



**Islamic Republic of Afghanistan
Da Afghanistan Bank**

Reserve requirement for monetary policy purposes: revised regulation

Summary

The regulation on reserve requirements for monetary policy purposes has been amended, to bring it into line with recommendations of the International Monetary Fund.

Purpose of rule changes

The purpose of the rule changes is to improve the effectiveness of the reserve requirement as a tool of monetary policy. Three key changes are made:

1. The afghani-denominated DAB capital note is eliminated from the list of eligible assets. (This change, which was recommended by the International Monetary Fund, is necessary in order to increase the effectiveness of the capital note issuance as a separate tool of monetary policy.)
2. The existing requirement of 8 percent is reaffirmed.
3. The penalties for non-compliance are clarified and strengthened.
4. DAB will begin paying interest on the amount of afghani-denominated current account at DAB that is required to meet the 8 percent minimum. No interest will be paid on excess reserves.

The elimination of capital notes from the definition of eligible assets, which was recommended by the International Monetary Fund, will improve the effectiveness of the capital notes as a tool of monetary policy by enabling them to be issued and withdrawn from the market as needed, in order to influence the aggregate amount of banking organizations' afghani-denominated current account at DAB, and therefore the monetary base¹. DAB will also begin paying interest on required reserves (but not on excess

¹ The function of the capital note in this context is similar to that of government securities in more highly-developed financial markets, although the effect on the central bank's own balance sheet differs. When DAB sells a capital note to a banking organization, it debits the bank's current account at DAB and credits capital notes (a liability of DAB). The monetary base declines. When a central bank sells a government security to a bank, it debits the bank's current account at DAB and credits its holdings of government securities (an asset of that central bank). The monetary base declines in this instance, too. These declines

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reserves) by means of a formula to be announced by circular, and then retroactively crediting the appropriate amount to the banking organization's current account at DAB at the end of each reserve maintenance period. **DAB will credit the current account only upon receipt of the Reserve Requirement Report, and not on the basis of any other information submitted to DAB.**

DAB wishes to remind banking organizations of their obligations under the DAB Law and Banking Law to operate in a safe and sound manner, in accordance with laws and regulations. Banking organizations must also play their part in the implementation of monetary policy and the implementation of these revisions to the reserve requirement will give DAB one more tool to carry out its legislative mandate to promote price stability.

in the monetary base promote declines in the broader monetary aggregates, and in the supply of credit in the economy.

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Article Three: Required Reserves

Part A — General.

§ 3.1.1. Authority.

This regulation on required reserves is pursuant to the authority granted to DAB by Articles 66 and 67 of the Decree Law of Da Afghanistan Bank (DAB Law) and by Article 35 of the Law on Banking in Afghanistan (Banking Law)

§ 3.1.2. Definitions.

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

- a) “*Base deposits*” shall mean the sum of deposits of non-financial institutions and other clients from line 14 of the balance sheet schedule of the financial reports.
- b) “*Base period*” shall mean the reserve accounting period in which a financial institution shall calculate their average daily base deposits that, when multiplied by the required percentage, yields the daily average required balance.
- c) “*Current account*” shall mean the demand deposit balances held by a financial institution with DAB.
- d). “*Currency*” shall mean bank notes issued by DAB that are legal tender in accordance with Article 3 of the DAB Law.
- e) “*Daily average required balance*” shall mean the average daily total holdings of eligible assets that must be maintained in order to satisfy its required reserves.
- f) “*Eligible assets*” shall mean Afghani-denominated vault currency and Afghani-denominated current account at DAB. . DAB has deemed these assets

as eligible to constitute a part of the required reserves of that financial institution for the purposes of this regulation.

- g) “*Reserve accounting period*” shall mean the accounting period set by DAB, not fewer than 28 days and not exceeding 31 days, for which a financial institution shall make the calculations necessary for the completion of the report referred to in § 3.2.5 of these regulations.
- h) “*Reserve deficiency*” shall mean the amount by which the total required balance exceeds the total actual balance.
- i) “*Total actual balance*” shall mean the actual average daily holdings of eligible assets.
- j) “*Total required balance*” shall mean the daily average required balance.

Part B—Required Reserves and Calculation.

§ 3.2.1. Required Reserves.

Each financial institution shall maintain required reserves comprised of the total actual balance in the form of eligible assets during a base period at the prescribed minimum average sum of base deposits. This prescribed minimum percentage will be announced periodically by DAB’s Open Market Committee. The initial minimum percentage is 8 percent, in effect until superseded by a Committee announcement.

§ 3.2.2. Foreign currencies.

For the purposes of calculating the total required balance, deposits that are denominated in foreign currencies shall be converted to Afghani using DAB’s daily buying rate for the currency concerned.

§ 3.2.3. Base periods.

The base period shall be 28 days, or be of such duration as DAB shall advise in later circulars. The first day of each period shall be a Friday and the last day of each 28-day period shall be a Thursday. In a circular annexed to this regulation and in subsequent circulars, DAB shall provide details of the first and subsequent base periods and reporting dates for the determination by each financial institution of its daily average sum of deposits.

