Da Afghanistan Bank

Asset Classification and Provisioning Regulation

Financial Supervision Department

2015

Table of Contents

Part A: General

1.0 Authority

This Regulation on asset classification and provisioning is pursuant to the authority granted to DAB by Article 35.2.4 of the law of Banking in Afghanistan (Banking Law).

2.0 Applicability

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

3.0 Aims and Objectives

a) 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.

b) 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 must form a specific reserve for losses on Standard, Watch, Substandard, and Doubtful assets.
3. Banks must immediately charge off assets classified asLoss.
4. Reserve for losses must be formed in sufficient amounts, based on the classification process and other relevant information.
5. Objective and subjective criteria for asset classification must be defined.

c) 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.

4.0Definitions

In this regulation, unless, the context otherwise requires:

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

b) 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.

c) **Contingent Liability:**contingent liability also referred to as off-balance sheet itemsmeans:
   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:
      a) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
      b) 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 underwriting commitments.

d) **Underwriting commitments:** mean commitments given by commercial banks/Depository Financial Institutions to the limited companies at the time of theissuing 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).

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

f) **Overdraft (OD):** refers to loans that is subject to monthly interest payment and other charges but is not subject to monthly installments, and that settles for 5 consecutive days each calendar year.

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

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

i) **Board of Supervisors:**Definedas perArticle 49, 50 and 51 of Banking Law of Afghanistan.

j) **Board of Management:**Defined as per Article 56 of Banking Law of Afghanistan.

k) **Audit Committee:**Defined as Article 52 of Banking Law of Afghanistan.

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

m) **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.

n) **In the process of collection:** collection of a debt is proceeding in due course either (1) through legal action against the borrower, including judicialenforcement 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.

o) **Defaulted Asset (Nonperforming asset):**means an asset which is classified Doubtful or Loss.Credits are considered Defaulted Asset when any of the following conditions are met:

1. The amount advanced exceeds the customer's approved borrowing line for 91 consecutive days or more.
2. Interest is due and unpaid for 91 days or more; or
3. The account has been inactive for 91 days or more and the customer's deposits are insufficient to cover the interest capitalized during that period.

p) **Past due (overdue) asset:** a loan or other asset on which:

1. Principal or interest payments are due and unpaid for one day or more; or
2. Interest payments equal to a sum of one day's interest or more has been capitalized, refinanced, or prolonged.

Loans without pre-established repayment schedules are considered past due when any of the following conditions are met:

3. The amount advanced exceeds the customer's approved borrowing line for one day;
4. Interest is due and unpaid for one day or more; or
5. The account has been inactive for more than 30 days.

q) **Provision for losses:** an item of expense that is debited in order to increase the reserve for losses.

r) **Bai Jaizi:** is temporarily transferring the ownership right of the 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.

s) **Eligible Collateral (Readilymarketable collateral):**defined in Article 6,b,24 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.

t) **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. (The term Reserve for losses means the same as provision for losses.)

u) **Well secured (fully Secured):** means a credit facility that has following characteristics:

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 has a current market value equal to 120 percent or more of the principal amount of credit in question.

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

w) **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 placements.

x) **Category A countries:**list of these countries will be provided by the circulars of Da Afghanistan Bank from time to time.

5.0 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 B: Asset classification

6.0 Provisions for asset classification

a) On a quarterly 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 so reclassified to the worst classification of any part of the credit risk exposure, and not merely the proportions which is/are in arrears.

b) Followings 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 and positive information on the borrower's credit worthiness before credit approval.
2. If current market value of collateralized property is sufficient to cover not less than 60% of payment of principal and accrued interest, relevant asset shall be classified one class lower after classification based on section 8.0 of this regulation. If it is insufficient, underlying asset shall be classified as Doubtful or Loss as per section 8.0 of this regulation.

