



**Islamic Republic of Afghanistan
Da Afghanistan Bank**

Article Twelve: Licensing, Regulation, and Supervision of Depository Microfinance Institutions

Part A — General.

§ 12.1.1. Authority

This regulation on the licensing, regulation, and supervision of depository microfinance institutions (DMFIs) is pursuant to the authority granted to DAB by Articles 2.2.3 and 42.4 of the Law on Banking in Afghanistan (Law).

DMFIs, which take deposits and make loans, would normally be subject to Article 2.1 of the Law, which states that *“no person shall engage in the business of receiving money deposits or other repayable funds from the public for the purpose of making credits or investments for his own account in Afghanistan without a banking license issued by Da Afghanistan Bank...”* However, DMFIs are hereby deemed to qualify for exemption from Article 2.1 pursuant to Article 2.2.3, which exempts *“persons who, by virtue of the nature or size of their business or the origin of their resources, are exempt by Da Afghanistan Bank from the requirements of this Decree Law; exemptions so granted by Da Afghanistan Bank may be conditional or limited in time, or they may be partial and list certain provisions of this Decree Law that shall apply to the person receiving the exemption.”*

DAB hereby deems that DMFIs are fully exempt from the requirements of Chapters II, III, IV, V, VIII, and XI of the Law, conditional to their compliance with the requirements of this regulation. DMFIs are fully subject to the requirements of Chapters I, VI, VII, IX, and X, with the exception that the word “DMFI” is to be substituted for the word “bank” in all references, “DAB” is to be substituted for “Financial Services Tribunal.”

In addition, a DMFI is a “financial institution” under the Anti-Money Laundering and Proceeds of Crime Law” and “Law on Combating the Financing of Terrorism,” and is subject to all regulations issued by DAB or other organs of government under those Laws.

In order to be considered a DMFI and be licensed, regulated, and supervised under this regulation, it is not necessary for the microfinance institution to engage in every permitted activity of a DMFI. Accordingly, microfinance institutions that accept only mandatory deposits or no deposits at all may voluntarily choose to be licensed as DMFIs, and DAB will consider their license applications and regulate and supervise these institutions under the same set of requirements as if they were actually taking voluntary deposits.

§ 12.1.2. Definitions. The definitions below are supplementary to the definitions in Chapter I of the Law.

- a) *Administrator* – a member of the Council of the DMFI or the general manager, treasurer, or compliance officer of the DMFI.
- b) *Capital distribution* – payment to shareholders of a dividend on shares, the repurchase of shares, or other transactions that, in DAB’s sole discretion, result in the distribution of the DMFI’s assets to its shareholders in a similar manner as a dividend or share repurchase.
- c) *Common bond* – the commonality of interest (such as employer, occupation, or delineated community) shared by the members or groups of members of a DMFI.
- d) *Delineated community* – for a DMFI whose membership is based partially or completely on residential location, the clearly-defined neighborhood, village, town, city, or district, the residence in which qualifies one for membership in the DMFI.
- e) *Depository microfinance institution (DMFI)* – a legal entity that accepts voluntary savings deposits only from a membership defined by a common bond, such as employment at the same legal entity or defined groups of entities or in the same occupation, or residence within the same delineated community, and grants microcredits only to that same membership. Microfinance institutions that accept only mandatory deposits from members are not considered to be DMFIs. Microfinance institutions that accept only mandatory deposits or no deposits at all may voluntarily choose to comply with these regulations in order to receive a license from DAB, and shall also be considered DMFIs for purposes of this regulation.
- f) *Exposure* – exposure to a single obligor or group of related obligors includes the sum of deposits (if the obligor is a bank or foreign bank branch), loans, leases, and accounts receivable that is repayable by that single obligor. For the purposes of calculating exposure to a bank or foreign bank branch, deposits shall be multiplied by 20 percent. Exposure is to be calculated on a gross basis; that is, without the deduction of loan-loss reserves or available collateral.
- g) *Field of membership* – definition of the type of membership generally served by the DMFI. For example, “agricultural” DMFIs primarily serve farmers, agricultural suppliers, and distributors of agricultural products.

- h) *Financial capital* – the difference between a DMFI’s assets and its liabilities, where those assets and liabilities are calculated according to international accounting standards.
- i) *Group loan* – Group loans, or group-guaranteed loans, involve a mutual or co-guarantee responsibility between members, rather than collateral. A group guarantee requires that members self-select one another based on their assessment of each other’s character and ability to repay a loan. If one member is unwilling or unable to make a payment, the other members are required to cover for him/her, immediately contributing the missing portion to their group’s repayment. The DMFI therefore deals with the group as a whole in managing delinquencies. The small, short-term loans are extended in the form of a continuous, gradually increasing line of credit to the group.
- j) *Group of related obligors* -- a group of related obligors is defined as two or more persons (natural, juridical, or both) who are connected, directly or indirectly, in such a way that the financial soundness of any of them may affect the financial soundness of the other or others, or the same factors may affect the financial soundness of some or all of them, or if as a result of the structure of their relationship the other person is in fact ultimately responsible for the credit outstanding. More specifically, individual obligors of a DMFI are considered a group of related obligors:
 - i) When the expected source of repayment for each loan is the same for each obligor, and neither obligor has another source of income from which the loan (together with the obligor’s other obligations) may be fully repaid.
 - ii) When loans are made to obligors who are related directly or indirectly through common control, including where one obligor is directly or indirectly controlled by another obligor, where such control is defined as possessing a qualifying holding in the other obligor.
 - iii) When substantial financial interdependence exists between or among the obligors. Substantial financial interdependence is deemed to exist when 50 percent or more of one obligor’s gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other obligor. Gross receipts and expenditures include gross revenues/expenses, intercompany loans, dividends, capital contributions, and similar receipts or payments.
 - iv) When separate obligors borrow from a DMFI to acquire a business enterprise of which those obligors will, collectively, own more than 50 percent of the voting securities or voting interests.
 - v) In other cases, when DAB determines, based on an evaluation of the facts and circumstances of particular transactions, that the financial soundness of any obligor may affect the financial soundness of any other. The individual obligors under a group loan are not automatically considered a “group of related obligors,” although some or all of them may be so considered if the facts warrant.
- k) *Insolvency* – the condition of having regulatory capital less than 40 percent of any minimum requirement, or financial capital less than 2 percent of total assets.

