



# INTEROPERABILITY OF FINANCIAL SERVICES PROVIDERS AFGHANISTAN

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## ABSTRACT

The political events of August 2021 triggered a complex economic crisis in Afghanistan. A robust digital payment ecosystem that supports an efficient distribution of aid to those most affected by the crisis is critical. The establishment of the Afghanistan Payment System (APS) in 2011 aimed to provide a safe and secure way for individuals, businesses and government entities to conduct digital financial transactions, but the recent crisis has hindered its progress. This report assesses the current state of the APS and provides recommendations to increase interoperability across financial services providers to support the effective distribution of aid and longer-term sustainable development outcomes in Afghanistan.

# Introduction

*The Afghan economy has been experiencing a dramatic contracting trend since 2020 which was precipitated by the events of August 2021. Resultantly, the GDP contracted by 20.7 percent in 2021 and an estimated 3.6 percent in 2022 despite a considerably generous humanitarian and basic human needs assistance package by the international community.<sup>1</sup>*

The World Bank estimates a total GDP contraction of 30 percent between 2020-2022. This enormous and rapid economic decline has plunged the population into destitution and extreme vulnerability to natural calamities such as drought, quakes, and floods. UNDP estimates show that 84 percent of Afghans are not able to spend as much as AFN 2,268 (US\$26) per person per month (national poverty line) on their daily needs. Around 97 percent of households are unable to meet basic needs, including food and medical care. This is purely due to economic factors, which include the international community cutting off aid when the Taliban took over, but also a 5.9 magnitude earthquake in 2022, and droughts and flooding that impacted crops. At the beginning of the crisis, there were very legitimate fears about the complete collapse of the country's economy; however, a pipeline of cash flow in by the United Nations maintains some stability, as the central bank's reserves remain frozen.

To distribute the cash, humanitarian agencies and development partners need simple, fast, transparent and cost-effective ways to release and channel cash-based interventions to those who need it the most, in particular those in remote areas and women. A robust digital payment ecosystem includes a secure digital payments infrastructure inclusive of all private sector players so that beneficiaries can receive funds into any account and then conveniently and affordably use or cash out those funds. Given the limited availability of cash-out points or merchant payments, interoperability is key to reducing infrastructure investments of individual financial service providers (FSPs).

<sup>1</sup> United Nations Development Programme, 'Afghanistan Socio-Economic Outlook 2023,' Kabul, 2023.

Interoperability in the financial sector refers to the ability of different FSPs to work together seamlessly, allowing individuals and businesses to easily access a range of financial services. The establishment of a single interoperable system for all FSPs drives efficiency among market players and provides the right incentives for individuals and micro, small and medium-sized enterprises (MSMEs) to accept electronic payments over cash for aid disbursements and other financial transactions (i.e. merchant payments, utility bill payments, loan payments, etc.). Common rules and protocols for payment providers translate into services that are more affordable and convenient for everyone, in particular for those in the last mile. Developing an interoperable system requires a participatory process with all FSPs, which can help development actors ensure a sustainable and inclusive financial system.<sup>2</sup> With this in mind, in 2011, the Afghanistan Payments System (APS) was created, resulting from a combined effort of the United States Agency for International Development (USAID), the World Bank and a consortium of FSPs. The APS supported various payment channels, including mobile payments, internet banking and card payments.

This report presents an assessment of the APS and provides some recommendations to increase interoperability across FSPs as a driver of more effective distribution of aid in Afghanistan. The report also takes into consideration the political events of August 2021 which triggered a complex economic and financial crisis.

<sup>2</sup> Negre, Alice, and William Cook, 'Interoperability in Digital Financial Services: Emerging Guidance for Funders', Technical Note, CGAP, Washington, DC, 2021.

# Digital financial services in Afghanistan

The digital financial services (DFS) industry in Afghanistan is quite limited. Today, there are four mobile money operators (MMOs) licensed by Da Afghanistan Bank (DAB), the central bank of Afghanistan: Roshan (M-Paisa), Etisalat (mHawala), MTN (MoMo) and Afghan Wireless (My Money). The reach of the MMOs is quite limited, providing services to fewer than 1 percent of the country's population<sup>3</sup> through a network of only about 9,828 registered agents (see Table 1) concentrated mostly across major cities (according to DAB's Non-Banking Financial Institution Supervision Department). Their services include mainly airtime top-ups, bill payments and store value accounts, they are driven by Unstructured Supplementary Service Data (USSD), and they are not interoperable.



