



**Da Afghanistan Bank**  
**Banking Supervision Department**

**Enforcement Regulation**

**March 2021**

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## **Summary**

Da Afghanistan Bank (DAB) issue a regulation on enforcement.

The circulation of the regulation for comment is consistent with Article 3 of the Decree Law of Banking in Afghanistan (Banking Law), which requires that a regulation be published in the manner “best calculated to bring the regulation to the attention of the domestic banking industry.” If DAB determines that the delay in issuing a regulation that would be caused by circulating the regulation for public comment would be a “serious threat to the interests of the banking system” it may forego this requirement. In the case of this regulation, DAB chooses to circulate the regulation for public comment.

## **Purpose of rule**

The purpose of the regulation is to give guidance to banks on how to conduct operations in a sound and prudent manner by providing examples of particular actions deemed unsound and imprudent. The regulation further inventories the options that DAB has to respond to such actions.

## **Background and summary of rule**

The regulation implements Articles 46 through 52 of the Banking Law in establishing various procedures of enforcement mechanisms to apply in response to unsafe or unsound practices of problem bank situations caused by financial weakness, poor management or operating in violation of the law. A wide range of actions and conditions, ranging from operating with inadequate capital, to engaging in hazardous lending and lax collection practices to operating without adequate internal controls are considered unsound or imprudent. Additionally, various types of inaction, including failure to keep accurate financial records and to make provision for an adequate allowance for credit losses are considered unsound or imprudent.

When faced with a financial institution operating in an unsound or imprudent manner, DAB can, depending upon the severity and urgency of the circumstances, issue a written warning, a written supervisory order or issue a plan to take corrective action or to take prompt corrective action. The procedures for a formalized plan to take corrective action are detailed in the regulation. Finally, use of extraordinary measures, as set forth in Article 48 of the Banking Law, is also addressed in the regulation.

## **Enforcement Procedures**

### **Legal base: Article eight banking law**

#### **Part 1: General**

#### **Article 1: Authority**

This regulation on enforcement procedures is pursuant to the authority granted to DAB by Articles 46 through 52 of the Decree Law of Banking in Afghanistan (Banking Law).

#### **Article 2: Definitions.**

In this subpart the following terms shall have the meanings assigned:

- (1) *adequately capitalized institution* – a financial institution whose capital ratios are in compliance with DAB requirements, but is not well-capitalized.
- (2) *critically undercapitalized institution* - a financial institution whose regulatory capital to risk-

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weighted assets ratio is less than 6%, or whose core capital to risk-weighted asset ratio is less than 3%.

- (3) regulatory capital to risk-weighted assets ratio is less than 8% or whose core capital to risk-weighted asset ratio is less than 4%, but is not critically undercapitalized.
- (4) *solvency or liquidity of a bank is threatened* - with regard to capital insolvency, being classified as an undercapitalized institution as defined under this regulation; and with regard to liquidity insolvency, having difficulty meeting the legitimate claims of depositors or other creditors, defined as a quick ratio of 10% or less and broad liquidity ratio of 7% or less, as defined in Regulation Five.
- (5) *undercapitalized institution* – a financial institution whose capital in either category is less than the required level, but is not critically or significantly undercapitalized.
- (6) *unsound or imprudent manner* - any action or inaction that is contrary to generally accepted standards of prudent operation and if continued would present an abnormal risk of loss or damage to an institution.
- (7) *well capitalized institution* – a financial institution whose regulatory capital to risk-weighted assets ratio is greater than 14% and whose core capital to risk-weighted asset ratio is greater than 7%.

### **Article 3: General goals and objectives.**

This regulation aims at the following:

- (1) To set forth a transparent process that DAB will follow to intervene in a timely manner in applying enforcement measures against financially weak or poorly managed banks or banks operating in violation of the Banking Law or regulations issued by DAB under that law.
- (2) To set forth standards used and sample practices that will trigger enforcement against institutions whose solvency is threatened, whose operations are conducted in an unsound or imprudent manner or who are operating in violation of the Banking Law or regulations issued by DAB under that law.

## **Part 2: Unsound or Imprudent Practices**

### **Article 4: Actions Deemed Unsound or Imprudent**

The Banking Law details a number of preliminary actions that DAB should undertake if it determines that a bank is about to conduct or is conducting its operations in an “unsound or imprudent manner.” Section 8.1.2 above sets forth a general definition for this concept and the following examples are intended to give guidance in the form of particular actions deemed unsound or imprudent:

- (1) Engaging in hazardous lending and lax collection practices which include, but are not limited to, extending credit which is inadequately secured; extending credit without first obtaining complete and current financial information; extending credit in the form of overdrafts without adequate controls; and extending credit with inadequate diversification of risk.
- (2) Operating without adequate liquidity, in light of the bank's asset and liability mix.
- (3) Operating without adequate internal controls including failing to maintain controls on official checks and unissued certificates of deposit, failing to segregate duties of bank personnel, and failing to reconcile differences in correspondent bank accounts.

