Da Afghanistan Bank

Banking Supervision Department

Asset Classification and Provisioning Regulation

March 2021

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Part 1: General

Article 1: Authority

This regulation on Asset Classification and Provisioning is pursuant to the authority granted to DAB by Article 70 and 177 of Banking Law.

Article 2: Applicability

This regulation is applicable on all conventional banking institutions, licensed by Da Afghanistan Bank (Central Bank of Afghanistan).

Article 3: Aims and Objectives

(1) This regulation aims at the following:

1. To collect reliable information on the total capital and assets of the bank, used for calculating economic normative regulating banking activities.
2. For the purpose of calculating the amount of provision for losses to be deducted as an expense item in calculating profit.

(2) The objectives of this regulation are as follow:

1. Banks are encouraged to form a general reserve for losses on Standard loans to their clients.
2. Banks shall form a specific reserve for losses on Watch, Substandard, Doubtful and loss assets.
3. Reserve for losses must be formed in sufficient amounts, based on the classification process and other relevant information.
4. Objective and subjective criteria for asset classification to be defined.

(3) Based on the results of supervision, DAB can require banks to adjust its assets classification as well as its reserve for losses in accordance with Part B herein.

Article 4: Definitions

In this regulation, unless, the context otherwise requires:

(1) **Asset**: refers to credits extended to others from Banks's perspective in the form of loans, securities, contingent liabilities or other assets.

(2) **Bai-Jaizi:** is temporarily transferring the ownership right of collateral to the lender through legal process until the settlement of the credit. The lender can only sell the collateral through due judicial process in case the borrower defaults.

(3) **Borrower (Obligor):** refers to individual or legal entity that is obliged to pay credit/credit plus interest.

(4) **Capitalization of interest:** agreements, understandings or courses of conduct between a bank and its borrower under which unpaid interest due on an outstanding loan is added to the principal amount of such loan with the intention that the borrower will pay the full amount of the accumulated principal at a later date. The effect of capitalizing interest is that the borrower ends up paying interest on the accumulated (but unpaid) interest.

(5) **Collateral:** is a property (movable/immovable) that a borrower offers as a way for a lender to secure the loan. If the borrower stops making the promised loan payments, the lender can seize the collateral to recoup its losses.

(6) **Contingent Liability:** also referred to as off-balance sheet items means:

1. a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non- occurrence of one or more uncertain future events not wholly within the control of the enterprise; or
2. a present obligation that arises from past events but is not recognized because:
   2.1. It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
   2.2. The amount of the obligation cannot be measured with sufficient reliability.
3. And includes letters of credit, letters of guarantee, bid bonds/performance bonds, advance payment guarantees and under writing commitments.

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

(8) **Eligible collateral (Readily Marketable Collateral):** defined in Article 6, b, 29 of this regulation as per paragraph 145 of International Convergence of Capital Measurement and Capital Standards – A Revised Framework, dated June 2006 and issued by the Basel Committee on Banking Supervision, is commonly referred to as Basel II.

(9) **Immovable Property**: means property that could not be moved without decomposition and change in shape and substance and include house, building, land and fixed assets.

(10) **In the process of collection of a debt**: is proceeding in due course either:

1. Through legal action against the borrower, including judicial enforcement procedure; or
2. Under appropriate circumstances, through other efforts not involving legal action, and is reasonably expected to result in repayment of the debt or in its restoration to current status through payment of the principal and interest due.

(11) **Items subject to classification:** claims on financial institutions, underwriting commitments, loans, off-balance sheet items, securities, contingent liabilities, credit substitutes, placements and other assets.

(12) **Loan rescheduling/restructuring:** a practice that involves rescheduling/restructuring the terms of an existing loan that is classified as doubtful, in order to ease payment of loan.

(13) **Medium Credit**: is a loan that its amount is greater than AFN 5,000,000 and less then AFN 15,000,000 or equivalent in other currencies;

(14) **Micro Credit:** is a loan which its amount is equal or less than AFN 500,000 or equivalent in other currencies;

(15) **Movable Property**: means property that could be moved without decomposition and any change in substance and form and include the tangible (goods) and the intangible such as documents of title, securities, receivables, copyrights, trademarks and patents.

(16) **Non-Performing Asset (NPA):** means an asset which is classified as doubtful and loss.

(17) **Other form of security:** means hypothecation of stock (Inventory), assignment of receivable, lease rentals, contract receivables.

