank holding company of the bank
3. Governance arrangements of each member entity of the group, and the quality thereof
4. Business activities of each member entity of the group;
5. Financial position and performance of each member entity of the group;
6. Risk analysis of each member entity of the group;
7. Links (governance; business; financial; risk; operational; other) between each member entity of the group

(2) A group that contains a bank must develop its group, governance, business, control and organizational structures in such a way that it should not impede or restrict Da Afghanistan Bank supervisors and any control function (including external and internal auditors, risk management function and the compliance function) from performing their duties;

(3) Every bank of a group is obliged to have separate set of financial statements to determine its assets, liabilities, income, and expenses as an independent legal person.

Article 11: Compliance with prudential requirements by a banking group

(1) Where a bank is part of a banking group, the following requirements are applicable to the banking group:

1. Banking group capital adequacy is subject to article 68 of the Banking Law;
2. Banking group foreign exchange net open position is subject to article 73 of the Banking Law;
3. Banking group investment in other companies is subject to article 83 of the Banking Law;

(2) Da Afghanistan Bank is empowered to regulate and enforce other requirements of the Banking Law of Afghanistan by adopting regulations and establishing procedures on banking groups.

(3) Banking groups must have adequate policies and procedures related to capital adequacy, large exposure and exchange rate risk.

(4) The ultimate parent company of the banking group must comply with requirements of paragraph (3) of this article;

(5) Da Afghanistan Bank must review policies and procedures at least once a year for the purpose of ensuring the safety and soundness of a bank and to ensure its compliance with the related party policies. Da Afghanistan Bank is empowered to require such amendments as Da Afghanistan Bank deems necessary in policies and procedures of bank or banks that are members of a group.

(6) If Da Afghanistan Bank determines that the banking group capital is not enough for the bank's protection, Da Afghanistan Bank can oblige a bank to hold surplus capital for the purpose of bank protection or carry out its activities on a higher capital adequacy ratio than the specified minimum requirement.

Article 12: Role of Board of Supervisors

The Board of Supervisors

(1) Must ensure that a bank has an approved policy on extension of credit to related parties.

(2) Must maintain effective oversight over all aspects of related persons, related person's transactions and related person's exposures.

(3) Must ensure that transactions with related persons comply with the relevant policies and are controlled and monitored independently of the related person.

(4) Must ensure that exceptions to the policy, processes and limits are reported to the appropriate level of the bank's senior management and, if necessary, to the Board of Supervisors, for timely action.

(5) Is the only body authorized to write-off a related party exposure, which must be properly motivated and recorded?

Article 13: Repetitive Related Party Transactions

The Board of Supervisors may grant omnibus approval for related party transactions proposed to be entered with the bank subject to the following conditions:

(1) The Board of Supervisors shall lay down the criteria for granting the omnibus approval in line with the policy on related party transactions of bank, and such approval shall be applicable in respect of transactions which are repetitive in nature;

(2) The Board of Supervisors shall satisfy itself of the need for such omnibus approval and that such approval is in the interest of the bank. Such omnibus approval shall specify:

a. the name/s of the related party, nature of transaction, period of transaction, and maximum amount of transaction that can be entered into,

b. the indicative base price / current contracted price and the formula for variation in the price if any, and

c. such other conditions as the Board of Supervisors may deem necessary;

(3) Provided that where the need for related party transaction cannot be foreseen and aforesaid details are not available, Board of Supervisors may grant omnibus approval for such transactions subject to their cumulative aggregate value not exceeding 1 (one) percent of bank's regulatory capital.

(4) A board of Supervisors shall review, at least on a quarterly basis, the details of repetitive related party transactions entered into by bank pursuant to each the omnibus approval given.

(5) Such omnibus approvals shall be valid for a period not exceeding one year and shall require fresh approvals after the expiry of one year.

(6) The provisions contained in the paragraphs (1) to (5) of this article shall not be applicable to transactions between bank and (i) a government company or (ii) a wholly owned subsidiary whose accounts are consolidated with that bank.

Article 14:

All related party transactions are required to be reported to the Board of Supervisors along with the justification for entering into these transactions. Transparency and disclosure.

a. Details of all related party transactions shall be disclosed quarterly to stock exchanges along with the compliance report on corporate governance.

b. The policy on related party transactions shall be put on the website of bank and a web link thereto shall be provided in the annual report.

Article 15: DAB empowered to designate a related person

The DAB is empowered to designate as a related person any person it considers to be a related person.

Article 16: Effective Date of Regulation

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

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Annexure I

Examples of related persons and related person transactions

Note: The examples of related persons and related person transactions hereunder are not meant to constitute an exhaustive listing but are presented for illustrative purposes only.

Related persons:

A qualifying shareholder in a bank of bank controlling company

A qualifying shareholder in a company which is part of a banking group. These include companies in which the group hold an interest of 20 percent of higher, irrespective which group entity holds the interest and irrespective whether the interest is held directly or indirectly.

A member of a board of supervisors, a management board, a key decision-making organ (such as an operational committee) or a control function (such as an audit committee, risk committee, credit risk committee, internal audit function, external audit function, compliance function) of any company which is part of a banking group. A close relative, as defined, of any of the foregoing persons. Enterprises in which any of the foregoing persons hold a qualifying holding. Other key personnel in the group or such enterprises.

A related person includes a person who exercises significant influence over any of the above persons.

Related person transactions

Sale, purchase or supply of any goods or materials by or to a bank; Selling or disposing off or buying any property by or to a bank; Leasing of any property by or to a bank;

Availing or rendering of any services by or to bank (this will include all banking services); Appointment of any agent for purchase or sale of goods, materials, services or property by or to a bank;

Any related party's appointment to any office or place of profit in bank or its subsidiary company or its associate company (where bank holds more than 20% shareholding); Underwriting the subscription of any securities or their derivatives of bank by a related party.

Leasing of bank's owned premises to some subsidiary or associate company or other related party or taking on lease premises owned by some subsidiary or associate company or other relatedparty.

A contract or arrangement with a subsidiary or associate company.

A contract or arrangement with some private company in which bank's director is a member or director.

Appointment of a relative of a director or bank or a subsidiary or associate company.

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