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INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT PAPER

ON A

PROPOSED ADDITIONAL GRANT

IN THE AMOUNT OF SDR14.4 MILLION
(US\$ 20 MILLION EQUIVALENT)

TO THE

ISLAMIC REPUBLIC OF AFGHANISTAN

FOR A SECOND ADDITIONAL FINANCING

FOR THE FINANCIAL SECTOR RAPID RESPONSE PROJECT

October 3, 2016

Finance & Markets
SOUTH ASIA

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CURRENCY EQUIVALENTS

Exchange Rate Effective AUGUST 31, 2016

Currency Unit
SDR 0.71718519 = US\$1
US\$1.39434 = SDR 1

FISCAL YEAR
January 1 – December 31

ABBREVIATIONS AND ACRONYMS

AF	Additional Financing
AIBF	Afghanistan Institute of Banking and Finance
APS	Afghanistan Payment systems
DAB	Da Afghanistan Bank (Afghanistan's Central Bank)
FSRRP	Financial Sector Rapid Response Project
ICT	Information and Communications Technology
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
ISN	Interim Strategy Note
PDO	Project Development Objective
PIC	Project Implementation Cell
SCD	Systematic Country Diagnostic
TA	Technical assistance

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ISLAMIC REPUBLIC OF AFGHANISTAN
SECOND ADDITIONAL FINANCING FOR AFGHANISTAN: FINANCIAL SECTOR RAPID
RESPONSE PROJECT

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ADDITIONAL FINANCING DATA SHEET

Afghanistan

Financial Sector Rapid Response – Second Additional Financing (P160073)

SOUTH ASIA

GFM06

Basic Information – Parent							
Parent Project ID:	P119047	Original EA Category:	C - Not Required				
Current Closing Date:	30-Jun-2018						
Basic Information – Additional Financing (AF)							
Project ID:	P160073	Additional Financing Type (from AUS):	Restructuring, Scale Up				
Regional Vice President:	Annette Dixon	Proposed EA Category:	C- Not Required				
Country Director:	Robert J. Saum	Expected Effectiveness Date:	15-Dec-2016				
Senior Global Practice Director:	Gloria M. Grandolini	Expected Closing Date:	31-Oct-2019				
Practice Manager/Manager:	Niraj Verma	Report No:	PAD1958				
Team Leader(s):	Ahmed Mohamed Tawfick Rostom						
Borrower							
Organization Name	Contact	Title	Telephone	Email			
Ministry of Finance	Moheb Arsalan J.	Focal Point for the World Bank / ARTF Portfolio	93790850761				
Project Financing Data - Parent (Financial Sector Rapid Response Project-P119047) (in USD Million)							
Key Dates							
Project	Ln/Cr/TF	Status	Approval Date	Signing Date	Effectiveness Date	Original Closing Date	Revised Closing Date
P119047	IDA-H7320	Effective	25-Aug-2011	27-Aug-2011	06-Sep-2011	30-Jun-2014	30-Jun-2018
P119047	IDA-H8930	Effective	26-Nov-2013	10-Mar-2014	04-Jun-2014	30-Jun-2016	30-Jun-2018

Disbursements									
Project	Ln/Cr/TF	Status	Currency	Original	Revised	Cancelled	Disbursed	Undisbursed	% Disbursed
P119047	IDA-H7320	Effective	XDR	11.90	11.90	0.00	7.35	4.55	61.79
P119047	IDA-H8930	Effective	XDR	4.40	4.40	0.00	1.76	2.64	39.98
Project Financing Data - Additional Financing Financial Sector Rapid Response - Additional Financing (P160073)(in USD Million)									
<input type="checkbox"/>	Loan	<input type="checkbox"/>	Grant	<input checked="" type="checkbox"/>	IDA Grant				
<input type="checkbox"/>	Credit	<input type="checkbox"/>	Guarantee	<input type="checkbox"/>	Other				
Total Project Cost:		20.00		Total Bank Financing:		20.00			
Financing Gap:		0.00							
Financing Source – Additional Financing (AF)								Amount	
BORROWER/RECIPIENT								0.00	
International Development Association (IDA)								20.00	
Total								20.00	
Policy Waivers									
Does the project depart from the CAS in content or in other significant respects?							No		
Explanation									
Does the project require any policy waiver(s)?							No		
Explanation									
Team Composition									
Bank Staff									
Name	Role	Title	Specialization	Unit					
Ahmed Mohamed Tawfick Rostom	Team Leader (ADM Responsible)	Senior Financial Sector Specialist		GFM06					
Anand Kumar Srivastava	Procurement Specialist (ADM Responsible)	Senior Procurement Specialist		GGO06					
Zohra Farooq Nooryar	Financial Management Specialist	Sr Financial Management Specialist		GGO24					
Aminata Ndiaye	Team Member	Young Professional		GFM06					
Aza A. Rashid	Team Member	Program Assistant		GFM06					