(18) **Overdraft (OD):** refers to loans that is issued for the purpose of working capital only and is subject to monthly interest payment and other charges but is not subject to monthly installments.

(19) **Past Due (Overdue) Assets:** are loans or other assets that on which:

1. Principal or interest payments are due and unpaid 31 days or more; or
2. Interest payments equal to sum of 31 day's interest or more have been capitalized, refinanced, or prolonged.
3. Loans without pre-established repayment schedules are considered past due when any of the following conditions are met:
   3.1. The amount advanced exceeds the customer's approved borrowing line for more than 30days;
   3.2. Interest is due and unpaid for 31 days or more; or
   3.3. The account has been inactive for more than 30days.

(20) **Placement:** is placement of bank funds at another bank in the form of demand deposit, interbank call money, time deposit, certificate of deposit, credit, and other similar fund placement.

(21) **Repossessed asset:** is the asset or collateral which the creditor takes possession of it through legal process in case of borrower's default.

(22) **Reserve for losses:** a contra asset account that is intended to absorb estimated losses in the bank's portfolio of assets subject to classification, or a liability account that is intended to absorb estimated losses in off-balance sheet items subject to classification. (Reserve for losses means the same as provision for losses.)

(23) **Small Credit:** is a loan which its amount is greater than AFN 500,000 and less than AFN 5,000,000 or equivalent in other currencies;

(24) **Term Loan:** a specific amount of loan that has specified repayment schedule (installments), interest rate and maturity date.

(25) **Underwriting commitments:** mean commitments given by commercial banks/depository financial institutions to the limited companies at the time of the issuing of equity/debt instrument, that in case the proposed issue of equity/debt instrument is not fully subscribed, the un-subscribed portion will be taken up by them (commercial banks/depository financial institutions).

(26) **Well Secured:** A credit facility will be considered well secured (fully Secured) if the following characteristics are met:

1. All documentation is binding on all parties and is legally enforceable as determined by sufficient legal review by the bank to verify this legal certainty.
2. The bank has the right to liquidate or take legal possession of the collateral in a timely manner in the event of default, insolvency or bankruptcy.
3. The bank has taken all necessary steps to perfect and maintain the bank's security interest in the collateral.
4. The "estimated recoverable amount" of the collateral exceeds the amount of the credit exposure including the costs of liquidation.

5. The collateral shall have market value equivalent to determined loan to value (LTV) ratio or more of the principal amount of credit approved.

Article 5: Credit Risk Management

Licensed banks shall be required to maintain sound and acceptable policies and practices to prudently manage and control their credit portfolio and exposure to credit risks. The credit risk management should provide, at minimum, a credit policy and credit review process.

Part 2: Asset Classification

Article 6: Provisions for Asset Classification

(1) On monthly basis, all banks must self-classify each of their loans, securities, contingent liabilities or off-balance sheet items and other assets to provide reserve for losses within one of the five categories set forth below. These self-classifications must be documented, with justifications given for the classifications, in the bank's files, and the classification documents must be signed by the individual responsible for performing the classifications and the individual responsible for reviewing their accuracy. In making the decision to classify an asset within one of the five classification categories listed below, a bank shall use its informed judgment but must be guided by the standards and components set forth below with respect to each such category.

Self-Classification of assets by banks shall be subject to review by DAB. Differences between classification decisions of DAB with respect to any asset and that of the classifying bank shall be subject to negotiation between them, but the classification decision of DAB shall be final for all purposes.

Where any part of a credit risk exposure, whether principal or interest, goes in arrears or its credit quality deteriorates to such an extent that it requires to be classified into a category other than Standard, the total amount of the credit risk exposure must be reclassified to the worst classification of any part of the credit risk exposure, and not merely the proportions which is/are in arrears.