- l) *Investor* – a unit of government, national or international non-governmental organization, government-sponsored enterprise, governmental aid agency, for-profit legal entity whose mission statement, charter, by-laws or other founding documents both authorize and promote investments in microfinance institutions and that has prior experience in making investments in microfinance institutions in at least one country of the world outside of Afghanistan, or international or multilateral donor agency, which supplies funds (other than a deposit) to a DMFI, in the form of debt securities or non-membership shares.
- m) *Leasing* -- Leasing refers to the "rental" (transfer of the right of usage) over the medium to long term of capital goods and consumer durables. The leased asset remains the property of the DMFI for the duration of the lease agreement and is "rented" by the lessee. In contrast to conventional rental arrangements, however, the lessee assumes obligations normally falling to the owner (e.g. maintenance) and any risks associated with the asset and its use. In return for the right to use the asset, the lessee pays leasing installments comprising a capital repayment component plus interest, calculated on the basis of the anticipated term of the agreement. On expiration of the agreement, the leasing company will usually offer to sell the asset to the client for the imputed residual value. Leasing can be classified as either “financial leasing” or “operating leasing” under Afghan income tax law and international accounting standards, depending on the terms of the agreement.
- n) *Liquid assets* -- liquid assets mean the sum of: cash in vault; current account with DAB; other liabilities of DAB; demand deposits with licensed commercial banks or permitted foreign bank branches in Afghanistan; and time deposits with such banks or branches.
- o) *Mandatory deposit* – funds that have been placed by a member with a DMFI as a condition of obtaining credit from the DMFI. The placement of such funds must be prescribed in and governed by the explicit terms of the loan documents.
- p) *Member* – a natural or legal person (except for a unit of government or a state-owned enterprise) that has fulfilled the necessary requirements to acquire the right to borrow from a DMFI. Units of government and state-owned enterprises are not eligible to become members.
- q) *Membership share* – a share of stock in a corporation or a partnership unit in a limited-liability company that is owned by a member. A membership share shall only be considered financial capital or regulatory capital if the membership share is not redeemable. If the membership share is redeemable at the option of the member or the DMFI, then the membership share shall be considered a liability for purposes of computing financial capital or regulatory capital.
- r) *Microcredit* – a loan whose principal balance at disbursement, exclusive of fees and interest (whether or not capitalized), does not exceed AFN 500,000 or equivalent; such limit may be amended by supervisory circular of DAB. .

- s) *Non-conforming loan* – a proposed loan whose purpose, amount, documentation, or in any other aspect deviates from the DMFI’s lending policy and would ordinarily result in a denial, but is nevertheless viewed by the general manager and the compliance officer as an acceptable business risk.
- t) *Non-membership share* – a share or partnership interest in a DMFI that is not a membership share.
- u) *Qualifying holding* – a direct or indirect ownership of shares or partnership interests in a DMFI which represents 10 percent or more of the capital or voting rights, or which makes it possible to exercise significant influence over the management of the DMFI.
- v) *Qualifying small balance loan* – a loan whose principal balance at disbursement, exclusive of fees and interest (whether or not capitalized), is between AFN 500,001 and AFN 1,000,000; such parameters may be amended by supervisory circular of DAB.
- w) *Regular variable rate credit* – a loan with a variable interest rate that may change only at predetermined intervals (such as once a month or once a quarter) and is calculated at a predetermined margin over a predetermined reference interest rate (such as the interest rate on 28-day DAB capital notes).
- x) *Regulatory capital* – financial capital minus intangible assets, plus certain liabilities (such as subordinated debt or debt/equity hybrid instruments) that have been approved by DAB on a case-by-case basis to be included in the calculation of regulatory capital.
- y) *Relative* – grandparent, parent, brother, sister, spouse, son, daughter, grandson, granddaughter, husband of brother or sister, brother or sister of spouse, spouse of brother or sister of spouse, niece, nephew, uncle, aunt, or first cousin.
- z) *Shareholder* – an owner of a membership share or non-membership share.
- aa) *Sponsor* – an individual, national or international non-governmental organization, governmental aid agency, or international or multilateral donor agency, that establishes a DMFI and sometimes acts as an affiliated party, sharing office space, equipment, certain staff, a similar name, or other evidence of links.
- bb) *Voluntary deposit* – a savings deposit that is placed by a member with a DMFI that is not connected with obtaining credit from the DMFI or is in excess of the amount of deposit that is required in order to obtain the desired amount of credit.

§ 12.1.3. General goals and objectives.

- a) This regulation aims at the following:
 - 1. To set forth DAB's requirements as to the licensing, corporate governance, permitted and prohibited activities, minimum prudential standards, and reporting of DMFIs, in order to protect depositors.
 - 2. To encourage more standardization in the ownership and activities of DMFIs, to more clearly differentiate them from commercial banks and other financial institutions, with the aim of minimizing customer confusion arising from a plethora of different types of financial institutions.
- b) The objectives of this regulation:
 - 1. DMFIs will be able to obtain licenses from DAB, and their activities will be fully authorized by these implementing regulations.
 - 2. DMFIs will be required to meet international standards in corporate governance, capital adequacy, liquidity measurement and management, asset classification and loan loss provisioning, diversification of credits, and transactions with related parties.
- c) Adherence by DMFIs to the standards set by this regulation will be monitored by DAB through on-site examinations and off-site analysis of data.

Part B — Organization objectives, and powers of DMFIs

§ 12.2.1. Legal form of DMFIs and corporate separateness from sponsors and investors.

- a) DMFIs are required to organize themselves as corporations, owned by their members and, in certain circumstances, by non-member investors.
- b) DMFIs must be legal entities separate and distinct from their sponsors and investors. They must have separate corporate governance, maintain separate books and records, and their transactions with sponsors and investors (including any sharing of staff) must be conducted at market-related prices, rents, and interest rates.

