



Project Information Document (PID)

Concept Stage | Date Prepared/Updated: 30-Mar-2020 | Report No: PIDC27837

**BASIC INFORMATION****A. Basic Project Data**

Country Afghanistan	Project ID P171886	Parent Project ID (if any)	Project Name Strengthening Afghanistan's Financial Intermediation (P171886)
Region SOUTH ASIA	Estimated Appraisal Date May 25, 2020	Estimated Board Date Jul 31, 2020	Practice Area (Lead) Finance, Competitiveness and Innovation
Financing Instrument Investment Project Financing	Borrower(s) Government of Islamic Republic of Afghanistan	Implementing Agency Da Afghanistan Bank, Afghanistan Credit Guarantee Foundation (ACGF)	

Proposed Development Objective(s)

The PDO is to strengthen financial sector stability, financial safety net and access to finance for MSMEs in Afghanistan

PROJECT FINANCING DATA (US\$, Millions)**SUMMARY**

Total Project Cost	60.00
Total Financing	60.00
of which IBRD/IDA	60.00
Financing Gap	0.00

DETAILS**World Bank Group Financing**

International Development Association (IDA)	60.00
IDA Grant	60.00



Environmental and Social Risk Classification

Moderate

Concept Review Decision

Track II-The review did authorize the preparation to continue

Other Decision (as needed)

B. Introduction and Context

Country Context

- 1. Substantial improvements in development outcomes have been observed in Afghanistan since 2001, particularly in expanded access to water, sanitation and electricity, education, and health services.** Macroeconomic management remains strong, government revenues have grown consistently since 2014, and the government has engaged in a range of business environment and public financial management reforms. Expanded access to health, education, and infrastructure has seen rapid improvements in outcomes, with Afghanistan catching up with other low-income countries against key development indicators. While progress has been uneven, increased access to services and infrastructure has driven significant development gains.
- 2. At the same time, Afghanistan continues to experience insecurity and political uncertainty. Final results of September 2019 Presidential elections were announced only in February 2020.** Civilian casualties exceeded 10,000 again in 2019: 3,403 civilians killed and 6,989 injured. Displacement crisis persisted and the number of conflict-induced IDPs increased from 369,700 in 2018 to more than 400,000 in 2019. 505,000 refugees returned to Afghanistan, mainly from Iran, during 2019.
- 3. Negotiations between the US and the Taliban have concluded on February 29, 2020, but the process of a political settlement is only beginning.** Meanwhile, current international support pledges are due to expire in 2020, creating uncertainty regarding the sustainability of security and development expenditures. This has fundamental implications for the economy, with growth and investment constrained by weak confidence.
- 4. Afghanistan's economy is estimated to have grown by 2.9 percent in 2019 due to easing of drought conditions and rapid agricultural growth.** The trade deficit remains extremely large, over 30 percent of GDP, financed mostly by grant inflows. Fiscal performance continued to improve with domestic revenues reaching 14.1 percent of GDP. Political uncertainties, however, dampened private sector confidence and non-agriculture growth. The basic needs poverty rate was 55 percent at the time of the last survey (2016/17) and is expected to have worsened since. In 2020, growth is expected to slightly increase to 3.3 percent, but it will likely remain modest and subject to substantial downside risks. Poverty is expected to remain high.
- 5. Short-term priorities include continued implementation of reforms to improve private sector confidence, mobilize investment, and ensure confidence of the international community.** Over the medium-term, reforms should focus on attracting additional investment in agriculture and extractives, to deliver increased employment, exports, government revenues, and growth. To ensure that benefits of growth are maximized and widely shared, continued investment is required in human capital, regional connectivity, expanded infrastructure, and an improved business regulatory environment.