(2) Following are general provisions:

1. Banks shall classify their loans, securities, contingent liability and other assets by its maturity term and qualitative perspective. In addition, banks should conduct thorough assessment of the borrower's capacity, character, capital, collateral and condition, and all necessary information on the borrower's credit worthiness before credit approval.
2. To estimate qualitative performance of any assets, Banks shall receive borrower's financial statements on annual basis and shall perform due analysis and evaluation.
3. For asset which is being investigated by legitimate detective authority because of it might be obtained through criminal offensive activities, provisioning shall be done for subjected asset. Amount of provision is subject to the discretion of bank's management.
4. For the reasons, borrower's financial solvency is being deteriorated or borrower is unable to meet the payment schedule (default occurs) according to initial contract/agreement. Banks may take the following actions for initial conditions amended assets:
   a. lower interest rate;
   b. forgive or deduct accrued interest payment;
   c. extend maturity date;

d. decrease the limit (OD),

5. Banks cannot change the type of credit, unless the customer closes the current credit and requests for a new one. Banks should process the new credit request of customer in normal manner.
6. Banks cannot increase the borrowing limit of the existing customers without due diligence and proper analysis of the application.
7. If any assets to borrower and its related body in banks or their assets in other banks are qualified as nonperforming assets, banks shall perform reclassification on the assets attributable to that particular borrower and its related body. When doing so, reclassification should be only one class above the lowest class of the borrower's assets in particular bank and others.
8. In case, banks jointly provide credit to one particular borrower, one of the banks will take the lead of the credit. It must be clearly defined in the contract/agreement.
9. To eliminating potential risks, movable collateral shall be insured by a reputable insurance company and insurance document shall be filed in related loan file.
10. Ownership of all immovable collateral shall be transferred through Bai Jaizi (بیع‌جایزی), to the bank.
11. Further requirements of both movable and immovable property shall be determined through DAB circular from time to time.
12. Banks should disburse overdraft facility in the borrower's current account. All transactions and calculation of interest for the borrower should be recorded in that account only. Banks should not extend Overdraft facility in borrower's personal account.
13. Banks are required to set "write-off" policy on their bad/loss loans and submit the updated list of loans written off from balance sheet and report their recovery status to DAB on regular basis.
14. A bank must accrue interest on interest-earning assets on a monthly basis if the frequency of actual payment by the obligor is less than monthly. Interest received on past due loans shall be recognized as income.
15. In case, a portion of a credit is insured by an organization/donor (domestic or foreign) through guarantee scheme acceptable to DAB, the borrower shall insure the non-secured portion by additional collateral.
16. The following collateral instruments are eligible for recognition as eligible collateral (readily marketable collateral):
    a. Cash (as well as certificates of deposit or comparable instruments issued by lending bank) on deposit with the bank which is incurring the counter party exposure;
    b. Gold;
    c. Debt securities not rated by a recognized external credit assessment institution where these are:
        i. Issued by a bank;
        ii. Listed on a recognized exchange;
        iii. Classified as senior debt; and

iv. All rated issues of the same seniority by the issuing bank must be rated at least BBB- or A-3/P-3 by a recognized external credit assessment institution; and

v. The bank holding securities as collateral has no information to suggest that the issue justifies a rating bellow BBB- or A-3/P-3 (as applicable); and

vi. The supervisor is sufficiently confident about the market liquidity of the security.

d. Equities (including convertible bonds) that are included in a main index.

e. Undertakings for collective investments in transferable securities and mutual funds where;

i. A price for the units is publicly quoted daily; and

ii. The transferable securities and mutual fund is limited to investing in the instruments listed in this paragraph.

iii. Acceptable guarantee or counter guarantee issued by a highly regarded and reputable financial institution.

f. Acceptable guarantee or counter guarantees of countries which will be provided by the circulars of Da Afghanistan Bank from time to time.

Article 7: Classification Categories

There are five loan classification categories as set forth below:

(1) Standard

An asset classified as Standard is paying in a current manner or at most past due for the period of 1-30 days, fully secured and is supported by sound net worth, profitability, liquidity and cash flow of the obligor.

Standard assets are sufficiently secured with respect to the repayment of both the principal amount and interest. An overdraft would be regarded as Standard if monthly interest payments and other charges are past due for 1-30 days, and there was regular activity on the account with no sign of a hard core of debt developing.

(2) Watch

An asset should be classified as Watch if the principal and/or the interest remain outstanding for 31-60 days.

An asset classified as Watch is adequately protected, but is potentially weak. Such an asset constitutes an unwarranted credit risk, but not to the point of requiring a classification of Substandard. The credit risk may be minor, and most instances, bank management can correct the noted deficiencies with increased attention.

Assets must be classified no higher than Watch if any of the following are present:

1. the bank loan officer's inability to properly supervise them due to lack of expertise;
2. the loan was not made in compliance with the bank's internal policies;
3. Failure to maintain adequate and enforceable documentation; or poor control over collateral.
4. Assets that are past due 31-60 days for principal or interest payments.