§ 12.2.2. Objectives of DMFIs

The main objective of DMFIs shall be to increase well-being amongst the low-income sector of the population, to serve the financial needs of communities that lack adequate banking services, and to facilitate the mobilization of savings of this sector towards the creation of income-earning enterprises.

In carrying out their activities, DMFIs shall serve their members and their delineated communities. They shall operate with an orientation toward profit, with appropriate attention to risk management and control of costs.

§ 12.2.3. Authorized and prohibited activities of DMFIs

DMFIs may engage in any or all of the following activities:

- a) Attracting funds from members by means of savings deposits and time deposits.
- b) Granting microcredits to members.
- c) Granting qualifying small balance loans to members; however, the aggregate amount of these qualifying small balance loans is limited to 40 percent of the regulatory capital of the DMFI.
- d) Granting group loans to administrative bodies that will on-lend the funds as microcredits to members of the group and assist the DMFI in enforcing repayment of the loans; however, the maximum size of a group loan is limited to AFN 2,500,000.
- e) Granting financial leases or operating leases to members.
- f) Investing in debt securities issued by the Ministry of Finance or by Da Afghanistan Bank.
- g) Investing in equity securities issued by a legal entity that is jointly owned by itself, other DMFIs, and other eligible credit institutions, the purpose of which entity is to act as a wholesale lender to these eligible credit institutions or to provide other services such as marketing, training, technical assistance, cash management, correspondent banking, risk management tools, etc., for the sole benefit of the eligible credit institutions.
- h) Maintaining a correspondent account at Da Afghanistan Bank or a licensed commercial bank.
- i) Carrying out funds transfer operations to or from its own branches, other DMFIs, or commercial banks licensed by DAB or foreign branches permitted by DAB on behalf of clients.
- j) Issuing membership shares and (if approved by DAB) non-membership shares
- k) Rendering consulting and informational services that are consistent with promoting the lending for which the DMFI was founded.
- l) Renting to members and non-members special premises or cases for the keeping of documents and other valuables.

- m) Selling credit-related insurance products to member-borrowers as an agent for other companies.

DMFIs may not engage in any of the following activities:

- a) Attracting current account deposits from members, or any account that is similar to a current account that can be debited by the customer by writing a check or requesting a payment order.
- b) Attracting any type of deposit from non-members.
- c) Granting any credit to non-members, or granting credits other than microcredits to members.
- d) Owning real estate beyond that which is necessary to conduct the business of the DMFI.
- e) Denominating monetary assets or monetary liabilities in foreign currency (except for small amounts of foreign banknotes and coins not to exceed 5 percent of the assets of the DMFI). An existing microfinance institution that is seeking a DMFI license and has existing monetary liabilities denominated in foreign currency may maintain an equal or lesser amount of monetary assets denominated in that same foreign currency for a period of not more than six months following the receipt of its final license. The license application must indicate clearly the plans of the DMFI to either extinguish the assets and liabilities denominated in foreign currency or redenominate them in afghani within the six-month time frame.
- f) Granting any credit to sponsors, investors, or administrators.
- g) Investing in equity securities of any kind, except those mentioned earlier in this section.
- h) Investing in debt securities other than those issued by the Ministry of Finance or Da Afghanistan Bank.
- i) Guaranteeing the debt of any person to another person by any means.
- j) Issuing letters of credit in any form.
- k) Acting as a foreign exchange dealer, money service provider, payments system operator, or securities service provider, as those terms are defined in the Law on Da Afghanistan Bank or by regulations issued by Da Afghanistan Bank.
- l) Using other than DAB, a licensed commercial bank, permitted branch of foreign bank, or licensed money service provider to transfer its own funds to another location or another party within or outside of Afghanistan, or to receive funds from investors

Part C – Licensing of DMFIs

§ 12.3.1. Registration as a legal entity.

Before filing an application with DAB for licensing as a DMFI, a prospective DMFI must register with the relevant authorities as a “non-distributive corporation.”

§ 12.3.2. Designation of power of attorney.

Before filing a licensing application with DAB, a prospective DMFI must designate one individual that can sign documents and speak on behalf of the prospective DMFI throughout the licensing process.

§ 12.3.3. Documents required to be filed as part of licensing application.

The following documents must be submitted as part of the licensing application. DAB will not consider the application until all of the following documents are filed and contain the necessary information:

- A document confirming that the non-refundable application fee has been paid.
- Proposed by-laws of the DMFI.
- A business plan setting forth the activities in which the DMFI plans to engage.
- An abbreviated, projected balance sheet and profit and loss statement covering three years of operations.
- A clear statement of the common bond, field of membership, and delineated community of membership.
- A demonstration that there is an adequate initial membership base with potential for growth.
- A proposed organization chart of the DMFI.
- A proposed credit policy for the DMFI.
- A proposed asset-liability management policy for the DMFI.
- A complete, accurate list of all proposed sponsors and investors, including contact information.
- A *pro forma* opening balance sheet for the time the license is received, showing clearly that the net assets of the DMFI will equal or exceed the initial and ongoing minimum financial capital requirement, as well as the percentage ownership of the initial capital by each proposed investor.
- A statement clearly describing the proposed relationship between the DMFI and proposed sponsors and investors.
- A statement describing how the DMFI plans to fulfill its anti-money laundering responsibilities.

- Full biographical information on proposed administrators, including names, addresses, contact telephone numbers and/or email addresses, and a CV showing education and employment history.

§ 12.3.4. Timeframe for considering licensing application.

When all the required documentation has been submitted, DAB will notify the individual with power of attorney that the application has been deemed complete.

Once the application has been deemed complete, DAB will issue its approval or denial within 5 calendar weeks.

When reviewing the materials submitted by the applicant, DAB may request additional information to complete the required documentation, or modifications to documentation already submitted. If a request by DAB for additional information has not been fulfilled within 2 calendar weeks (or within some other timeframe as specified by DAB in the request), the application will be considered abandoned, and DAB will take no further action on that application.

During the application process, the individual designated as having power of attorney must be continuously available either in person, by phone, or by email. DAB will accept no excuses for non-responsiveness by that person to inquiries or requests for additional information.

§ 12.3.5. Basis for denial of licensing application.