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- (4) Engaging in speculative or hazardous investment policies.
  - (5) Paying excessive dividends in relation to the bank's capital position, earnings capacity and asset quality.

**Article 5: Inaction Deemed Unsound or Imprudent.**

The following examples are intended to give guidance in the form of particular inaction deemed unsound or imprudent:

- (1) Failure to provide adequate supervision and direction over the administrators of the bank to prevent unsafe or unsound practices, and violation(s) of laws, rules and regulations.
- (2) Failure to make provision for an adequate allowance for credit losses.
- (3) Failure to post the general ledger promptly.
- (4) Failure to keep accurate books and records.
- (5) Failure to account properly for transactions.
- (6) Failure to enforce programs for repayment of loans.
- (7) Failure to obtain or maintain on premises evidence of priority of liens on loans secured by real-estate.

**Article 6: Conditions Deemed Unsound or Imprudent.**

The following examples are intended to give guidance in the form of particular conditions deemed unsound or imprudent:

- (1) Inadequate amount of capital for the amount, kind and quality of the assets held.
- (2) Maintenance of unduly low or negative net interest margins.
- (3) Excessive overhead expenses.
- (4) Excessive volume of credits subject to adverse classification or past due.
- (5) Excessive net loan losses.
- (6) Excessive volume of fixed and other non-earning assets.
- (7) Excessive large liability dependence.

**Part 3: Inventory of Actions at the Disposal of DAB**

**Article 7: Written Warning**

The first step in enforcement actions is to issue a written warning to the bank pursuant to Article 46.1 of the Banking Law. The warning, which may be issued on the basis of inspection findings, puts the bank's management on notice that the bank is operating in an unsound or imprudent manner or is violating a law or a regulation.

**Article 8: Written Supervisory Order (WSO)**

If the written warning does not elicit corrective action, DAB can serve the bank a WSO pursuant to Article 46.2 of the Banking Law. A WSO is a request to the bank's management board to present a plan with specific written commitments to take corrective action in response to problems or

concerns identified by DAB. If the bank fails to present a plan, if DAB deems the plan to be unacceptable, or if the bank does not take the corrective action as promised in the plan, then preventive action has not worked and DAB needs to pursue more severe, more formal enforcement action.

**Article 9: Plan to Take Corrective Action (PTCA)**

If more formal measures are required, DAB can request that a bank present PTCA, as detailed in Article 47 of the Banking Law. These are formal written supervisory agreements developed by DAB and the bank’s Management Board and the Board of Supervisors and accepted by DAB. As the law provides, DAB may use a PTCA to require a bank to cease any statutory or regulatory violation or unsafe practice. The agreements may also require affirmative corrective action to address any existing violations, management or operational deficiencies, or other unsound practices.

**Article 10: Order to Take Prompt Corrective Action (PCA)**

- (1) If the supervisory agreement is not fulfilled, and corrective action is urgently required, DAB may issue an order to take prompt corrective action (cease and desist order) as detailed in Article 48 of the Banking Law. These orders may require the bank to stop or undertake a variety of actions, including suspending borrowing or deposit taking, removing an administrator, freezing existing deposits or increasing capital.
- (2) DAB may also impose a fine on the bank, not to exceed one percent of the sum of common stock and share premium on common stock of the bank.

**Article 11: Summary of Capital Categories, CAMELS Ratings, Corrective Measures**

CAMELS	Well	Adequate	Under	Sign. Under	Critic. Under
3	Warning	Warning	WSO	N/A	N/A
4	N/A	N/A	WSO PTCA	PTCA PCA	N/A
5	N/A	N/A	PTCA PCA	PTCA PCA	PTCA PCA

In general, a CAMELS rating of 3, 4, 5 leads to a presumption that an enforcement action is warranted.

N/A = Specific combination of capitalization and CAMELS is unlikely

**Part 4: Plan to Take Corrective Action**

**Article 12: Contents of a Plan to Take Corrective Action**

- (1) PTCA must contain the following elements:
  1. an analysis of causes of the worsening of the financial standing or unprofitable activity of the financial institution, in particular addressing the violations and deficiencies noted in the most recent report of examination undertaken by DAB;
  2. specific corrective measures to be taken, including specific goals to be achieved and realistic projections as to the time period within which such achievement is expected;
  3. realistic projections of improvements in the financial institution’s financial condition