Under no circumstances should a Watch classification be utilized as a compromise between Standard and Substandard.

(3) Substandard

An asset should be classified as Substandard if the principal and/or the interest remain outstanding for 61-120 days.

Overdrafts are considered Substandard when the advances exceed the customer's borrowing line for 61-120 consecutive days or the borrowing line has expired for 61- 120 days or interest is due and unpaid for 61-120 days and deposits are insufficient to cover the interest capitalized during the period.

Substandard loans and advances show clear manifestations of credit weaknesses that jeopardize the liquidation of the debt. Substandard loans and advances include loans to borrowers whose cash flows are not sufficient to meet currently maturing debts, loans to borrowers which are significantly undercapitalized, and loans to borrowers lacking sufficient working capital to meet their operating needs.

Assets must be classified no higher than Substandard if any of the following deficiencies of the obligor are present:

1. Inadequate liquidity
2. cash flow less than repayment of principal and interest
3. If the primary sources of repayment are insufficient to service the debt and the bank must look to secondary sources of repayment, including collateral.
4. If the bank has acquired the asset without the types of adequate documentation of the obligor's net worth, profitability, liquidity, and cash flow that are required in the banking organization's lending policy or there are doubts about the validity of that documentation.
5. If default occurs to "initial conditions amended asset" the asset should be classified at least in Sub-standard class.

(4) Doubtful

Defaulted assets and advances for which the principal and/or the interest remain outstanding for 121-480 days shall be classified Doubtful.

Doubtful loans and advances display all the weakness inherent in loans and advances classified as Substandard but with the added characteristics that they are not well

secured and the weaknesses make collection or liquidation in full, on the basis of currently available information, highly questionable and improbable.

The possibility of loss is extremely high, but because of certain mitigating circumstances, which may work to the advantage and strengthening of the facility, its classification as an estimated loss is postponed until its more defined status is ascertained.

Assets must be classified no higher than Doubtful if any of the following deficiencies of the obligor are present:

1. operational losses, including the necessity to sell assets to meet operating expenses;
2. illiquidity;
3. Cash flow less than required interest payments;

4. doubts about true ownership;
5. Complete absence of faith in financial statements;
6. If the advance amount exceeds the customer's approved borrowing line for 121 consecutive days or more.
7. If the account has been inactive for 121 days or more and the customer's deposits are insufficient to cover the interest capitalized during that period.
8. If the market value of collateral has dropped to an extent that its coverage ratio is below 60% of payment of principal and accrued interest, the relevant asset shall be classified into Doubtful classification regardless of its terms performance when borrower's solvency is being deteriorated or bankrupted.

(5) Loss

Defaulted assets and advances for which the principal and/or the interest remain outstanding for 481 or more days shall be classified as Loss.

Loans and advances shall be classified as Loss when they are considered uncollectible and of such little value that their continuation as recoverable facilities are not defensible. This classification does not imply that the facility has absolutely no recoverable value, but rather it is not practical or desirable to defer making full provisions for the facility even though partial recover in future may not be entirely ruled out.

Loans and advances classified as Loss include those to bankrupt companies and insolvent firms with negative working capital and cash flow or those to judgment debtors with no means or foreclosable collateral to settle the debts.

Banks should retain such facilities on their books for the period of no more than 12 months, while pursuing future recoveries and 100 percent loan loss provisioning should be made. After 12 months, they shall be written off immediately (via a credit to the asset balance on the balance sheet) against the loan loss provisioning made.

Assets must be classified no higher than Loss if any of the following deficiencies of the obligor are present:

(1) The obligor seeks new loans to finance operational losses.

(2) Location in an industry that is disappearing.

(3) Is bankrupt or does not have physical existence;

(4) Location in the bottom quartile of its industry in terms of profitability.

(5) Technological obsolescence.

(6) Very high losses.

(7) Borrower resorts to sale assets at a loss to meet operational expenses.

(8) Total revenue less than production costs.

(9) No repayment source except liquidation.

(10) Presence of money laundering, fraud, embezzlement, or other criminal activity.

(11) Owners are not prepared to inject fresh capital.