DAB can deny the application and refuse to issue the license on any of the following grounds:

- The proposed administrators do not meet the qualifications listed in Section 12.4.15.
- The proposed sponsors or investors do not conform to the definitions of these terms in Section 12.1.2.
- The common bond, field of membership, or delineated community are poorly defined, or it is unlikely that the desired membership base can be achieved.
- The business plan does not demonstrate continuing compliance with minimum capital and liquidity requirements.
- The proposed credit policy does not demonstrate an understanding of the principles of sound microcredit.
- The proposed statement of plans to fulfill AML responsibilities does not demonstrate an understanding of these responsibilities.
- The proposed asset-liability management policy does not demonstrate a clear understanding of these responsibilities.
- If assets or liabilities denominated in foreign currency are present, the application does not clearly indicate how and when the assets or liabilities will be either extinguished, or redenominated in afghani within the required six-month time frame.

DAB will provide the applicant with a written notice setting forth the grounds for denial.

If the application is denied, the sponsors are ineligible to reapply for a period of one year.

§ 12.3.6. Final conditions for granting of license certificate.

If DAB issues an approval, the sponsor(s) will be notified. Thereafter, the sponsors must demonstrate to the satisfaction of DAB within two months that the prospective DMFI possesses the necessary capital. The demonstration must consist of evidence of ownership of assets in sufficient amount to offset any liabilities and still result in the minimum amount of initial capital.

Once DAB is satisfied that the capital is sufficient, DAB will grant the license certificate, and the DMFI may begin attracting mandatory and voluntary deposits and granting loans.

§ 12.3.7. Grounds for revocation of license.

DAB may revoke the license of a DMFI if any of the following grounds are present:

- The DMFI is insolvent.
- DAB discovers that information submitted as part of the licensing application was false.
- The DMFI has not sufficiently maintained separateness from its sponsors or investors.
- The DMFI has not limited its lending or deposit taking to its originally-defined membership based on the common bond, field of membership, and delineated community.
- The DMFI has engaged in any of the prohibited activities listed in 12.2.3 of this regulation.
- The DMFI has violated laws or regulations, or has engaged in practices that endanger the solvency or liquidity of the DMFI.
- The DMFI has violated an enforcement action issued by DAB.
- The DMFI has not made use of its license within six months after the date of effectiveness, or the DMFI has ceased for more than six months to engage in the business for which it was licensed.
- The DMFI or any of its sponsors or investors has engaged in criminal activities.
- The sponsors or investors have asked DAB to revoke the license.

§ 12.3.8. Revocation of license upon request by sponsors or investors.

The shareholders of a DMFI may apply to DAB in writing to revoke the license of the DMFI. The application must be accompanied by a shareholders' resolution certifying the desire to have the license revoked, and a liquidation plan, including the designation of the person or persons responsible for the liquidation, together with a report of an independent external auditor acceptable to DAB.

The request may be approved only if DAB approves the liquidation plan and the liquidator, and the DMFI has enough assets to repay its liabilities to its depositors and other creditors.

As an alternative to liquidation, the shareholders may request that the DMFI be merged with another licensed DMFI. In place of a liquidation plan, the request for license revocation must be accompanied by a shareholders' resolution of the surviving DMFI that the surviving DMFI agrees to assume all of the assets and liabilities of the disappearing DMFI. DAB will approve or deny the request for license revocation based in part on the impact the merger would have on the surviving DMFI. In no case will DAB approve a merger that has the effect of weakening the surviving DMFI.

§ 12.3.9. Head office and branches of DMFI; acceptable name.

The DMFI may operate out of one or more offices, and must designate one of its offices as its head office.

The DMFI must notify DAB at least 30 days prior to the opening of any office or the moving of an office from one location to another, and furnish DAB every 6 months with a list of all offices, including addresses, telephone numbers, email addresses, and the name of a relevant contact person at each office.

The offices of a DMFI are not separate legal entities and do not have separate capital or separate balance sheets. All offices of a DMFI must use the same name, with only minor variations permitted (such as indicating the location of the office).

The word "bank," "banking organization," "banking institution," or any similar word or phrase that gives the misleading impression that the DMFI is a bank licensed by DAB may not form any part of the DMFI's name, either officially or unofficially.

The head office of the DMFI is responsible for ensuring that the transactions entered into by the other offices are in compliance with applicable laws and regulations, and also with policies and procedures issued by the head office.

Part D – Corporate Governance of DMFIs

§ 12.4.1. Shareholders of DMFI.

The member shareholders and non-member shareholders collectively of a DMFI are the highest governing body of the DMFI. The frequency and timing of meetings of the shareholders, and their rights and responsibilities, may be determined independently by each DMFI and stated in the by-laws of the DMFI, subject to the following restrictions:

1. A shareholder may not transfer its share to another party that does not meet the definition of "member" or "investor" in § 12.1.2 above.

2. A shareholder may not acquire or dispose of a qualifying holding in the DMFI unless it follows the procedures outlined in Part E below.
3. A shareholder may not receive a capital distribution from the DMFI that does not comply with the restrictions listed in §12.6.5 below.

§ 12.4.2. Required designation of shareholder representatives.

Member-shareholders as a group, and each non-member shareholder separately, must designate a single individual as its representative. This representative must be available at all times, either in person or by phone or email without undue delay, for meetings with DAB on issues involving the DMFI. DAB also reserves the right to convene a meeting of some or all of the shareholder representatives as a group.

§ 12.4.3. By-laws of DMFI.

A DMFI is required to have written by-laws, which serve as the main document governing the DMFI's operations, defining authorities, and setting the broad guidelines within which more specific policies are adopted.

At a minimum, by-laws must cover:

1. The DMFI's field of membership and requirements for membership;
2. The scope of the DMFI's activities and the services that it can offer;
3. The duties and responsibilities of its administrators and other key employees.