**Prior to the political events that took place in August 2021, common use cases of mobile money included payment of utility bills, airtime top-ups and salary payments.**

Mobile apps and QR payments were available but with extremely limited use cases. In 2017, only 9 percent of Afghans had received a digital payment<sup>4</sup> (Findex 2017), and only 2.7 percent of women. According to 2021 Findex data, the situation deteriorated even further for women, with the proportion receiving digital payments falling to 1.6 percent.

Table 1. Number of mobile money agents in Afghanistan

DIGITAL FINANCIAL SERVICES PROVIDERS	NUMBER OF AGENTS
M-Paisa	1,100
MTN MoMo	2,742
MyMoney	2,200
mHawala	500
HesabPay	3,000
Refah Payment Services	286
Total	9,828

<sup>3</sup> Global Findex Database 2021.

<sup>4</sup> Global Findex Database 2017.

There are two payment institutions (PIs), entities that provide payment services, that are also regulated by DAB and are operating: HesabPay and Refah Payment Services. These PIs currently operate across 34 provinces and have a network of over 24,500 agents (of which 12 percent are women) using points of sale (POS) and mobile applications.

HesabPay, for example, is a blockchain-based platform providing a digital wallet solution already reaching 400,000 people. The platform is integrated with APS to be able to work across all banks and AfPay card users, and clients are able to transfer/access funds domestically via either a smartphone application or a QR code. In addition to the 4 MMOs and the 2 PIs there are 10 licensed banks with a combined network of 378 automated teller machines (ATMs) (see Table 2), 300 branches, approximately 1.3 million cardholders and 2,000 POS devices.

Table 2. Number of ATMs in Afghanistan

BANK	NUMBER OF ATMS
AIB	140
Azizi Bank	89
New Kabul Bank	42
Ghazanfar Bank	10
Islamic Bank of Afghanistan	46
FMFB	10
AUB	24
BMA	17
Pashtany	8
Total	378

Some of the banks have established partnerships with MMOs. There are six microfinance institutions (MFIs) with an outreach of 43,964 clients going through multiple challenges which limit their capacity to currently provide services. Of the 840 money service providers (MSPs) licensed by DAB, AliShaq and AfghanSharq are working to provide their services digitally. Tables 3–5 provide a summary of the different channels allowing the delivery of DFS in Afghanistan.

Table 3. Channels allowing banks to deliver DFS

BANK	PERSON/BUSINESS NEEDS A BANK ACCOUNT TO USE THE FOLLOWING AVAILABLE DIGITAL CHANNELS		
	CARDS	APP FOR SMARTPHONES	E-VOUCHERS
AIB	✓	✓	✓
Azizi Bank	✓	✓	✓
Islamic Bank of Afghanistan	✓	✓	✓
AUB	✓	✓	✓
BMA	✓	✓	✓
Pashtany	✓	✓	✓
NKB	✓	✓	✓
Maiwand Bank	✓	✓	✓
FMFB	✓	✓	✓
Ghazanfar Bank	✓	✓	✓

Table 4. Channels allowing MMOs to deliver digital services

MMO	PERSON/BUSINESS NEEDS A MOBILE MONEY ACCOUNT TO USE THE FOLLOWING AVAILABLE DIGITAL CHANNELS			
	USSD ENABLED	APP FOR SMARTPHONES	E-VOUCHERS	QR CODES
M-Paisa	✓	✓	✓	✓
mHawala	✓	✓	✓	✓
MyMoney	✓	✓	✓	✓
MTN MoMo	✓	✓	✓	✓



Table 5. Channels allowing PIs to deliver digital services

PI	PERSON/BUSINESS NEEDS EITHER A MOBILE MONEY ACCOUNT OR A BANK ACCOUNT TO USE THE FOLLOWING AVAILABLE DIGITAL CHANNELS			
	USSD ENABLED	APP FOR SMARTPHONES	E-VOUCHERS	QR CODES
HesabPay	✓	✓	✓	✓
Refah Payment Services	✓	✓	✓	✓



In March 2022, UNCDF, in partnership with UNDP, launched a pilot to digitize payments made by international non-government organizations (INGOs) to beneficiaries of UNDP’s flagship programme, Area Based Approach for Development Emergency Initiatives (ABADEI).