3. To estimate qualitative performance of any assets, Banks shall receive borrower's financial statements on annual basis and shall perform due analysis and evaluation.
4. 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.
5. For the reasons as 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 actions to lower the interest rate, lower the limit (OD), provide discounts (release), or deduct accrued interest payment. It is considered as "initial conditions amended asset"
6. 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.
7. Banks cannotincrease the borrowing limit of the existing customers without due diligence and proper analysis of the application.
8. If default occurs to "initial conditions amended asset"the asset should be classified at least in Substandard class.
9. If any other debt or assets to borrower and its related body in Banks or their assets in other banks are qualified as defaulted assets, Banks shall perform reclassification on the assets attributable to that particular borrower and its related body. When doing so, reclassification outcome class should be not more than 1 class above the minimum class of the borrower's assets in particular Banks and others.
10. In case that several banks have jointly financed one particular project by items in forms of loan, securities and/orcontingent liability, one of the banks will take the lead of the credit. This decision must be clearly defined in the contract/agreement.
11. The value of collateral in Bai jaizi (بیع جایزی), should be at least equal to 120 percent of the credit approved.
12. Banks cannot extend credit classified asSubstandard or below.
13. Banks should extend Overdraft facility in the borrower's current account with the bank, and all transactions and calculation of interest for the borrower should be recorded in that account only.
14. Loan loss provisioning for Overdraft loan, should be calculated on the outstanding balance.
15. Bank should issue a termination letter to borrower, with or without borrowers' request, before closing a loan, security and contingent liability.
16. Banks are required to submit the updated list of loans written off from balance sheet and their recovery status to DAB on a quarterly basis.
17. Interest calculation should be suspended on Defaulted Assets and advances. However, claims on defaulted borrowers can be recorded separately for legal purposes.
18. Beside quarterly classification, Assets shall be reclassified whenever change occurs concerning maturity term and qualitative performance. Internal audit unit

of the Banks shall monitor the enforcement of provisioning requirement under rate specified in this regulation and shall report to Audit Committee.

19. Interest received on past due loans shall be recognized as income, when received.
20. Board of Supervisors shall set “write-off” policy regarding their bad debts.
21. Eligible collateral (Readily marketable collateral): the following collateral instruments are eligible for recognition as eligible 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 counterparty exposure.

    b) Gold

    c) Debt securities not rated by a recognized external credit assessment institution where these are:

        1. Issued by a bank; and
        2. Listed on a recognized exchange; and
        3. Classified as senior debt; and
        4. 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 institutions; and
        5. The bank holding the securities as collateral has no information to suggest that the issue justifies a rating bellow BBB- or A-3/P-3 (as appliclabe); and
        6. The supervisor is sufficiently confident about the market liquidity of the security.

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

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

        1. A price for the units is publicly quoted daily; and
        2. The transferable securities and mutual fund is limited to investing in the instruments listed in this paragraph.
        3. 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.

25. A credit with Fully Secured collateral should be upgraded to better class, if not classified as Loss.

8.0 Classification categories

There are five classification categories as set forth below:

a) Standard

An asset classified as Standard is paying in a current manner, Fullysecured 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 there was regular activity on the account with no sign of a hard core of debt developing.

b) Watch

An asset should be classified as Substandard if the principal and/or the interest remain outstanding for 1-30 days during examination.

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 must be classified no higher than Watch if any of the following deficiencies are present: below-average or declining profitability; barely acceptable liquidity.
5. Assets that are past due 1-30 days during examination for principal or interest payments.

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

c) Substandard

An asset should be classified as Substandard if the principal and/or the interest remain outstanding for 31-90days.