Other areas that should be addressed in the by-laws include:

1. Official information about the DMFI, including official name, address, DAB docket number and date of issue of license;
2. Specific goals for which the DMFI was founded;
3. The minimum membership share purchase required to join and any other minimum requirements of members, such as age or length of residence in the community;
4. A statement of the common bond and delineated community;
5. The process of handling disputes with members and possible expulsions;
6. The rules governing shareholder meetings and membership meetings, if any;
7. The rules governing nomination of Councilors for submission to DAB for approval;
8. The rules governing the selection of members for various committees and the duties and responsibilities of those committees;
9. The duties and responsibilities of the general manager, treasurer, and compliance officer;
10. The broad types of liquid investments that are allowable, including deposits in banking organizations, and the criteria for selecting those banking organizations;
11. The process for the development and review of the annual budget;
12. The process by which loan-loss reserves are formed and the minimum amounts;

13. The requirement that administrators and employees disclose any conflict of interest, including the removal of an administrator or employee for failure to disclose;
14. The provision that the DMFI may voluntarily merge with another DMFI if so decided by shareholders;
15. The process by which the by-laws may be amended.

§ 12.4.4. Council of DMFI.

The next-highest governing body of the DMFI is the Council. The Council must have an odd number of at least three Councilors. The non-member shareholders as a group, and the member-shareholders as a group, are responsible for nominating Councilors in close proportion to their shareholdings. Each nominated Councilor is subject to approval by DAB.

The nomination of a Councilor must be accompanied by the full biographical information as described in § 12.3.3 above, plus shareholders' resolutions documenting that it is the intent of the non-member shareholders as a group, or the member-shareholders as a group, to nominate this particular individual to the Council.

The general manager, treasurer, and compliance officer may not simultaneously be Councilors.

§ 12.4.5. Duties and responsibilities of the Council.

The Council of a DMFI has the following responsibilities:

1. To appoint and dismiss the manager, treasurer, and compliance officer, and determine their compensation.
2. To appoint certain administrators, employees, and/or members to a Credit Committee, whose functions it shall be to receive loan applications and make decisions on whether or not to grant credit.
3. To ensure that the DMFI complies with laws and regulations.
4. To adopt policies and procedures for risk management and internal controls, consistent with the long-term goals of profitability, capital adequacy, and the protection of member-depositors.
5. To approve numerical limits on measurable risk parameters, as needed.
6. To ensure that these policies and procedures are followed.
7. To approve or deny non-conforming loan applications referred by the compliance officer.
8. To appoint the external auditor, subject to DAB's approval.
9. To ensure that internal and external audits are carried out, and that audit-related reports are made available to shareholders and to DAB in a timely manner.

The Councilors of a DMFI have the following duties:

1. To act honestly and in good faith.

2. To act in the best interests and for the benefit of the DMFI and its long-term goals of profitability, capital adequacy, and the protection of depositors.
3. To act independently, free from undue influence of any person.
4. To access the necessary information in order to discharge their responsibilities.
5. To report to DAB in a timely manner any violation of laws or regulations, or any potential or developing problem with liquidity, capital adequacy, or any other situation that could threaten the interests of the depositors.

§ 12.4.6. Meetings of the Council.

The Council must meet at least four times during each financial year, and may meet more often if it so desires.

DAB has the right, at any time, to order the Council to convene a meeting within a certain time period and consider a specific agenda, appoint an observer to any board meeting, or order minutes or board resolutions to be turned over to DAB within a limited time period.

A Councilor must not deliberate on any matter in which he or she has an economic interest. If such matters arise before the Council, the Councilor must inform the other Councilors of his or her economic interest in advance of any discussion of those matters, and leave the meeting.

§ 12.4.7. General manager of DMFI.

The DMFI must have one individual designated as general manager, reporting to the Council. The appointment of the general manager must be approved by DAB at least 15 days before the person takes office. The general manager may attend the Council meetings as a non-voting member.

§ 12.4.8. Duties and responsibilities of the general manager.

The general manager is the chief executive officer of the DMFI, responsible for day-to-day management of the organization and the compliance with the policies and procedures adopted by the Council. He or she must perform or supervise the employees in hiring additional staff as needed, signing up new members, posting transactions to members accounts, processing payroll deductions, posting the journal and cash record and general ledger, accepting money for deposit and loan payments, processing loan applications, writing checks, and many other administrative duties. He or she is responsible for certifying the credibility, accuracy, and timeliness of the financial statements prepared at the request of DAB or any other entity.

§ 12.4.9. Treasurer of DMFI.

The DMFI must have one individual designated as treasurer, reporting to the general manager. The appointment of the treasurer must be approved by DAB at least 15 days before the person takes office.

§ 12.4.10. Duties of treasurer.

The treasurer is the chief financial officer of the DMFI, and is responsible for the preparation of financial statements and tax forms, drafting broad guidelines for the organization's tolerance for risk and expectations from investment for approval by the Council, and monitoring their implementation. He/she is also responsible for managing the liquidity position of the DMFI.

§ 12.4.11. Compliance officer of DMFI.

The DMFI must have one individual designated as compliance officer, reporting to the Council. The appointment of the compliance officer must be approved by DAB at least 15 days before the person takes office.

§ 12.4.12. Duties of compliance officer.

The compliance officer is the internal auditor of the DMFI, and in addition is responsible for monitoring compliance by the DMFI with laws, regulations, internal policies and procedures, internal controls, and resolutions of the Council. Other responsibilities of the compliance officer are:

1. To evaluate the reliability of information produced by accounting and computer systems.
2. To review all loan applications for completeness of information and consistency with loan policy, and to refer non-conforming loan applications to the Council for decision.
3. To review appraisals of property or goods to be used as collateral, if required.
4. To establish appropriate accounting procedures and accounting controls to be used by the treasurer.
5. To review operations and transactions of the DMFI that could adversely affect the condition of the DMFI.
6. To arrange for the work of the external auditor that has been selected by the Council.
7. To periodically verify that members meet the criteria for membership.

§ 12.4.13. Credit committee.

The Council may establish a credit committee, or it may vest those duties and responsibilities solely in the general manager. The general manager is automatically a member of the credit committee. Other members may be selected from among the employees, or from among the broader membership on a paid or volunteer basis.

The Councilors, treasurer, and compliance officer may not serve on the credit committee.

§ 12.4.14. Duties of credit committee.