Asset classification criteria are summarized below:

Asset Classification	Objective Criteria	Reserve for loss required
Standard	A performing asset which is being repaid in accordance with the contract or at most past due for 1-30 days	1 percent (Optional)
Watch	31-60 days past due status (most favorable classification - could be lower based on qualitative criteria).	At least 5 percent
Substandard	61-120 days past due status (most favorable classification - could be lower based on qualitative criteria).	At least 25 percent
Doubtful	121-480 days past due status (most favorable classification - could be lower based on qualitative criteria).	At least 50 percent
Loss	481 days or more past due status	(This category of loans shall be retained in bank balance sheet for the period of 12 months for recovery purposes and 100 percent loan loss provisioning should be made. After the period, they shall be immediately written off with the provisions made.)

Table 1

Placements/deposits with other banks/financial institutions for fixed term to earn interest for period of 1 month or more, fall under credit definition and are subject to classification and provisioning. Banks must prepare clear policies on this purpose by which they could assess and manage related risks. Classification and provisioning of placements would be determined by DAB circular.

Article 8: Classification of Micro and Small Credit

The objective criteria for micro and small credits are as below:

Class	Past due	Provision
Standard	0-30 days	1 percent (Optional)

Watch	31-60 days	5 percent
Substandard	61-90 days	25 percent
Doubtful	91-180 days	50 percent
Loss	181 or above	100 percent

Table 2

Banks shall consider subjective criteria as elaborated in this regulation while classifying micro and small credits. Collateral requirements of these loans would be determined by relevant circular.

Article 9: Suspension of Interest on Nonperforming Assets and Advances

The following conditions shall apply to accrual and suspension of interest on all loans and advances classified as Doubtful or Loss, thus constituting them as NPA:

(1) All categories of non-performing loans and advances classified as Doubtful and Loss shall be placed on non-accrual status and the interest shall not be taken as income when earned. However, claims on these credits can be recorded separately for future recoveries and legal purposes.

(2) The previously accrued and uncollected interest on such assets but taken as income shall be reversed by debiting the income statement and crediting an "Interest-In- Suspense" account. Subsequent accrual of interest shall be credited to the interest in suspense account until such loans and advances are brought current by full settlement of the delinquent principal and interest.

(3) Interest can only be taken out of suspense when it has actually been paid by the debtor. However, the funds for the repayment of the delinquent loans and advances shall not be obtained through new loans and advances from the same financial institutions.

(4) Payments made for repayment of the loans and advances should be applied first to penal and other charges, interest and then the principal.

Article 10: Provisions for Loan Losses

The provisions to be made against the loans and advances depend on the classification of each asset. Minimum provisions shall be made as follows:

Banks may establish reserves in amounts higher than the minimums required, if the facts warrant. The classification of assets and the concomitant determination of the sufficiency of the reserve must be reviewed not less than monthly.

(1) All adjustments to classifications and the reserve for losses, and all accrued provisions and reintegrated provisions necessary to make these adjustments to the reserve, must be made in the same reporting period. In no case shall a bank adjust its classifications during one month and make the necessary provisions in a subsequent period.

(2) The amount of the reserve must be based on facts and circumstances as of the evaluation date, and after charge-off of all assets or portions of assets classified Loss.

(3) Banks must continue to make reasonable efforts to collect on assets that are charged off. The act of charging off does not eliminate the obligor's contractual responsibility to fully repay the principal balance and accrued but unpaid interest on the asset.

(4) Any new loan to a given borrower must be initially classified under the same category as the most adversely-classified previous outstanding loan to the same borrower.

(5) Banks may move an asset that is not classified bellow Sub-Standard to a more favorable classification category, and reintegrate the provision and reduce the reserve for losses, only if the bank can satisfactorily demonstrate that the asset's quality has improved significantly, and an explicit, written decision of the bank's credit committee outlining the justifications for the more favorable classification is placed in the asset's file.

Article 11: Repossessed Assets

Banks can repossess assets as per Article 67.2 of Banking Law with prior authorization of DAB. They shall repossess collaterals of their borrowers that are classified nonperforming assets as below:

(1) To foreclose the collateral, banks shall sell the property through court process. If they fail to find the competent buyer, banks can repossess the property following legal processes.

(2) The property repossessed by bank, shall be recorded in the books of the bank at the date the title deed is transferred to the bank.

(3) Banks shall transfer the determined value (final Mahzar value) of collateral from loan account to repossessed account on the balance sheet.

(4) Repossessed assets are neither held for business purposes nor for bank usage and are only kept for the purpose of reselling and banks shall have unrestricted physical possession of property.