Ehsanullah Nasiree	Team Member	Program Assistant		SACKB	
Faly Diallo	Team Member	Finance Officer	Loan Operations	WFALN	
Folad Hashimi	Team Member	Temporary		SACKB	
Gul Sayyar	Team Member	Consultant		GGO24	
Harish Natarajan	Team Member	Lead Financial Sector Specialist		GFM2B	
Juan Carlos Alvarez	Counsel	Senior Counsel		LEGES	
Mohammad Arif Rasuli	Safeguards Specialist	Senior Environmental Specialist		GEN06	
Nazir Ahmad III	Team Member	Private Sector Specialist		GTC06	
Qais Agah	Safeguards Specialist	Consultant		GSU06	
Sau Ngan Wong	Team Member	Senior Counsel		GFM02	
Subika Farazi	Team Member	Financial Sector Specialist		GFM06	
Extended Team					
Name		Title		Location	
Locations					
Country	First Administrative Division	Location	Planned	Actual	Comments
Afghanistan	Kabul	Kabul	X	X	
Institutional Data					
Parent (Financial Sector Rapid Response Project-P119047)					
Practice Area (Lead)					
Finance & Markets					
Contributing Practice Areas					
Additional Financing Financial Sector Rapid Response - Additional Financing (P160073)					
Practice Area (Lead)					
Finance & Markets					
Contributing Practice Areas					
Consultants (Will be disclosed in the Monthly Operational Summary)					
Consultants Required ? Consultants will be required					

I. Introduction

1. This Project Paper seeks the approval of the Executive Directors to provide an additional grant in an amount of SDR 14.4 million (US\$20 million equivalent) to the Islamic Republic of Afghanistan for the Financial Sector Rapid Response Project (FSRRP) [P119047/IDA-H7320].

2. The proposed Second Additional Financing (AF) will help finance the costs associated with increasing the scope of the parent project and also sustaining some of its achieved results in several areas, including strengthening the capacity of the central bank and improving the financial infrastructure. In addition, the project paper seeks the approval of the extension of the closing date of the original and first additional financing from June 30, 2018 to October 31, 2019, and revision of the results framework to reflect the new proposed activities.

3. Since effectiveness of the original grant, the FSRRP has been rated in the satisfactory range respectively for both Implementation Progress (IP) and the progress towards achieving its Development Objectives (DO).

II. Background and Rationale for the Second Additional Financing in the amount of \$20 million

- **Country context**

4. **Afghanistan has made substantial progress since the overthrow of the Taliban regime in late 2001.** In September 2014, the country had its first democratic and peaceful transition of power. The newly formed National Unity Government has embarked on an ambitious reform agenda to revitalize the economy. Despite a solid stride towards growth and stability, the economy remains under significant pressure. Economic growth has slowed, falling from 6 percent in 2011 to 1.5 percent in 2015¹. Declining global food, fuel and other commodity prices combined with weakening domestic demand in 2015 has resulted in a fall in inflation into negative territory. Consumer price inflation dropped to -1.5 percent, down from 4.5 percent in 2014. Poverty, however, has remained stubbornly unchanged mainly due to increasing income inequality. The medium-term outlook points to slow post-transition recovery. Real GDP growth is projected to increase to 1.9 and 2.9 percent in 2016 and 2017 respectively, conditioned on improvements in the security environment and strong reform momentum, which could help restore confidence in the economy.

