



## **Islamic Republic of Afghanistan Da Afghanistan Bank**

### **Summary**

Da Afghanistan Bank (DAB) regulation on the secondary market for Capital Notes issued by DAB and this regulation approved by DAB supreme council on 18<sup>th</sup> March 2008.

### **Purpose of regulation**

The purpose of the regulation is to establish a basic framework for secondary market transactions in Capital Notes issued by DAB. DAB issues Capital Notes with a view to managing liquidity in the financial system as a means of executing monetary policy, which is one of the basic tasks of DAB under the Law on Da Afghanistan Bank (the DAB Law). The effectiveness of the use of Capital Notes for monetary policy will be enhanced by the establishment of a properly functioning secondary market for bringing together buyers and sellers of Capital Notes that have been issued and for carrying out purchases and sales and other types of secondary market transactions involving Capital Notes.

### **Background and summary of regulation**

The formulation, adoption and execution of monetary policy is one of the key methods for achieving and maintaining domestic price stability, which is the primary objective of DAB under the DAB Law. The purchase and sale of Capital Notes by DAB on the secondary market (commonly referred to as open market operations) will allow DAB to increase or decrease, as appropriate in view of monetary policy goals, liquidity in the financial system. A properly functioning ongoing secondary market in Capital Notes, in which buyers and sellers participate to accomplish their own business or investment objectives, will enhance DAB's ability to effect its open market operations whenever needed.

In addition to the primary objective of domestic price stability, a secondary objective of DAB is to foster the liquidity, solvency and proper functioning of a stable market based financial system. The establishment of an efficient secondary market for Capital Notes will help to achieve this secondary objective as well.

On March 23, 2006, the Supreme Council of DAB amended the Capital Note Issuance and Auction Regulation to regulate the primary market in Capital Notes and to establish the basic terms and conditions of Capital Notes. The following regulation will establish and regulate the secondary market for Capital Notes.

[This regulation approved by the supreme council of DAB on 18<sup>th</sup> March 2008](#)

More particularly, the regulation will provide that the secondary market for Capital Notes is an over-the-counter market where transactions are negotiated bilaterally between buyers and sellers. The regulation further provides that transactions may occur between banks, between a bank and any other investor, or between investors. Because Capital Notes are issued in electronic rather than physical certificate form, Capital Notes are held through a two-tier system of securities accounts. The first tier is a securities account maintained by a bank or other licensed entity on the books of DAB. The second tier is a securities account maintained for investors by banks that have been authorized by DAB to hold securities for investors who do not have accounts with DAB.

The regulation requires that a bank authorized to hold securities for investors must have an adequate system for accounting for such securities. The regulation further requires that fully-paid investor securities must be segregated from assets of the bank and must be kept free of liens created by the bank. Clearance and settlement of secondary market transactions generally will occur through the securities settlement system maintained by DAB and in accordance with the Rules Governing the Transfer of Capital Notes and Operation of the Central Depository.

The regulation also establishes certain market conduct rules and prohibits manipulation, deception or fraud, price-fixing, other anti-competitive conduct, misrepresentation of material facts, or false or misleading statements. Fees and commissions charged to investors are required to be reasonable and not unfairly discriminatory.

Finally, the regulation establishes the role of DAB for facilitation of the market and surveillance of the market, and provides sanctions for failure of market participants to comply with the requirements of the regulation.

The authority for adoption of this regulation arises from several different provisions of the DAB Law. Under Article 4, paragraph 3.g., one of the basic tasks of DAB is to establish, maintain and promote sound and efficient systems for transfers of securities issued by the State or DAB and for the clearing and settlement of transactions in such securities. This regulation helps to achieve this goal for Capital Notes. Furthermore, the secondary market infrastructure developed for Capital Notes can be easily adapted to the issuance and trading of securities issued by the State if and when the government needs to borrow in the future.

Under Chapter X of the DAB Law, DAB is exclusively responsible for the regulation and supervision of securities service providers in accordance with the objectives of Article 101, which includes promoting confidence in and public understanding of securities services, securities transfer systems and financial markets. The provisions relating to the role of banks in the holding of Capital Notes and in the transfer of interests in Capital Notes regulates banks as securities service providers under these provisions of the DAB Law.

DAB issues Capital Notes and determines the terms and conditions of the Capital Notes pursuant to Article 8, paragraph g. of the DAB Law. The scope and method of transferability of Capital Notes are part of their terms and conditions.



**Islamic Republic of Afghanistan  
Da Afghanistan Bank**

**Article Four: Regulation on the Secondary Market for capital Notes**

**PART A-GENERAL PROVISIONS.**

**§ 4.1.1. Scope.**

- (a) This regulation applies to all secondary market transactions in Capital Notes and to parties to such transactions.