(5) Property selling timeline shall not exceed four (4) years and major portion of repossessed assets shall be sold out in first two years. In case, banks fail to sell the property within the given timeline, the property shall be written off from the balance sheet.

(6) Banks supervisory board shall collect reliable information on the quality of these assets and monitor them periodically.

(7) The reserved provisions for repossessed assets shall be recorded under deferred income on the liability side until the actual realization through sale of property occurs.

(8) Banks' risk management (committee) should identify, assess, monitor and analyze the risks associated with repossessing assets for the sake of settlement of loans already classified as doubtful and loss and inform supervisory and management boards.

(9) Banks are required to have written policies on repossessing assets associated with IFRS 5 'Non-Current Assets held for sale and discounted operations.

(10) An extensive and smart sale plan for settlement of claim or debt property shall be made separately for each transaction approved by the bank Supervisory board.

(11) All repossessed assets transactions shall be reviewed by external audit periodically and adequate and appropriate monitoring system shall be established.

(12) All repossessed assets must be reviewed regularly by internal audit and shall be reported on regular basis to audit committee and supervisory board.

(13) All records of repossessed assets shall be kept and be available for DAB examiner's verification.

(14) Repossess arrangements shall not call for any further payments by banks except in case, legal authorities clearly mentioned.

(15) Banks are not allowed to sell the repossessed property to their affiliates or related parties.

(16) Banks at first shall settle outstanding amount on acquisition of property under repossessed assets transaction. The remaining amount shall be recorded as other income/loss in income statement, when the actual sale proceeds are taken place in cash through sale of property.

(17) While acquiring assets title, legal fees, transfer costs and direct costs shall be directly added/ capitalized to the outstanding amount of loan.

(18) Repossessed asset shall be controlled and monitored by the bank.

(19) Total repossessed assets at all time should not exceed 5% of the bank's total assets.

(20) Actual realized gain/loss, provision reversal and loss reduction shall be recognized separately in financial statements and its settlement results through repossession shall be disclosed in financial statement's notes.

Article 12: Rescheduled and Restructured Credit

Banks must have in place written policies which define the circumstances and conditions under which a credit may be rescheduled or restructured. The policies should address the controls to avoid "ever-greening" of credit, including situations where credit may be rescheduled or restructured more than once, and provisioning policies with respect to such credit. In addition:

(1) Banks must reassess the customer's financial position, having regard to all relevant circumstances surrounding the customer's financial condition and prospects for repayment, before a credit can be rescheduled or restructured. In addition, adequate resources must be allocated to closely monitor and follow up on the performance of rescheduled and restructured credit.

(2) Banks shall appropriately classify the rescheduled and restructured facilities based on the assessment of the financial condition of the customer and the ability of the customer to repay based on the restructured terms. Credit that has been rescheduled and restructured shall not lead to improved classification immediately upon perfection of the relevant documentation in relation to the rescheduling and restructuring exercise.

(3) Da Afghanistan Bank acknowledges that in specific and exceptional circumstances, such as when customers are affected by natural disasters, rescheduling and Restructuring exercises may involve the granting of moratorium on credit repayments. As part of sound credit management practices, banks are expected to establish clear parameters and internal processes for the consideration of moratorium on credit repayments, including proper authority for the approval of the moratorium. These processes should also be subject to adequate monitoring and review by an independent function.

(4) Senior management or Credit Committee should receive periodic reports on the performance of rescheduled and restructured credit facilities. The reports should provide adequate information, including default status and the frequency of rescheduling or restructuring for the same customer, to facilitate managements or the committee's oversight of compliance with the bank's internal policies on rescheduling and restructuring and assessment of risks associated with the credit portfolio. Any material impact on the risk profile of the bank should be raised to the Board of Supervisor's attention in a timely manner.

(5) A loan cannot be restructured or/and rescheduled more than once. A restructured/rescheduled loan shall not be upgraded into a better classification category unless the borrower:

1. in case of overdraft facilities, has satisfactorily performed for a minimum of two consecutive months; or
2. In case of term loans, have timely paid two consecutive installments.

(6) Once loans and advances are classified as Doubtful, they shall be reclassified or upgraded merely on the ground of rescheduling or roll-over of payment of interest and principal. The loans and advances shall only be renewed, rolled over or returned to accrual status if the borrower repays all the delinquent interest or/and principle from his own funds prior to the rollover or renewal.