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- that are expected to be achieved on carrying out of the indicated measures;
4. a quarterly budget of income and expenditures, with procedures for reconciling variances between actual and projected income and expenses; and
  5. timeframes (no less than quarterly) under which the financial institution must submit periodic reports to DAB on its progress in meeting the requirements of the plan.
- (2) Depending upon the causes of the capital deficiency or asset quality problems, the plan also must include measures to achieve the following goals, insofar as they are applicable to the financial institution's capital situation:
1. forming reserves for possible losses on loans and other assets at necessary amounts;
  2. diversifying assets;
  3. closing unprofitable branches;
  4. developing a plan to improve the quality of credit granting, monitoring the progress of repayments of credits, and addressing adversely classified assets;
  5. improving the collection of past due credits; and
  6. disposing of unprofitable investments.
- (3) With regard to issues other than capital and asset quality, the plan also must include measures to achieve the following goals:
1. applying measures with regard to creation and subsequent intensive development of the internal audit function;
  2. revising the institution's accounting/management information system to make it possible for the institution's management to obtain immediate information regarding the institution's asset portfolio (including, in particular, for loan, the borrower's name, outstanding balance, whether the loan is current or past due, and the amount of any accrued interest); and
  3. reviewing the financial institution's management structure, with a view toward streamlining and enhancing its efficiency, and to make necessary changes based on this review.
- (4) A financial institution under a PTCA shall submit reports, no less frequently than quarterly, to DAB, regarding its progress of implementing the plan. DAB may require more frequent reports if it determines this to be necessary based on the financial condition of the institution.
- (5) In the event that an undercapitalized financial institution becomes significantly undercapitalized, DAB may require the institution to amend its plan.

### **Article 13 Restriction on Activities of Undercapitalized Institutions**

- (1) An undercapitalized financial institution may not:
1. pay dividends or distribute profits in any other form;
  2. increase its risk-weighted assets (including on balance sheet and off-balance sheet items that are risk weighted) more than 5% per fiscal year;
  3. establish new branches or engage in new lines of business without the approval of DAB, based on a determination that such action would be consistent with, and would further

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- the goals of, the plan to take corrective action; or
4. buy back any shareholders 'stock.
- (2) A significantly undercapitalized or critically undercapitalized financial institution is prohibited from doing any of the items in subparagraph a), and, in addition, may not:
1. attract new deposits;
  2. pay interest rates on deposits in excess of market rates;
  3. invest in securities of other legal persons;
  4. increase risk-weighted assets (including on balance sheet and off-balance sheet items that are risk weighted) more than 1.25% per quarter.
  5. increase the salary or other form of compensation, or pay any bonus to any member of the financial institution's board of directors or persons with power of management;
  6. engage in transactions with related persons of the institution, as defined in DAB Regulation Four issued pursuant to the Banking Law.

The restrictions of this subparagraph also apply to undercapitalized institutions that fail to submit a plan to take corrective action within the time period required by this Notification, or fail to implement a plan approved by DAB. DAB may also impose any of the restrictions in this paragraph on an undercapitalized institution if it determines such restrictions to be necessary in order to successfully implement the plan to take corrective action approved by DAB.

- (3) The restrictions in subparagraphs a) and b) shall become applicable at the time that the financial institution's capital position becomes known to the board of directors or management of the institution.

#### **Article 14: Termination of a Plan to Take Corrective Action**

- (1) On the termination of the time period specified in a plan to take corrective action (which cannot be more than one year), DAB shall make a conclusion as to the further activity of the financial institution.
- (2) The plan to take corrective action can be terminated early in the case of successful implementation of the measures specified in the plan. A plan to take corrective action cannot be terminated unless the financial institution has been restored to the required capital adequacy ratios and addressed any other deficiencies recognized in the plan to take corrective action. This must be confirmed by the reported materials and a full-scope examination of the institution.
- (3) In the event of failure to implement the plan, DAB has the right to take any enforcement or other measures specified in the Banking Law that it deems appropriate, including an order to take prompt corrective action, placement into conservatorship, revocation of banking license and forced liquidation.

### **Part 5: Use of Extraordinary Measures**

#### **Article 15: Circumstances Warranting Extraordinary Measures**

- (1) Article 48 of the Banking Law enumerates a variety of powers that DAB has at its disposal in



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order to take prompt corrective action, some of which are considered extraordinary measures. These are measures that should only be considered by DAB in the most extreme cases of financial or operational distress. Article 48.4, requires that DAB issue specific guidelines regarding the use of select extraordinary measures, specifically where:

- DAB may order the bank not to repay any money on deposit or advance (moratorium on liabilities).
  - DAB may order the bank not to pay or transfer any amount to any person, or order the bank not to create an obligation, contingent or otherwise, to do so (moratorium on transfers and obligations).
- (2) These extraordinary measures can be undertaken if the appointment of a conservator under Article 54 of the Banking Law is considered imminent by DAB or if there are indications that the bank has engaged in criminal activities that may jeopardize the financial standing of the bank.

### **Part 6: Effective date of regulation**

#### **Article 16: Publication in DAB web site**

This regulation will become effective upon its adoption by the supreme council of DAB.