Sectoral and Institutional Context

- 6. The financial sector in Afghanistan is bank-dominated and concentrated in urban areas.** The sector consists of 13 banks: seven private commercial banks, one private full-fledged Islamic bank, three state-owned banks, and two foreign bank branches. All banks in the three categories are regulated and supervised by the central bank, Da Afghanistan Bank (DAB). The ratio of total banking sector assets to GDP in 2018 was 23 percent. The three largest banks owned 49 percent of banking sector assets in 2018. Private banks are dominant; state-owned banks (SOBs) own only 27 percent of the total banking sector assets. In addition, there is a formal microfinance sector, consisting of six microfinance institutions (MFIs) and an apex microfinance facility: MISFA (Microfinance Investment Support Facility for Afghanistan)¹.
- 7. Robust financial safety nets and stability are essential to increase confidence in the banking system.** Trust and confidence in the banking sector are yet to fully recover after the Kabul Bank crisis in 2010. The financial sector continues to remain vulnerable as it copes with the systemic challenges uncovered by the collapse of Kabul Bank. A massive fraud led to a run on the country's then-largest bank, necessitating a government bailout, equivalent to 5 percent of Afghanistan's GDP in 2011.
- 8. Therefore, deposit insurance, bank resolution and crisis management frameworks, robust financial sector oversight and capacity building are crucial for strengthening banking stability.** During the run, half of the assets of Kabul Bank were withdrawn. To contain the run, DAB guaranteed the deposits and extended a last-resort-facility of US\$825 million.
- 9. Due to low intermediation and depth of banking sector, lending to Micro, Small and Medium Enterprises (MSMEs) is very limited, estimated at only 16 percent of total bank lending as of end December 2019.** MSMEs – mostly micro and small businesses are also served by the microfinance institutions. As at end-2019, MSMEs represented about a fifth of MFI lending, with an average outstanding loan below \$17,000. According to the 2017 MSME finance Gap, around 54 percent of Afghan MSMEs are financially constrained; 40 percent of which are fully constrained². Women-owned or managed MSMEs represent barely 2 percent of the current MSME financing. To facilitate access to finance, Afghanistan Credit Guarantee Foundation (ACGF) was established to provide partial credit guarantees to eligible financial intermediaries for lending to small and medium enterprise sectors.

Relationship to CPF

- 10. The project is fully aligned with the Government's National Priority Program (NPP) on Private Sector Development that clearly specifies access to finance for the private sector as a key priority.** It is also corresponding to the Country Partnership Framework's pillar 1 relating to building efficient government as well as pillar 2 emphasizing inclusive growth.

C. Proposed Development Objective(s)

- 11. The project development objective is to strengthen financial sector stability, financial safety net and access to finance for MSMEs in Afghanistan.**

¹ Including four partners are First Micro Finance Bank (FMFB, which is a commercial bank), FINCA (an international not-for-profit corporation), Mutahid Development Finance Institution, and OXUS Development Network. The sector includes two non MISFA partner MFIs.

² International Finance Corporation (IFC) Enterprise Finance Gap Database (2017)



Key Results

12. The expected key results include:

- i) increased capacity of DAB to supervise financial sector;
- ii) strengthened financial safety net with well governed and capitalized deposit insurance fund; and
- iii) enhanced access to finance for SMEs.

D. Concept Description

13. To achieve the PDO the project will include the following critical activities:

- **Technical assistance:** i) reforming the legal and regulatory framework for the financial safety net including the deposit insurance, as well as, the banking resolution and crisis management frameworks; ii) strengthening of the technical and institutional capacity of the Afghanistan Deposit Insurance Corporation (ADIC), including the sustainability assessment of ADIC, adequacy of its capitalization and identification of financing gap; ii) capacity building and technical assistance to DAB to strengthen its overall regulatory and supervisory capacity, including related to on- and off-site bank supervision, regulation and supervision of other financial institutions, antimoney laundry and countering financing of terrorism, international financial reporting standards, risk-based audit, financial consumer protection, forensic audit of commercial banks, etc.); and iv) strengthening capacity of ACGF including technical assistance to participating financial intermediaries (i.e. banks and MFIs) to scale up its risk management capabilities as well as internal controls and processes so as to expand outreach to MSMEs in a sustainable way.
- **Investment in DAB’s IT Infrastructure.** Investing in DAB's IT infrastructure including: i) modernization of the Core Banking System (CBS) so as to strengthen DAB's oversight and risk management capacity; ii) automation of off-site supervision; iii) investment in critical IT to operationalize deposit insurance function; and iv) modernization of the collateral registry and public credit registry to facilitate access to finance
- **Financial support to further capitalize the Deposit Insurance Fund**
- **Financial support to Afghanistan Credit Guarantee Foundation (ACGF)** whose current capital stock will be fully committed in the near future to support its growth plans

Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Screening of Environmental and Social Risks and Impacts

Environmental and social risk and impact under the project are limited to operations of ACGF. This is a financial intermediary financing project supporting ACGF as an established entity with a strong record of E&S risk management. The participating financial institutions’ (FIs, i.e. banks, microfinance institutions) lending– guaranteed by ACGF - will exclusively focus on small and medium enterprise borrowers (final beneficiaries) including activities with limited environmental risk based on experience to date. The potential impacts are expected to be low in magnitude, easily mitigated and temporary in nature. ACGF has established grievance mechanism allowing the final beneficiaries to lodge complaints with FIs which if serious in nature or unresolved at FI level are addressed by ACGF.



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APPROVAL

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