The pilot used six different digital payment solutions—mobile wallets, debit cards, e-vouchers, virtual accounts, QR codes and AfPay cards—from seven different FSPs, including two banks (Ghazanfar Bank and Islamic Bank of Afghanistan), two PIs (Refah Payment Services and HesabPay) and three MMOs (M-Paisa, MyMoney and MoMo). Other development partners, such as the World Food Programme (WFP), the United Nations Children’s Fund (UNICEF), the World Health Organization (WHO) and the Office of the United Nations High Commissioner for Refugees (UNHCR), are using similar types of DFS.

Some of the barriers that have prevented the uptake of DFS in Afghanistan include the following:

- Lack of ID to comply with know your customer (KYC) requirements. According to the Afghanistan Central Statistics Organization, in 2019, 47 percent of men had a national identification card (eTazkiras) compared to 17 percent of women. However, an estimated 10,000 eTazkiras are being distributed each day.
- Low ownership of mobile phones. According to the International Telecommunication Union (ITU), 66 percent of men and 31 percent of women owned a mobile phone in 2021 (ITU, 2021).<sup>5</sup> However, 9.23

5 International Telecommunication Union. ‘Measuring digital development. Facts and figures. 2021,’ Geneva, 2021.

million of the 27.49 million phones in Afghanistan are smartphones, and ownership is increasing at 7 percent per year.

- Although 88 percent of the population has Global System for Mobile (GSM) coverage, which includes coverage of both 2G and 3G GSM networks, mobile network coverage is limited or non-existent in areas outside the major cities. Efforts are underway to improve mobile network coverage in these areas, and Internet access is increasing at 9 percent per year.
- People's financial and digital capabilities and awareness about mobile money services are quite low, although picked up much faster by the new generation (Afghanistan has the youngest population in the world outside sub-Saharan Africa).
- Lack of appetite of major DFS providers to go to the last mile.
- Afghans' trust in Hawalas, a 200-year-old honour-based network of money transfer providers which, despite being informal, are convenient and more efficient than more formal money transfer services.
- Lack of interoperability across FSPs, reducing the usefulness of digital disbursements.
- Lack of coordination among FSPs, donors and governments.

Some of these barriers, such as limited financial and digital capabilities, low levels of ownership of mobile phones, lack of ID, and cultural barriers, are affected by gender dynamics which exacerbate the exclusion of women from DFS. For example, women's freedom of movement and other human rights have been restricted by a series of edicts issued by the *de facto* authorities. These measures make it difficult for women to travel to government offices or other locations where they can apply for an *eTazkira*, which in turn prevents them from opening an account to receive digital payments.



**If they can overcome the barrier to comply with simple KYC requirements, they still face cultural and economic barriers that prevent them from owning a mobile phone that will allow them to receive/make digital payments.**

Equally important, an interoperable payment system that is not inclusive of institutions that are more likely to serve women (i.e. MFIs) or design their products bearing in mind the specific barriers women face in terms of lower digital and financial capabilities or lower mobile phone ownership (i.e. MFIs, emerging PIs, etc.) also becomes a barrier that exacerbates the exclusion of women from DFS.

# The role of the APS

*The APS was established to bring interoperability among financial institutions in Afghanistan to enable real-time retail payments and advance financial inclusion. It was intended to perform three basic functions.*

## As a payment switch operator

The APS was expected to process payments and clear transactions between different financial institutions. The switch was responsible for the clearing and settlement of real-time retail payments, with integration into the Afghanistan Transfers System, which is responsible for real-time gross settlements (RTGS). In simple terms, the APS would allow Aicha, an imaginary Afghan woman with an account at AIB Bank, to pay AFN500 for her groceries at Wali's supermarket, which has a card terminal installed by Azizi Bank. This is what would actually happen:

- The card terminal at Wali's supermarket would send a message to Azizi Bank with the information about Aicha's transaction.
- Since Aicha's card is from AIB Bank, Azizi Bank (the owner of the card terminal) would send the information to the APS to handle the transaction.
- The APS would recognize Aicha's card and send the information to AIB Bank.
- AIB Bank would verify that Aicha is indeed the owner of the card, check if she has enough money, if the PIN was correct, etc., and then debit the transaction amount from her account and send a message to the APS approving the transaction.
- The APS would record in its ledger that AIB Bank owes Azizi Bank AFN500.
- Azizi Bank would send a message approving the transaction to its card terminal at Wali's supermarket, and Aicha could go home with her groceries.
- Aicha's account would be debited and Wali's account would be credited in real-time.