**§ 4.1.2. Definitions.**

- (b) “DAB” means Da Afghanistan Bank.
- (c) “Bank” means a licensed bank doing business within the Islamic Republic of Afghanistan.
- (d) “Capital Note” means a marketable debt security that is issued by DAB in book-entry form and is a direct obligation of the Bank.
- (e) “Central Depository” means the securities accounts maintained by DAB to reflect holdings of Capital Notes by banks, foreign exchange dealers, and money service providers.
- (f) “Client Omnibus Account” means the tier 1 account of a bank that is specifically designated to hold investor securities.
- (g) “investor” means any person that purchases, sells, or holds an interest in a Capital Note through a securities depository.
- (h) “secondary market transaction” means: a) the purchase or sale of Capital Notes other than the purchase of Capital Notes directly from DAB at the time of issuance; b) transactions pursuant to repurchase agreements, sale and buy back agreements, and securities lending agreements; c) derivative transactions (e.g. securities swaps); d) transfer of title arrangements; e) pledges; f) or any other similar derivative financial transaction involving Capital Notes.
- (i) “securities depository” means a bank authorized by DAB to hold securities for the account of others through tier 2 accounts.
- (j) “tier 1 account” means a securities account maintained by a bank, a foreign exchange dealer, or a money service provider in the Central Depository to reflect holdings of Capital Notes.
- (k) “tier 2 account” means a securities account maintained by an investor in a securities depository to reflect the investor’s holdings of Capital Notes.

## **PART B-ORGANIZATION OF THE SECONDARY MARKET.**

§ 4.2.1. **Capital Notes Exempt from Registration.** Pursuant to Article 97.2. of the DAB Law, Capital Notes are exempt from registration under Article 97.

### **§ 4.2.2. Organization and Infrastructure of Secondary Market.**

- (l) Secondary market transactions are negotiated bilaterally as over-the-counter transactions.
- (m) Any person may engage in a secondary market transaction involving Capital Notes.
- (n) All secondary market transactions must be cleared and settled through the Capital Notes settlement system maintained by DAB in accordance with the applicable regulations, rules, and instructions, except that the following transactions may be cleared through a securities depository:
  - (1) transactions where both parties maintain a tier 2 account through the same securities intermediary;
  - (2) transactions concluded between an investor or bank and its securities depository.
- (o) The interest acquired by through a secondary market transaction shall be held through one or more securities accounts in accordance with the provisions of Part III.

## **PART C- HOLDING OF CAPITAL NOTES**

### **§ 4.3.1. Central Depository.**

- (p) DAB operates the Central Depository and settlement system for Capital Notes. The operation of the Central Depository and settlement system will be governed by the system rules established by the Bank.
- (q) Any bank, foreign exchange dealer, or money service provider that maintains a current account at DAB may be a participant in the Central Depository.

### **§ 4.3.2. Holdings of interest in Capital Notes.**

- (r) A participant in the Central Depository may hold Capital Notes through one or more tier 1 accounts in the Central Depository.
- (s) A participant may have two types of tier 1 accounts:
  - (1) an account that reflects Capital Notes held by the participant for its own account; and
  - (2) an account that reflects Capital Notes held by the participant but pledged as collateral to DAB (“a collateral account”).
- (t) A bank that is a securities depository must also have an account to reflect Capital Notes held for the account of investors (Client Omnibus Account).

- (u) An investor must hold Capital Notes through a tier 2 account in the name of the investor with an authorized securities depository.

**§ 4.3.3. *Approval of securities intermediaries.***

- (v) A licensed bank that wishes to hold Capital Notes on behalf of investors must obtain the prior approval of DAB.
- (w) To obtain approval, the bank must establish to the satisfaction of DAB that it will be able to comply with the requirements of this regulation regarding segregation and accounting for [fully-paid] securities held on behalf of others.
- (x) DAB shall assign to each approved securities depository a Client Omnibus Account in the Central Depository.

**§ 4.3.4. *Segregation.***

- (y) All Capital Notes held by a securities depository on behalf of investors must be segregated from all other assets of the securities depository, in particular Capital Notes held by the securities depository for its own account. The aggregate amount of Capital Notes held on behalf of investors must be held in the Client Omnibus Account described in section 7(c).
- (z) All [fully-paid] Capital Notes held on behalf of investors must be kept free of any lien granted or created by the securities depository.
- (aa) Under no circumstances may a securities depository make use of the Capital Notes held on behalf of investors.
- (bb) In the event of an insolvency of a securities depository, the Capital Notes held in the Client Omnibus Account managed by the securities depository will not be available to the liquidator, except for distribution of the Capital Notes to the investors according to their holdings. In case erroneous or fraudulent securities transfers have occurred between the Client Omnibus Account and any other tier 1 account of the securities depository, the liquidator will make the necessary adjustments in favor of the Client Omnibus Account.