Overdrafts are considered Substandard when the advances exceed the customer's borrowing line for 31-90 consecutive days or the borrowing line has expired for 31-90 days or interest is due and unpaid for 31-90 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. Assets must be classified no higher than Substandard 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 banking organization 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.
6. Overdrafts without pre-established repayment programs are considered Substandard when the advances exceed the customer's borrowing line for 31-90 days and deposits are insufficient to cover the interest capitalized during the period.

d) Doubtful

Defaulted assets and advances for which the principal and/or the interest remain outstanding for 91-360 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. permanent overdrafts,
2. operational losses,including the necessity to sell assets to meet operating expenses

3. illiquidity
4. Cash flow less than required interest payments;
5. doubts about true ownership
6. Complete absence of faith in financial statements.
7. If current market value of collateralized property is sufficient to cover not less than 60% of payment of principal and accrued interest, relevant asset shall be included into Doubtful classification regardless of its term performance when borrower's solvency is being deteriorated or bankrupted.

e) Loss

Defaulted assets and advances for which the principal and/or the interest remain outstanding for 361 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 is 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.

Licensed banks should not retain such facilities on their books while pursuing long-term recoveries. Losses should be taken in the period in which they surface as uncollectible.

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. Location in the bottom quartile of its industry in terms of profitability.
4. Technological obsolescence.
5. Very high losses.
6. Borrower resorts to sale assets at a loss to meet operational expenses.
7. Total revenue less than production costs.
8. No repayment source except liquidation.
9. Presence of money laundering, fraud, embezzlement, or other criminal activity.
10. Owners are not prepared to inject fresh capital.

Asset classification criteria are summarized below:

Table 1

Asset Classification	Objective Criteria	Reserve for loss required
Standard	A performing asset which is being repaid in accordance with the contract.	At least 1 percent
Watch	1-30days past due status (most favorable classification - could be lower based on qualitative criteria).	At least 5 percent
Substandard	31-90 days past due status (most favorable classification - could be lower based on qualitative criteria).	At least 25 percent
Doubtful	91-360 days past due status (most favorable classification - could be lower based on qualitative criteria).	At least 50 percent
Loss	361 days or more past due status	Immediate charge-off against the reserve for losses (100 percent).

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 but should not be considered in calculation of large exposure.

9.0 Rescheduled or rolled-over loans and advances

Once loans and advances are classified as Doubtful or Loss, they shall not 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 from his own funds prior to the roll-over or renewal, and if subsequently there has been a minimum of at least six months' satisfactory performance.

10.0 Suspension of interest on Defaulted Assets and advances

The following regulations shall apply to accrual and suspension of interest on all loans and advances classified as Doubtful or Loss, thus constituting them as defaulted assets.

a) 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.
b) The previously accrued and uncollected interest on such assets but taken as income shall be reversed by debiting the profit and loss account (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.

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

11.0 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:

1. For loans and advances classified as Standard: one (1%) percent of the outstanding balance and one (1%) percent ofoutstanding balance of Overdraft loan.
2. For Watch loans and advances classified as Watch: five (5%) percent of the outstanding balance and five (5%) percent of outstanding balance of Overdraft loan.
3. For loans and advances classified as Substandard: twenty five (25%) percent of the outstanding balance and twenty five (25%) percent of outstanding balance of Overdraft loan.
4. For loans and advances classified as Doubtful: fifty (50%) percent of the outstanding balance and fifty (50%) percent outstanding balance of Overdraft loan.
5. Loss loans and advances: one hundred (100%) percent of the outstanding balance and one hundred (100%) percent of outstanding balance of Overdraft loan.
6. Banks must make provisions for losses and establish reserves for losses in the minimum amounts as set forth in this regulation. Banking organizations 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 quarterly.
7. 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 period (month or quarter) and make the necessary provisions in a subsequent period.
8. 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.
9. Assets classified Loss must be charged off (via a credit to the asset balance on the balance sheet), and the reserve for losses reduced (via a debit) immediately upon determination of Loss status.
10. A banking organization 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.

11. 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.
12. A bank may move an asset 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 significantlythrough a minimum of at least six months' satisfactory performance, 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.