Every 24 hours, the APS would reconcile all the digital transactions performed during that day from different individuals, businesses, etc., sum up all the liabilities of the FSPs and calculate how much money was owed to each FSP. This is called settlement and usually requires a settlement bank, which is usually the central bank (DAB in the case of Afghanistan).

### **As a third-party service provider, to whom banks and other FSPs outsource some of their functions**

Breaking even purely on switching fees is often a challenge, in particular when the volume of the transactions is not enough. This was the case for the APS, and as a result, the system also developed other products for FSPs. For example, the APS was responsible for the national card scheme AfPay, which offered debit, prepaid and credit cards, and host management services which were used by some, but not all, banks. It also operated a financial messaging service that enabled FSPs to exchange financial services securely and efficiently.

### **As a *de facto* payment service provider to individuals, businesses and/or the government**

For example, the APS was the government payment aggregator and was integrated with the government revenue system. These systems included the Automated System for Customs Data (ASYCUDA) for customs revenues and the Standard Integrated Government Tax Administration System (SIGTAS) for tax and non-tax revenues. The APS also offered a product called \*246#, which enabled individuals with a feature phone to link an AfPay card to their mobile phone and conduct a series of transactions, such as transferring money, paying bills or checking their bank balance.

# The APS prior to August 2021

## Phase 1: the APS as an independent platform (2011–2017)

The APS was launched in 2011 as an independent agency, managed by its members and a supervisory board, including representatives from the financial sector and DAB. Voting members of the APS board from its inception in 2011 until 2017 included Azizi Bank, Bakhtar Bank (currently Islamic Bank of Afghanistan), Bank-e-Millie Afghan, Afghanistan Commercial Bank and Ghazanfar Bank. All other financial institutions were non-voting members. During this phase, the APS's operational costs were funded by the World Bank, the APS team was established and trained, and the necessary hardware and software was procured. As in other markets, the APS first focused on ATM interoperability, which was achieved across four major banks during this period.



During this phase, the switch infrastructure was built, allowing the APS to start performing its original role as the operator of the national payment switch.

## Phase 2: the APS as a government agency (2017–2021)

In 2017, DAB acquired the voting members' shares and incorporated the operational costs and salaries of the APS into its annual budget. However, the APS continued operating as an independent agency working under DAB's executive board, which included the governor and the deputy governors. In 2020, the composition of the executive board changed, and the APS transitioned into a government agency greatly subsidized by DAB. The transition would also prompt participation from other financial institutions (i.e. MMOs, PIs and MFIs) that were previously hesitant and resistant to join the APS due to high membership fees and the influence of competition as founders and board members. The APS also took the lead in packaging and completing the government's digital transformation for payments and revenues.

During this phase, DAB focused on standardizing the APS, modernizing the system and branching out to effectively become a vendor to FSPs, and positioned itself as the leader of the digital payment industry in the country. As a payment switch, the APS completed ATM interoperability across all 10 banks by 2020. Interoperability using cards for merchant payments, account transfers and both retail and wholesale transfers with the Afghanistan

Transfers System was achieved in Q1 2021. Prior to the crisis, however, full interoperability with MMOs or MFIs had not been achieved, as they had not completed their testing or agreed on interchange fees. This limited the usage and usability of account-to-account transfers, where the expectation is real-time clearing with low-KYC accounts. It also limited the ubiquity of merchant payments, as the bank card risk and acquisition costs were too high to reach the last mile. A truly inclusive, interoperable platform should provide merchants and customers with access to any of the services offered by all the FSPs in the market on one mobile device.