(7) If a borrower subsequently defaults after the rescheduled/restructured loan that has been upgraded to a better category by the bank; the loan shall be declassified in the same category as it was at the time of rescheduling /restructuring. However, banks at their discretion may further downgrade the classification taking into account the subjective criteria. The unrealized interest on such loans taken to income account shall be reversed.

Article 13: Overdraft Conditions

Banks should consider the difference between term loan and overdraft and should grant specific credit in accordance with the customer's nature of business/need. A clear difference for granting term loan and overdraft shall be determined in the credit policy of the banks. Banks must consider the following in their credit policies, but not limited to:

(1) There shall be 5 consecutive day mandatory cleanup in overdraft tenure.

(2) Turnover of the account should be at least 2 times more than the principal amount of overdraft.

(3) DAB, if deem necessary, will determine the percentage of overdraft to total loan portfolio by circular from time to time.

Article 14: Reporting Requirements

Banks shall submit to Da Afghanistan Bank on monthly basis the following statements, but not limited to:

(1) Classification of loans and advances and provisioning and movement in provisions and interest in suspense;

(2) Classification of loans and advances by segments;

(3) Statement of overdue and rescheduled loans and advances and performing and non-performing loans and advances;

(4) Collateral wise distribution of loans and advances;

(5) List of recovery and charged-off loans;

(6) List of adversely classified assets (an asset that has been classified as Substandard, Doubtful or Loss);

(7) List of repossessed assets;

(8) Classification of off-balance items;

(9) Classification of investments and other assets;

(10) And any other information required by DAB.

Article 15: Classification of Off-balance Sheet Items

Banks are required to review their off-balance sheet items monthly, classify them with adequate provisioning. Banks are obliged to have written policies for classification of Off-Balance sheet commitments containing criteria for each category of classification on their own judgment. The factors analyzed in evaluating a loan (financial performance, ability and willingness to pay, collateral protection, and future prospects) are applicable to the review of off-balance sheet items. When evaluating off-balance sheet credit transactions for determining a credit-quality rating, consideration must be first given to whether the bank is irrevocably committed to advance additional funds under the credit arrangement. The appropriate classification must be determined and applied if the bank should continue to fund the commitment and:

(1) A potential weakness exists that, if left uncorrected, may at some future date result in the deterioration of repayment prospects or the bank's credit position, or

(2) There is a well-defined weakness that jeopardizes repayment of a commitment.

The reserve for losses on off-balance sheet items, which is reported as an "other liability" rather than as a contra-asset, must adequately reflect the associated risks. While classification, off-balance sheet items with 100 % cash margin are not subject to provisioning. Where the off-balance sheet items are partially secured by cash margin, banks shall only allocate provision for the unsecured portion.

Banks should issue a written notice of expiry of off-balance sheet commitments to its beneficiary, containing that bank does not have any responsibility after expiry of the commitment and a copy of such notice shall be filed subsequently.

After expiry of off-balance sheet items and if terms and conditions of commitments (LG and/or LC) are not met, banks do not have further obligation and the off-balance sheet items shall be immediately written off from off-balance sheet of the banks.

Article 16: Classification of Investments and Other Assets

Banks are required to classify their investments and other assets monthly. They shall have written policies on classification and provisioning of investments and other assets containing criteria for each category of classification on their own judgment.

Article 17: Capitalization of Interest

No bank shall engage in any capitalization of interest arrangement unless it can demonstrate that:

(1) The debtor will be in a position to repay the loan out of its cash flow within a reasonable time.

(2) The possibility of interest compounding is provided for in the original agreement or was always understood by both parties to be available.

(3) The repayment of the total indebtedness is based upon a planned and reasonably likely future event; and

(4) Any other condition(s) or circumstance(s) deemed appropriate by DAB.

Article 18: Monitoring of Adversely-Classified, Past due, Non-performing Assets and Charged-off Loans

Banks must strictly monitor and keep accurate records of their adversely classified, past- due, nonperforming assets and charged-off loans, in the aggregate and by type of asset, and submit to their Board of Supervisors (or, for a permitted branch of a foreign bank, to the next-higher level of authority outside of Afghanistan) for each of their regularly scheduled meetings, and anytime upon their request, detailed information and analysis concerning these trends.

Article 19: Enforcement

In order to properly enforce this regulation, if needed, DAB will provide specific interpretations and impose additional requirements through circulars.

Article 20: Effective Date of Regulation

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