The credit committee's duty is to evaluate and approve or deny submitted loan applications. Applications are evaluated according to their consistency with the DMFI's loan policy, and the evaluation must include an analysis of the member-borrower's ability to repay based on the stated

purpose of the loan, the expected source of repayment, the member-borrower's financial condition, and his/her repayment history on other loans extended by the DMFI. The credit committee also appraises the value of collateral, if any, for possible review by the compliance officer. No loan may be approved whose purpose is not clearly stated in the application.

§ 12.4.15. Qualifications and disqualifications of administrators.

To be a Councilor, general manager, treasurer, or compliance officer of a DMFI, an individual must be highly literate and numerate and possess at least a high school education. The individual must also be honest and trustworthy and pass a basic examination indicating understanding of anti-money laundering responsibilities of financial institutions before taking up the post.

The following persons are disqualified from serving as administrators of a DMFI:

1. a person who is less than 21 years of age;
2. a person who has declared bankruptcy in any jurisdiction in the world;
3. a person who has been convicted of any criminal offense;
4. a person who is an official or employee of any organ of state authority, including any organ of provincial, district, or municipal administration, or a state-owned enterprise;
5. a person who currently serves as an administrator of another financial institution regulated by DAB;
6. a person who has been removed by DAB from his post at another financial institution regulated by DAB;
7. a former administrator of a financial institution regulated by DAB who has been declared by DAB to have contributed to the failure of that institution and the consequent placement of that institution into conservatorship, receivership, or liquidation.
8. a relative of another administrator.

Part E – Change in Control of DMFIs

§ 12.5.1. Prior approval of DAB required for certain acquisitions of shares.

DAB must approve in advance any acquisition by a single investor of a qualifying holding in a DMFI, or any increase in a qualifying holding past the thresholds of 20 percent, 33 percent, or 50 percent. The actual acquisition may take place no earlier than 30 days after DAB has given its approval.

Increases in a qualifying holding between the abovementioned thresholds do not require the advance approval of DAB.

Decreases in a qualifying holding below the abovementioned thresholds require only the prior notification of DAB, not prior approval.

DAB will grant approval for the acquisition only if the following conditions are met:

1. The potential investor meets the definition of “investor” in § 12.1.2 above.
2. That no facts are known that warrant the assumption that the influence that would be exercised on the DMFI as a result of the acquisition would threaten the sound and prudent management of the DMFI or of any other DMFI supervised by DAB.
3. That, if the application concerns an increase in a qualifying holding by an existing investor, the investor’s influence on the DMFI in the past has been positive and not detrimental in any way to the sound and prudent management of the DMFI.

§ 12.5.2. Mandatory divestiture of shares in certain circumstances.

If DAB determines that an investor is exercising its influence on the DMFI to the detriment of the solvency, liquidity, or prudent management of the DMFI, DAB may order the investor to transfer its shares to another investor before a specified deadline. While the mandatory divestiture is taking place, the investor may not exercise any rights granted to it by the DMFI’s by-laws, including the right to participate in the selection of Councilors.

Part F – Minimum initial and ongoing capital requirements for DMFIs

§ 12.6.1. Minimum initial and ongoing financial capital requirement.

At all times, upon receipt of its license and thereafter, the DMFI must maintain financial capital of at least AFN 25 million.

§ 12.6.2. Minimum ratio of regulatory capital to assets.

At all times, a DMFI must maintain a ratio of regulatory capital to total assets of 8 percent. In calculating total assets for the purposes of applying this requirement, the following assets are excluded:

1. Cash, current account at DAB, and other claims on DAB.
2. 80 percent of the balance sheet amounts of deposits at other banks or foreign branches located in Afghanistan.
3. Intangible assets.

§ 12.6.3. Individual minimum capital requirement.

If DAB decides that the risk profile of a DMFI warrants a minimum ratio of regulatory capital to total assets of higher than 8 percent, DAB may impose a higher percentage requirement. Grounds for imposing a higher percentage requirement include:

1. an excessive concentration of loans to entrepreneurs within a single sector of the economy;
2. excessive sensitivity of the DMFI’s net interest margin to changes in market interest rates (excessive interest rate risk);

3. deficiencies in management, including excessive turnover in the Council, general manager, treasurer, or compliance officer; a pattern of non-compliance with laws, regulations, sound business practices or the DMFI's own internal policies; ineffective internal controls; and inadequate physical security.
4. an excessive level of problem loans, defined as loans 61 or more days past due (gross of reserves) in excess of 10 percent of total assets.

§ 12.6.4. Consequences of noncompliance with minimum capital requirements.

Compliance with both minimum capital requirements (minimum financial capital and minimum ratio of regulatory capital to assets) will be assessed by DAB on a quarterly basis. If at any time, either through the preparation of the quarterly reporting forms on capital adequacy or through some other process, any administrator of the DMFI becomes aware that one or both of the capital requirements are not fulfilled, it is the responsibility of that administrator to notify DAB.

Upon learning of the capital deficiency, either by its own efforts or through notification by the DMFI, DAB will issue an "order for prompt corrective action" to the DMFI. This order will include the requirement that the DMFI submit a plan within 60 days of the effective date of the order describing the steps the DMFI will take to return to capital compliance.

The plan must include quarterly projections of balance sheets, profit and loss statements, and chargeoffs, and project a return to capital compliance within four quarters of the commencement of the plan.

§12.6.5. Restrictions on capital distributions

DMFIs are prohibited from making capital distributions that would result in failure to meet either the minimum ongoing financial capital requirement or the minimum ratio of regulatory capital to assets.

DMFIs may make a capital distribution only if the following conditions are met:

- a) The DMFI has been in existence as a corporation for at least three years.
- b) The DMFI has repaid to the Microfinance Investment and Support Facility for Afghanistan (MISFA) all of the money received by the DMFI or by its predecessor organization from MISFA in the form of grants (not loans) for tangible assets.
- c) The total amount of the proposed distribution plus all previous capital distributions for the fiscal year does not exceed profit to date for that year plus retained profit for the preceding two years.

Part G – Liquidity measurement and management.

§ 12.7.1. Minimum liquidity ratio.

At all times, a DMFI must maintain a ratio of liquid assets to total customer deposits of no less than 20 percent.

§ 12.7.2. Basic liquidity measurement and management.