**As a third-party provider of services for FSPs, the APS started offering host card management services through AfPay, operating the financial messaging service for FSPs, and added 22 products.**

However, only ATM cash out, balance inquiry and POS cash were actively used. Although the APS waived all membership and card personalization fees, the reception for the new services provided was mixed, in particular among those banks with good relationships with their own vendors and which they had no intention to abandon.

Finally, to increase the relevance of the APS's role as a payment service provider, the government started championing and incentivizing different use cases for interoperability. These included pushing digitization of government wages, revenue collection, pensions and social protection schemes—especially after the COVID-19 pandemic. The \*246# product was the last product developed before the crisis and took into consideration the low data penetration (using USSD) and the fact that very few financial institutions offered a mobile experience. When the product went live two months before the crisis, the number of transactions over the APS increased exponentially to six per second.

# The APS after August 2021

*After the collapse of the government in August 2021, the operations of the APS were severely impacted. The shortage of banknotes and the effect of international sanctions had a significant effect on the APS's settlement process.*

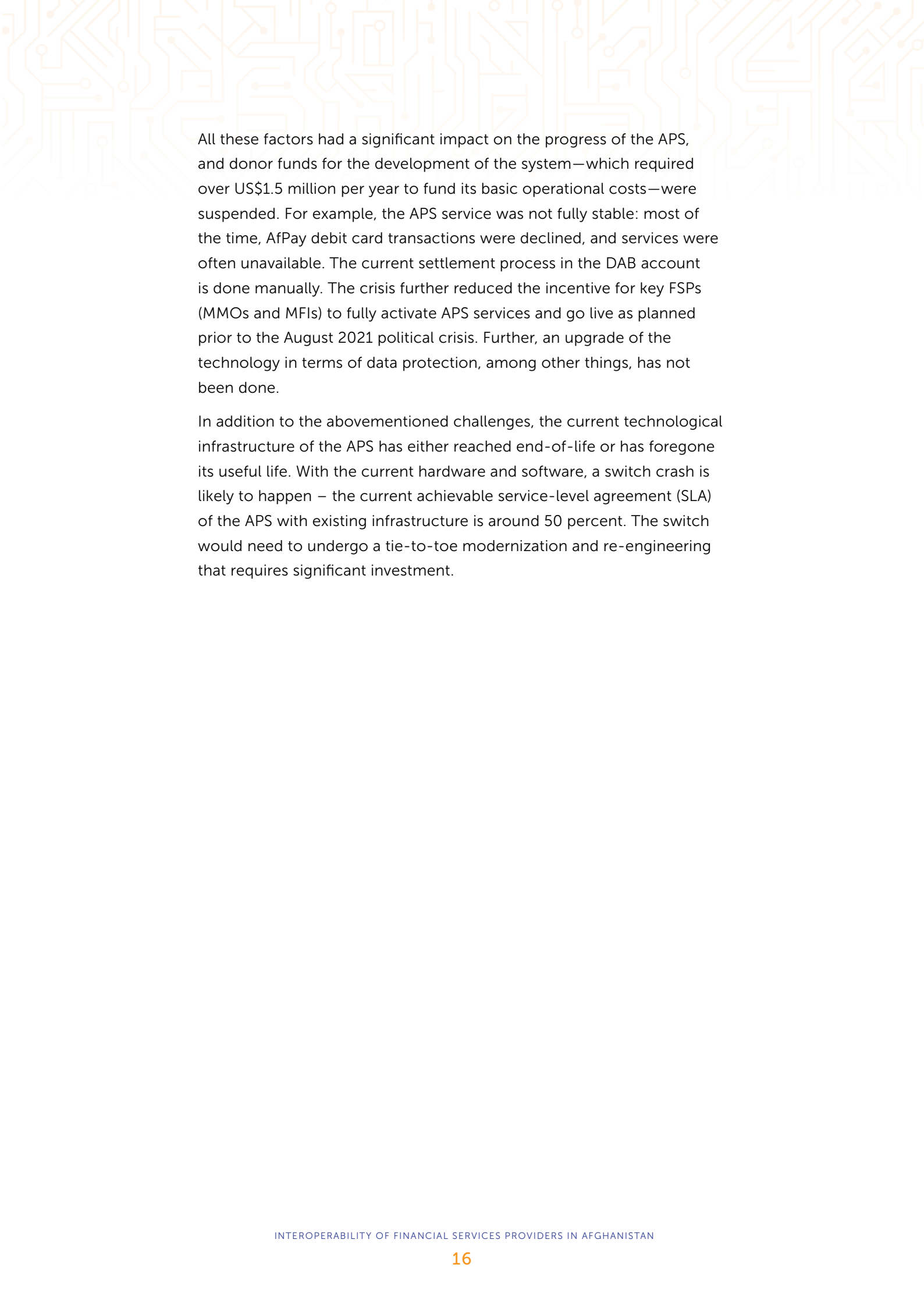
Afghan banks were no longer able to easily withdraw money (either in Afghani or U.S. dollars) from their accounts with DAB. The balances held with DAB ceased to be a settlement medium because banks were often limited in what they could do with them. Cash balances on reserve accounts with DAB could no longer be used as a form of collateral. Because some banks were rumoured to be insolvent, using the APS created material risks for 'good' banks. For example, a customer from a 'bad' bank would withdraw a lot of cash from an ATM of a 'good' bank, but the 'bad' bank failed to settle at the end of the business day.