12.0 Rescheduled and restructured credit

Banking institutions must have in place policies approved by the Board of Supervisors 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.

a) Banking institutions 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.
b) A banking institution 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 have 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.
c) 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, banking institutions 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.
d) 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 management's (or the Committee's) oversight of compliance with the banking institution'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 banking institution should be raised to the Board of Supervisor's attention in a timely manner.

13.0OD conditions

Banks should consider the difference between term loan and overdraft and should grant specific credit in accordance with the customer's current financial situation and performance. A clear difference for granting Term Loan and Overdraft should be drafted in the credit policy of banks.Banks must consider the following points in their credit policies:

a) Interest rate of Overdraft must be higher than Term Loan of similar nature.
b) There should be 5 consecutive days mandatory cleanup each calendar yearfor OD loans.
c) Turnover of the account should be at least 3 times more than the principal amount of OD loan.

14.0 Classification of microfinance credit

All conditions of this regulation are applicable on microfinance credit.

Class	**Past due**	**Provision**
Standard	0-30 days	1 percent
Watch	31-60 days	5 percent
Substandard	61-90 days	25 percent
Doubtful	91-180 days	50 percent
Loss	181 or above	100 percent

15.0 Collateral for microfinance and SME credit

Only following collaterals are acceptable for microfinance credits higher than 250000 AFS or its equivalent in other currencies, but a credit backed by collateral is not compulsory, it only affects classification of a credit if not classified as Loss.

a) Eligible collateral (Readily Marketable Collateral)
b) Sharia Deed Title (Qabala-e-sharai)
c) Common Deed Title (Qabala-e-urfi)

16.0Supervisory reporting requirements

Banks shall submit to Da Afghanistan Bank on quarterly basis the following statements:

- Classification of loans and advances and provisioning and movement in provisions and interest in suspense
- Classification of loans and advances by segments

- Statement of overdue and rescheduled loans and advances and performing and non-performing loans and advances.
- Collateral wise distribution of loans and advances
- List of Charged-off loans
- List of adversely classified assets (an asset and/or off-balance sheet item that has been classified as Substandard, Doubtful or Loss.)

17.0 Classification of off-balance sheet items

All banks are required to classify their off-balance sheet items on a quarterly basis and report to Da Afghanistan Bank on monthly basis. The factors analyzed in evaluating a direct 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 must continue to fund the commitment and:

a) 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
b) 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.

Off-balance sheet items should be classified on quarterly basis and provisioning should be made accordingly.

18.0 Interest accruals

a) 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.
b) Banks must suspend the accrual of interest on all interest-earning assets where the principal or interest payments have been past due for periods exceeding 90 days. The loan is then placed on "non-accrual status," and interest income will be recognized only upon payment in cash. The only exception to this rule is when such an asset is both Well-Secured and In Process of Collection.
c) Banks may place an asset on non-accrual status where principal or interest payments have been past due for periods 90or less, if there has been deterioration in the financial condition of the borrower.
d) When an asset is placed on non-accrual status, all accrued but unpaid interest for the current fiscal year must be reversed via a debit to interest income and a credit to a interest suspense account.
e) Banks may restore a non-accrual asset to accrual status only on full repayment of all past-due principal and interest and six months of satisfactory performance thereafter.

19.0 Capitalization of interest

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

a) The debtor will be in a position to repay the loan out of its cash flow within a reasonable time.
b) The possibility of interest compounding is provided for in the original agreement or was always understood by both parties to be available.
c) The repayment of the total indebtedness is based upon a planned and reasonably likely future event; and
d) Any other condition(s) or circumstance(s) deemed appropriate by DAB.

20.0 Monitoring of adversely-classified, past due, non-performing assets and charged-off loans

A banking organization must strictly monitor and keep accurate records of its adversely-classified, past-due, defaulted assets and charged-off loans, in the aggregate and by type of asset, and submit to its 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.

21. Enforcement

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

22. Effective date of regulation

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