The treasurer, or person he/she delegates to manage liquidity, must prepare and implement a written strategy for addressing temporary and long-term liquidity disruptions. The responsible person must also measure and monitor liquidity through the use of cash flow projections that forecast cash inflows and outflows over different planning periods to identify cash shortfalls and surpluses in future periods. Other methods may be used to supplement cash flow projections, but the use of cash flow projections is mandatory. In addition, a DMFI must build and maintain relationships with a broad range of member-depositors. Over-reliance on individual sources of funds (for example, greater than 20 percent of total deposits) is to be avoided.

Part H – Loan classification, loan-loss provisioning, and chargeoffs.

§ 12.8.1. Mandatory monitoring of past-due status of loans.

A DMFI must strictly monitor and keep accurate records of the number of days every loan is past-due in any required payment under the loan contract.

§ 12.8.2. Loan-loss provisioning.

A DMFI must have an adequate reserve for loan losses. These loan-loss reserves are formed by means of expenses (loan-loss provisions). The adequacy of the reserve, and the possible need for provisions to increase the reserve, must be assessed on a quarterly basis. At a minimum, the reserve must equal the sum of:

- 25 percent of the unpaid balance of loans 31 to 60 days past due
- 50 percent of the unpaid balance of loans 61 to 90 days past due
- 75 percent of the unpaid balance of loans 91 to 180 days past due

Higher reserves than these minimum percentages are strongly encouraged, if the DMFI possesses other information about the borrower that leads it to believe that a greater loan loss will be suffered.

§ 12.8.3. Chargeoffs.

A DMFI must charge off 100 percent of the unpaid balance of loans that are more than 180 days past due. The fact that the loan has been charged off does not relieve the borrower of his/her obligation to repay the unpaid balance, and the DMFI should continue efforts to collect these loans

The DMFI may charge off a loan that is past due for 180 days or less, if it possesses other information about the borrower that leads it to believe that the borrower will not repay the loan.

Part I – Large exposure limitations.

§ 12.9.1. General principles.

To reduce risk arising from the failure of an obligor or group of related obligors to repay their loans or other obligations to the DMFI, the DMFI is expected to diversify its client base and build relationships with a broad array of member-borrowers.

§ 12.9.2. Numerical limitation on exposures to a single obligor or group of related obligors.

A DMFI is prohibited from acquiring an exposure to a single obligor or group of related obligors of greater than 5 percent of its regulatory capital.

§ 12.9.3. Non-conforming exposures resulting from declines in regulatory capital or subsequent links among obligors.

If an exposure becomes nonconforming because of a decline in regulatory capital or subsequent links among obligors that result in their individual exposures being combined, DMFIs are required to take reasonably prompt action (as soon as possible, but no later than six months after the event) to bring the exposure back into conformance. Such action may require transferring a loan or other obligation to another financial institution or increasing regulatory capital.

Part J – Transactions with administrators or employees of the DMFI.

§ 12.10.1. Prohibition on loans to administrators.

No DMFI may extend a loan or lease directly or indirectly to any administrator.

§ 12.10.2. Restrictions on other transactions with administrators.

No DMFI may engage in any transaction with an administrator, where the terms and conditions of such transaction are less favorable to the DMFI than the terms and conditions of similar transactions with persons who are not administrators.

Examples of terms and conditions “less favorable” to the DMFI include, but are not limited to:

1. Buying any item from an administrator, or from a relative of an administrator or a company controlled by an administrator or relative of an administrator, at an above-market price.
2. Selling any item to an administrator, or to a relative of an administrator or a company controlled by an administrator or relative of an administrator, at a below-market price.
3. Paying higher interest rates on deposits of administrators than are offered to other members.
4. Employing an administrator’s relative who does not meet the qualifications for the position to which he/she has been appointed.
5. Paying a higher salary to an administrator’s relative than is paid, or would be paid, to another individual in a similar position.
6. Any other transaction that, in substance if not in form, is similar to any of the above transactions in unduly enriching an administrator or his/her family, to the detriment of the DMFI.

§ 12.10.3. Loans to member and non-member employees.

A DMFI may make a loan to an employee who is not a member, except that the loan may not be granted on terms or conditions less favorable to the DMFI than the terms and conditions of similar loans to members. A loan to an employee who is a member may not be granted on terms or conditions less favorable to the DMFI than those offered to other members.

Examples of “terms and conditions less favorable” include, but are not limited to:

1. Making a larger loan to the employee than would be offered to a member of similar standing;
2. Requiring less documentation from the employee than is required from a member of similar standing;
3. Charging a lower interest rate (or administrative fee, if interest is not charged) to the employee than would be charged to a member of similar standing;
4. Requiring interest payments or administrative fee payments to be made less frequently by the employee than would be required by a member of similar standing;
5. Allowing a longer repayment term than would be allowed to a member of similar standing.
6. Extending the maturity date of an existing loan to an employee, under conditions when a similar loan to a member would not be extended.

In the aggregate, loans to employees of the DMFI may not exceed 25 percent of the DMFI’s regulatory capital.

Part K – Accounting and reporting requirements.

§ 12.11.1. Use of international accounting standards mandatory.

DMFIs must maintain at all times accounts and records, and prepare quarterly and annual financial statements, adequate to reflect in accordance with international accounting standards their respective operations and financial condition, in such form and detail as shall be prescribed by DAB.

§ 12.11.2. Reporting requirements.

DMFIs must provide to DAB periodic balance sheets, profit and loss statements, data on past-due loans and loan-loss reserves, data on loan originations and chargeoffs, data on the maturity structure of assets and liabilities, and other reports of activities as DAB may require, at specified frequencies, to carry out its supervisory functions. In addition, DAB may require additional data to be submitted on an irregular or non-recurring basis, or may require data to be submitted on specific transactions, individuals, and firms.

The calendar to be used in filing the reports, which may be monthly, quarterly, semi-annually, or annually, is the Gregorian calendar; that is, the calendar that contains the months of January, February, etc.

§ 12.11.3. Public release of data collected by DAB from DMFIs.