**This unprecedented banking crisis resulted in lower transactions conducted via the APS, reducing its fees and hampering even further its business model.**

Championing and incentivizing use cases for interoperability was not a priority for the *de facto* authorities, wiping out many of the efforts made by the previous government. Grants previously given by the World Bank to cover some operational and maintenance fees and the costs associated with MMO integration were suspended.

The change of management at DAB after the takeover in August 2021 also affected the APS and its operations, as it lost some of its well-trained and experienced technical and operational staff members. For example, the lead of the Application team left in August during the evacuation, and the team was left with only one member responsible for the whole MMO integration, who also resigned a couple of months after. The Information Technology and Infrastructure department was also severely affected, impacting key areas of the APS's work such as the modernization of security systems and infrastructure. Critical procurement was suspended, causing serious operational problems. For example, the vendor that was hosting the disaster recovery site was left unpaid, and the work was left unfinished.



All these factors had a significant impact on the progress of the APS, and donor funds for the development of the system—which required over US\$1.5 million per year to fund its basic operational costs—were suspended. For example, the APS service was not fully stable: most of the time, AfPay debit card transactions were declined, and services were often unavailable. The current settlement process in the DAB account is done manually. The crisis further reduced the incentive for key FSPs (MMOs and MFIs) to fully activate APS services and go live as planned prior to the August 2021 political crisis. Further, an upgrade of the technology in terms of data protection, among other things, has not been done.

In addition to the abovementioned challenges, the current technological infrastructure of the APS has either reached end-of-life or has foregone its useful life. With the current hardware and software, a switch crash is likely to happen – the current achievable service-level agreement (SLA) of the APS with existing infrastructure is around 50 percent. The switch would need to undergo a tie-to-toe modernization and re-engineering that requires significant investment.



# What is needed to achieve interoperability

*The most relevant and immediate need to achieve interoperability across FSPs in Afghanistan is to allow for a more effective and transparent distribution of aid and cash transfers to the Afghan people in an inclusive manner. With that in mind, below are some of the possible interventions.*

## Establishing new governance of the APS

The system will need to replace the gap in leadership that was left after the crisis. That leadership and vision will likely need to be found among key trusted actors who can drive relative consensus among the private sector before presenting the solution to DAB. This type of non-ownership governance structure is similar to PPMI in the Philippines or WynePay in Myanmar. Recommendations should be made by a few influential industry leaders, with an explicit path to change who those leaders are eventually, with administrative and legal support.



**The first challenge that this committee would need to address is related to interbank settlement, which poses a significant obstacle to establishing an inclusive digital payment ecosystem.**

One possible solution could involve empowering a reputable commercial bank to handle the settlement function or having banks participate in a stablecoin settlement system. In both scenarios, settlement up to a certain limit would rely on prefunded accounts containing “fresh cash.” However, for this system to gain trust and acceptance from all participants, it would require thorough evaluation and consensus. Establishing this committee could serve as a starting point to assess the interest and feasibility of implementing such a solution.