**§ 4.3.5. *Accounts, accounting and statements.***

- (cc) Each securities depository must have an accounting system that, at any given moment:
  - (1) can accurately show, the amount of Capital Notes held in the name of the securities depository and the amount on behalf of investors;
  - (2) can accurately show the individual holdings of each investor held through that securities depository
  - (3) capture and retain information on all trades as required to process the trades, adjust holdings in securities accounts, and comply with reporting requirements to DAB.
- (dd) At all times, the aggregate of the amounts of an individual issue of a Capital Note held on behalf of investors in tier 2 accounts of a securities intermediary

must equal the total of that Capital Note reflected in the Client Omnibus Account with the Central Depository.

- (ee) Each securities intermediary must provide investors with periodic statements of account, with such frequency and containing such information as DAB shall prescribe.

**PART D- MARKET CONDUCT RULES AND OTHER REQUIREMENTS APPLICABLE TO MARKET PARTICIPANTS.**

**§ 4.4.1. *Standards of conduct.*** All banks, in conducting business in the secondary market, shall observe high standards of commercial honor.

**§ 4.4.2. *Prohibited conduct.***

- (ff) No person may induce a secondary market transaction involving any Capital Note by means of manipulation, deception, or fraud.
- (gg) No person, acting in concert with another, may engage in any conduct that directly or indirectly fixes a purchase or selling price or any other trading condition.
- (hh) No person, acting alone or in concert with others, may engage in any other conduct that substantially prevents or lessens competition in the market.

**§ 4.4.3. *Fees and commissions.***

- (ii) Charges, if any, for services performed by a bank for an investor in connection with a secondary market transaction must be reasonable and must not unfairly discriminate between investors.
- (jj) If a bank buys for its own account from an investor, or sells from its own account to an investor, the bank must buy or sell at a price that is fair, taking into consideration market conditions and the expense involved in the transaction.
- (kk) If a bank acts as agent for a investor in any transaction, the bank may not charge the investor more than a fair commission or service charge, taking into consideration market conditions, the expense involved in the transaction, and the value of any service the bank may have rendered by reason of experience and knowledge of the market.

**§ 4.4.4. *Reporting***

- (ll) On a [weekly] basis, each securities depository must report to DAB
  - (1) its holdings on behalf of investors in the form set out in Annex I of this regulation. [Annex I to require reporting that distinguishes between Afghan residents and non residents and among categories of investors such as natural persons, banks, insurance companies, and pension funds.]; and
  - (2) all secondary market transactions for that [week] as follows:

- (A) A transaction between banks shall be reported by the [selling bank].
  - (B) A transaction between a bank and an investor shall be reported by the bank.
  - (C) A transaction between two investors shall be reported by the securities depository for the [seller].
- (mm) The transaction report is required to be submitted in the form prescribed by DAB.

and shall contain the following information:

- (1) The identification number of the Capital Note;
- (2) The par value of the Capital Note;
- (3) The price of the transaction;
- (4) The time of execution; and
- (5) Any other information required by the Bank.

#### **PART E-CENTRAL BANK RESPONSIBILITIES**

**§ 4.5.1. Market facilitator.** DAB will take any or all of the following actions to enhance the liquidity, efficiency, and transparency of the secondary market:

- (nn) Establish or require the banks to establish a mechanism for handling investor complaints;
- (oo) Establish or request the banks to establish a forum for the determination of market practices, the exchange of information and ideas regarding the secondary market and its functioning, particularly with regard to efficient clearance and settlement of secondary market transactions;
- (pp) Adopt such additional rules and regulations governing the secondary market as DAB considers necessary or appropriate to achieve the purpose of this regulation;
- (qq) Conduct workshops for banks and for the general public on Capital Notes and the functioning of the secondary market;
- (rr) Publish written materials to disseminate information regarding Capital Notes and the functioning of the secondary market, including daily yields for outstanding issues of Capital Notes with standard remaining maturities.

**§ 4.5.2. Market surveillance.**

- (ss) DAB will carry out surveillance of the secondary market to
  - (1) detect disorderly market conditions and infringements of this regulation and other applicable rules;
  - (2) to identify anomalous price patterns and other issue-specific developments; and
  - (3) to assist DAB in the formulation and implementation of monetary policy.
- (tt) To facilitate surveillance, DAB may require banks and investors to report such information regarding the secondary market as DAB determines necessary or appropriate to enable DAB to conduct adequate surveillance.

§ 4.5.3..*Sanctions for failure to comply with requirements of this regulation.*

(uu) If a bank or investor fails to comply with any requirement of this regulation, DAB may:

- (1) Suspend or withdrawal authorization of the bank to act as a securities depository;
  - (2) Suspend or bar the bank from conducting transactions on behalf of investors;
  - (3) Suspend or bar the bank or investor from participating in auctions of new issues of Capital Notes or in secondary market transactions.
- (vv) The sanctions listed in subsection (a) are in addition to any other penalty, sanction, or corrective action that DAB may be authorized to take under applicable law, including the Law on Banking.