§ 3.2.4. Required reserve computation and reports

A financial institution shall calculate the total actual and required balances during each base period in the manner provided by the instructions in the circulars and report forms annexed to these regulations and in any later instructions that DAB may issue.

§ 3.2.5. Required reserve report.

A financial institution shall submit a report called the “Required Reserve Report” examples of which are annexed to these regulations, to the General Director, Financial Supervision Department of DAB, not later than 6 calendar days from the last day of each base period (normally a Wednesday).

§ 3.2.6. Reserve deficiency.

Whenever a financial institution incurs a reserve deficiency during a base period, as revealed by the required reserve report, DAB shall assess a non-refundable penalty for such deficiency. The penalty is calculated as 0.6 percent of the deficit amount and will be deducted from the financial institution’s current account with DAB. If a financial institution incurs a reserve deficiency in two consecutive base periods, the penalty for the second base period will be 0.75 percent of the deficit amount.

§ 3.2.7. Reserve deficiency transfer.

DAB shall make the transfer described in § 3.2.6. within five days of the receipt of the report that discloses the deficiency.

§ 3.2.8. Additional Penalties.

In addition to the penalties mentioned above, a financial institution that incurs a reserve deficiency in three consecutive base periods or in any four base periods in a 12-month period shall be subject to additional enforcement actions under Chapter VI of the Banking Law.

Deleted: ,

§ 3.2.9. Remuneration

Depending upon the development needs of the banking sector and consistent with Article 66.2 of the DAB Law, DAB may choose to pay interest on that portion of the bank’s AFN-denominated current account with DAB that is necessary in order to fulfill the total required balance. However, DAB will not pay interest on that portion of the bank’s current account with DAB that causes the total actual balance to exceed the total required balance.

In order to calculate that portion of the AFN-denominated current account at DAB on which interest will be paid (remunerable portion), DAB will perform the following calculation:

Remunerable portion = min (daily average required balance – daily average vault cash, daily average current account at DAB)² If (daily average required balance – daily average vault cash) is less than zero, then the remunerable portion is zero.

DAB will pay interest retroactively for the entire base period on the remunerable portion by crediting the financial institution's current account at DAB. DAB will set the interest rate according to a formula that will be released to banking organizations by circular, and that rate, the final value of which will be announced at the end of the reserve maintenance period, will be expressed as an annualized interest rate. No interest will be credited to the current account until after the required reserve report has been submitted.

§ 3.2.10. Date of effectiveness.

Banks shall be required to comply with this regulation as of the date of passage by the Supreme Council.

² Examples: a) if the daily average required balance is 80,000, daily average vault cash is 20,000, and daily average current account at DAB is 70,000, the remunerable portion is 60,000. b) if the daily average required balance is 80,000, daily average vault cash is 20,000, and daily average current account at DAB is 50,000, then the remunerable portion is 50,000. c) if the daily average required balance is 80,000, daily average vault cash is 90,000, and daily average current account at DAB is 50,000, then the remunerable portion is zero. In example (b), of course, the bank does not fulfill the requirement since the total actual balance is less than the daily average required balance.

Appendix: Sample Calculation

Days	Base Deposits	Vault Currency	Current Account	Total Eligible Assets	Excess Reserves	Remunerable Portion
1	767,000	19,000	45,000	64,000		
2	743,000	17,000	48,000	65,000		
3	721,000	15,000	44,000	59,000		
4	801,000	21,000	42,000	63,000		
5	799,000	25,000	49,000	74,000		
6	782,000	26,000	51,000	77,000		
7	817,000	22,000	52,000	74,000		
8	820,000	20,000	46,000	66,000		
9	804,000	19,000	45,000	64,000		
10	786,000	19,000	45,000	64,000		
11	798,000	26,000	44,000	70,000		
12	773,000	23,000	42,000	65,000		
13	756,000	22,000	39,000	61,000		
14	782,000	18,000	53,000	71,000		
15	794,000	17,000	54,000	71,000		
16	813,000	19,000	57,000	76,000		
17	821,000	15,000	53,000	68,000		
18	801,000	22,000	59,000	81,000		
19	802,000	21,000	57,000	78,000		
20	804,000	14,000	54,000	68,000		
21	796,000	19,000	54,000	73,000		
22	795,000	19,000	53,000	72,000		
23	789,000	17,000	52,000	69,000		
24	813,000	24,000	56,000	80,000		
25	800,000	23,000	61,000	84,000		
26	787,000	23,000	59,000	82,000		
27	792,000	19,000	57,000	76,000		
28	797,000	17,000	51,000	68,000		
Average	791,179	20,036	50,786	70,821	7,527	43,259

In the above example, the banking organization meets the requirement. Its daily average required balance is 63,294, which is 8 percent of the daily average base deposits of 791,179. Its daily average total balance is 70,821, and so the bank has excess reserves of 7,527.

The amount the bank has in its AFN-denominated current account at DAB, on average, is 50,786. However, not the entire amount is remunerable for interest – only the amount that is necessary (given the amount of vault cash) to satisfy the required reserve amount. That remunerable amount is 43,259 – which, when added to the daily average vault cash of 20,036 – yields the required balance of 63,294.