In addition, it is crucial to have a neutral entity that initially coordinates the members of the APS and acts as a fair mediator to establish partnerships between FSPs, aid agencies, INGOs and other relevant stakeholders. This coordination will facilitate the adoption of DFS

across different CBIs. Such support would equip leaders with adequate information and options to make informed decisions, learn collectively, build a shared understanding of the challenges and opportunities in AFG, and foster a community of practice.



**Another related objective of this entity could be to devise a long-term strategy for transitioning CBIs and all related social protection programmes to digital over a five-year period.**

To achieve this, an Industry Payment Strategy Coordination committee could be established as part of this entity. In the absence of strong central leadership and multiple power centres with varying incentives, empowering an organization to serve as a convener will be critical. Finally, the entity could also provide, DFS training to the current leadership and management of various FSPs.

### **Developing a new switch**

While it may seem hard to forgo the ten years invested in the APS development, a comparison of the gains against the new governance model may strongly support this option. This option might not be as challenging as it appears and could even be cost-effective, requiring minimal or zero capital expenditure, depending on the chosen model and carefully projected hardware and software capacity. If the focus is solely on digital payments for humanitarian and development interventions, the upfront investment required could be significantly reduced. For example, not only FSPs are more experienced today than ten years ago in the space of digital payments, but there have also been great technological breakthroughs and advances in fintechs and blockchain solutions which in turn will enable the switch to adopt futureproofing of the system to meet both humanitarian and mass-market needs. The governance structure of the new switch can be similar to the one in Myanmar or the Philippines, meaning it can be industry owned.

### **Ensure inclusivity of all FSPs**

Increasing participation to all FSPs, including MMOs, PIs, MFIs and smaller banks, is crucial. The APS, or an alternative national switch, needs a participation strategy. For example, not all FSPs will join on the first day, but there should be a minimum number to launch a product in the market. This ideally should include two banks, two MFIs and two MMOs but does not need all of them. The largest FSPs in each class are

usually the last to join. This strategy should include proposed incentives for first movers, but also FSP contributions required for participation in governance. The neutral body created as part of the recommendation above could also offer advice on rules and technology decisions to minimize barriers and maximize incentives for smaller FSPs.



**For the APS, an easy first step is to finish the integration and testing work that was begun before the collapse of the government. While this is the responsibility of the FSPs and the APS, it may require subsidization.**

Normally, this requires a centralized technical resource at the hub operator, as well as each FSP employing a system integrator. Subsidizing this process centrally by hiring a system integration team would be more efficient than providing direct funding to FSPs to do their own integration. Each FSP will need to manage its own relationships with its vendors. Some FSPs will need upgrades or new technology, so developing a programme to encourage partnerships between FSPs and technology providers, such as virtual tech roadshows or procurement assistance, would be beneficial.

The next focus should be on getting leading FSPs to accept all rules for new use cases. This will require creating an independent, inclusive and private sector-led body to explore the feasibility of a range of possible solutions and to moderate and document the proposed rules. The legal and administrative functions of the private sector governance of the APS or the new switch body should manage this process.

### **Testing, developing and/or scaling up use cases**

Appropriate and important use cases must be developed and scaled up, in particular those that take into consideration the barriers faced by women (i.e. lower financial digital capabilities, challenges to meet KYC requirements, etc.). These should focus on ensuring that when beneficiaries receive digital funds, they have the ability to use those funds in ways that are relevant to their lives. The key use cases for this are cash out, peer-to-peer payments and merchant payments. If the revival of the APS is possible, then the priority should be to properly launch the \*246# product and scale up this use case.

Beneficiaries will also need confidence that they can receive cash anytime, anywhere. Therefore, the next priority should be full integration of MMOs into the interoperable system and to design and launch a mobile cash-out product. Finally, while cash out is important for

beneficiaries, it is also the most expensive part of the transaction. For example, a person receiving a digital transfer of US\$100 in Afghanistan needs to pay 2–4 percent to cash out the transfer. A comprehensive digital ecosystem that allowed this person to use the transfer digitally, and avoid cash out fees, would result in savings of approximately US\$24–48 per year if they were receiving that same transfer every month. Therefore, building a mobile merchant acceptance product with a low-cost merchant acquisition and risk model (i.e. based on push rather than pull transactions) is key. This merchant acceptance system should be interoperable and not encourage the development of a closed-loop merchant ecosystem.