DAB reserves the right to release to the public, in printed or electronic form, all of the abovementioned data except loan originations and chargeoffs. DAB will not release to the public data on specific transactions, individuals, and firms. DAB will release data on specific transactions, individuals, and firms to other authorities for the execution of their official duties, if these authorities are specifically authorized in their own enabling legislation to receive such information.

§ 12.11.4. Penalties for late, inaccurate, intentionally false or misleading, or incomplete reporting.

DAB may impose sanctions on DMFIs and their administrators in the event of late, inaccurate, intentionally false or misleading, or incomplete reporting. These sanctions include, but are not limited to, fines, restrictions on activities, and suspension or removal of administrators.

Part L – Mandatory external audit of DMFIs and records retention.

§ 12.12.1. Fiscal year of DMFIs.

The fiscal year of a DMFI shall be from April 1 through March 31, unless legislation requires, or special permission has been obtained from DAB, to use a different fiscal year.

§ 12.12.2. Annual external audit.

Each DMFI must be audited annually, in accordance with international standards of accounting and audit, by an independent, external auditor appointed by the Council and approved by DAB.

The scope of the external audit shall include, at a minimum, an evaluation of the DMFI's internal control system, the accuracy of reporting to DAB, and compliance with legislation and this and other regulations issued by DAB. The external auditor shall report to DAB any breaches of law or regulation, and shall furnish to DAB any information requested by DAB that has been obtained from the DMFI in the course of performing the audit, regardless of any duties of confidentiality.

§ 12.12.3. Audit-related reports required to be submitted to DAB.

The external auditor must provide to DAB before July 31 of the new fiscal year a copy of its audit report, including the DMFI's audited balance sheet, statement of profit and loss, and statement of cash flows, and the external auditor's opinion on internal controls, accuracy of reporting to DAB, and compliance with laws, this regulation, or other regulations issued by DAB. The reports must be presented to DAB in both hard copy and electronic form, in a form suitable for posting on DAB's website.

§ 12.12.4. Records retention.

A DMFI must take reasonable precautions to prevent the loss or destruction of records, prevent falsification of entries, facilitate detection and correction of inaccuracies, and ensure that unauthorized persons do not have access to or use of these records. For the purposes of this Section, "records" mean books, accounts, statements, vouchers, securities, data on computer systems, and all documents relating to the business affairs, transactions, and property of the DMFI.

These records must be retained for a period of not less than ten years.

Part L – On-site examination of DMFIs by DAB.

§ 12.13.1. Requirements placed on the DMFI by the on-site examination process.

Each DMFI will be subject to periodic full-scope and occasional targeted on-site examinations by DAB examiners. In these examinations, DAB examiners will be authorized

1. To enter any office of the DMFI and to examine there the accounts, books, documents, and other records of the DMFI; and
2. To require administrators, employees, and agents of the DMFI to provide all such information on any matter relating to the administration and operations of the DMFI as DAB shall reasonably request.

DAB may ask the assistance of law enforcement officials to assist it in gaining access to the premises of a DMFI and to examine its accounts, books, and records.

§ 12.13.2. Report of examination.

DAB will provide the DMFI with a copy of each report of examination, which is not to be released to any party without the prior permission of DAB.

Part M – Relations between a DMFI and its deposit and loan clients.

§ 12.14.1. Terms and conditions of contracts.

Any deposit or loan agreement concluded with a member-borrower or member-depositor shall be accompanied by a written contract that indicates the rights and responsibilities of both the DMFI and the member, including a clear statement of the amounts owed by whom, to whom, and when.

The terms and conditions of all services provided by a DMFI to its members must be made public and readily available to members and potential members.

§ 12.14.2. Interest rates and fees.

The interest rates, commissions, bonuses, and servicing or administrative fees charged by a DMFI to its member-borrowers or paid by a DMFI to its member-depositors may be independently established by each DMFI.

Interest rates, if used in lieu of administrative fees charged on loans or paid on deposits, must be disclosed at an annualized rate regardless of the maturity of the credit or deposit or the frequency of payments.

No DMFI may offer a variable-rate loan that is not a regular variable-rate loan.

§ 12.14.3. Secured and unsecured lending.

A DMFI is free to determine in agreement with member-borrowers whether or not their loans will be secured by collateral, guarantees, or other commitments.

DMFIs may not accept their own shares of stock as security for a loan, and may not issue a loan to a member, the purpose of which is to buy additional shares in the DMFI.

§ 12.14.4. Prohibition on false advertisement.

A DMFI is prohibited from falsely or misleadingly advertising its activities. DAB has the right to require any DMFI to change or revoke any advertisement or other published information regarding its activities, if the information is falsely or misleadingly stated.

In the event that the demands of DAB are not met within the period of time specified by DAB, DAB may publish a statement that the advertisement or information is false or misleading. DAB has the right to claim the expenses it has incurred as a debt repayable to it by the DMFI.

§ 12.14.5. Confidentiality of customer information.

Present and past administrators and employees of a DMFI shall be required to keep secret, not to use for personal gain and not to permit to be examined by others unless required by law, any information that they obtained in the course of their services to the bank.

Exceptions to the above non-disclosure policy are the following:

1. The information may be disclosed to the officers, staff, and agents of DAB, to enable them to carry out their supervisory or investigative functions.
2. The information may be disclosed to a credit bureau, according to laws or regulations applicable to that credit bureau.
3. The information may be disclosed to another financial institution licensed or permitted by DAB, if such information is required by that financial institution in deciding whether or not to lend to, or accept deposits from, the DMFI.
4. The information may be disclosed to the Financial Intelligence Unit of DAB in connection with required reporting under laws concerning responsibilities of financial institutions in the fight against money laundering and terrorist financing.

Part M – Mergers between DMFIs and conversion of DMFIs to commercial banks.

[Reserved.]

Part N – Effective date of regulation.

§ 12.16.1. Regulation immediately effective upon adoption by DAB Supreme Council.

This regulation is effective immediately upon adoption by the Supreme Council of DAB, and shall be published in the DAB web site.

§ 12.16.2. Revocation of effectiveness of regulation by superseding legislation.

This regulation may be revoked by future superseding legislation concerning non-bank financial institutions, credit unions, DMFIs, or other legislation that clarifies or repeals Article 2.2.3 of the Banking Law.