**Building third-party payment initiation functionality for the APS or the new switch will help lower the cost of merchant acquisition and enable financial technology companies (fintechs) to offer mobile experiences directly to smaller bank customers without a payment experience. This functionality will enable fintechs and PIs to integrate and help the system grow.**

The existing network of 1,600 MSPs enjoying strong liquidity and trust among communities should also be leveraged to increase the adoption of DFS. We know that one of the major obstacles to DFS adoption in Afghanistan is the trust in the *Hawala* system as a trusted liquid network for affordable transfers. However, if we are able to include the *Hawalas* as a player in the digital ecosystem, then people would cash out from their digital wallets using a trusted and familiar face. This could represent a tipping point for the adoption of DFS in the country. The United Nations, INGOs and others making digital transfers could potentially encourage the enrolment of these MSPs as white-label agents. For example, a white-label agent network for MSPs could be developed and managed by a third party, which could be a PI, a licensed MSP or a fintech firm. Major *Hawalas*, for which the status quo is convenient, may not be interested in becoming white-label agents. However, there may be an opportunity to work with mid- and low-end *Hawaladar* who are willing to grow in the formal sector, expand across the country and take some of the market share from the major ones.

Working with PIs represents a promising opportunity for a sustainable agent network that can accelerate growth in digital payments adoption. These PIs have a deep understanding of the different segments in the market and the geography and a strong commitment to growth and innovation.

## **Financial and digital capabilities**

As developing new use cases will not be enough, citizens need to know about and understand the products enough to use them. This type of education and marketing initiative is crucial but slightly different from traditional digital financial literacy. It should take behaviour change science into consideration, should be done in a way that also informs clients about consumer rights and is most effectively done as a collaborative effort with the marketing teams of multiple FSPs.

## **Technical assistance and training for the APS of the new switch operator and for FSPs**

The two mission-critical internal areas highlighted in this report are the development of: (1) new use cases; and (2) digital and financial capabilities among consumers, businesses and government. Both these areas require the APS and FSPs to upskill—technical, promotional and operational upskilling in particular seems to be key for DFS adoption and growth in future. Investment in skills development, including vendor training, workshops, and engagement with regional fintech innovation working groups and initiatives, will expedite DFS adoption and growth in Afghanistan and drive digital payments.

# Conclusion

*Interoperability across FSPs is a critical component of a robust digital financial ecosystem. However, in Afghanistan, APS operations have been significantly impacted by the recent political crisis and the resulting economic instability.*

To get the APS back on track, it will be necessary to take a comprehensive approach that addresses governance, inclusivity, and financial and digital capabilities coupled with major investments in technical infrastructure. The establishment of the new switch, whose main use case, for now, will be cash transfers to cope with the current crisis, could be a more cost-effective option.

One of the most urgent priorities for either the APS or the new switch will be to establish a non-ownership governance structure that can provide stability and a vision for the system. This governance structure will need to involve key trusted actors who can drive consensus among the private sector, find solutions and work with DAB to ensure that the system is effective and trusted by all participants.



**In addition to governance, the system will need to focus on inclusivity, ensuring that all FSPs—including MMOs, Pls, MFIs and smaller banks—are able to participate in the system in a way that is beneficial for them.**

This will require developing a participation strategy that provides incentives for early adopters and minimizes barriers to entry for smaller FSPs. It is also key to pilot and scale-up use cases that are relevant and useful to Afghan citizens, with a particular focus on ensuring that women are included and are able to overcome the barriers that may prevent them from using DFS. Key use cases should include cash out, peer-to-peer payments and merchant payments. The operator of the switch or the APS should also explore ways to leverage existing networks—such as MSPs and *Hawalas*—to increase DFS adoption. This will drive not only more financial inclusion but also more transaction revenue for the platform, ensuring the system’s long-term sustainability.



Finally, investments in technical assistance and training for both APS staff and FSPs are critical to ensure that everyone involved in the digital payments ecosystem is equipped with the skills and knowledge necessary to support its growth and development. This will require investment in skills development, including vendor training, workshops, and engagement with regional fintech innovation working groups and initiatives.

While the country was just a few steps away from achieving interoperability across banks prior to the 2021 crisis, the current situation requires significant collective action to create a system that is inclusive and provides meaningful benefits to all Afghan citizens.