- **Sector Background**

5. **The financial sector in Afghanistan is still fragile and underdeveloped.** The banking sector is composed of 3 state-owned banks, 9 private full-fledged banks and 3 branches of foreign commercial banks. The banking system experienced great turbulence in the aftermath of the fall of Kabul Bank in September 2010. A range of factors contributed to this failure including fraud, weak governance, inadequate legislative, regulatory and supervisory frameworks, weak supervision (including limited enforcement), and weak enforcement of debt-related obligations.

¹ Source: World Bank

6. The authorities in Afghanistan recognize the importance of building an efficient and stable financial sector that is able to withstand the growing uncertainty and that can contribute to Afghanistan's growth and development goals. A sound financial sector is essential to support sustainable growth and poverty alleviation, through competition, innovation, economic diversification, and job creation. Constraints on economic growth include the potential costs of financial sector instability, gaps in the regulatory and supervisory frameworks, gaps in institutional capacity, the lost opportunities and costs arising from the lack of financial services for the country's firms and households, and lack of key financial services and financial markets. While the uncertain economic and security situation means that significant demand and supply side constraints to financial intermediation exist, the focus is to build the foundations of the financial sector and continue work towards these addressing key constraints to financial intermediation, such that, as and when conditions allow, the building blocks exist and the financial sector is able to respond appropriately.

7. DAB's leadership has been focusing on ensuring increased attention to financial sector reforms. The DAB leadership is supporting building blocks for a well-functioning financial system and strengthening the fundamentals for a more resilient financial sector in Afghanistan, including through the project's activities which support fundamental institutional capacity building and financial market infrastructure. Efforts to strengthen the financial sector currently focus on upgrading financial supervision capacity and strengthening the oversight capacity of the central bank and building market infrastructure. In addition, the Government is currently embarking on a comprehensive reform program supported under the Extended Credit Facility (ECF) which was approved by the International Monetary Fund Board on July 20, 2016. A key pillar of the program is to ensure soundness and efficiency of the financial sector. The scope of proposed activities under the AF will strengthen DAB's regulatory and oversight capacity; and efforts towards achieving these objectives robustly complement the IMF's program. The World Bank and the IMF have been closely coordinating on macroeconomic stability and financial sector developments.

- **Background of Parent Project**

8. The Financial Sector Rapid Response Project (FSRRP) was approved by the Bank's Board in August 2011 with a commitment amount of SDR 11.9 million (US\$19 million equivalent). In November 2013, the Board approved a first Additional Financing (AF) in the amount of SDR 4.4 million (US\$6.7 million). The project was also restructured along with the first AF and the Project Development Objective (PDO) was revised to cover additional activities relating to banking supervision and financial infrastructure. At that time, the original closing date was extended from June 30, 2014 to June 30, 2016. In May 2016, a level 2 project restructuring was undertaken to extend the project closing date from June 30, 2016 to June 30, 2018 to give DAB and the World Bank enough time to complete the implementation of ongoing activities under the original project and the preparation of the second Additional Financing (AF) requested by Government.

9. The PDO of FSRRP is to assist DAB to develop action plans for improved banking supervision and to establish key building blocks of financial sector infrastructure, including payment system, movable collateral registry and public credit registry. The project components consist of: (1) *Strengthening of DAB's capacity* (US\$8.0m) which inherited of activities previously planned under the Financial Sector Strengthening Project at the time of the 2013 restructuring. The project is financing the audits (financial, portfolio and institutional) of ten commercial banks operating in Afghanistan and

targeted technical assistance to DAB Financial Supervision Department; (2) *Development of the financial sector infrastructure (US\$14.7m)*. This component entails the modernization of the national payment system (mobiles and cards switch, RTGS/ACH/CSD²); Support to the establishment of Public Credit Registry and Support to the Afghanistan Institute of Banking and Finance; and (3) *Technical assistance and training for project implementation (US\$3.0m)* which covers technical assistance to support payment system modernization, as well as the Project Implementation Cell (PIC).

10. Since project effectiveness, the project has been rated in the satisfactory range respectively for both Implementation Progress (IP) and the progress towards achieving its Development Objectives (DO). The project was rated Moderately Satisfactory (MS) for DO and upgraded to Satisfactory (S) for IP in the most recent Implementation Status and Results Report (ISR) dated July 26, 2016. Loan covenants have been fully complied with to-date. As of September 25, 2016, the project has disbursed a total amount of US\$13.3 million which represents about 52 percent of total project funds. The project has faced several implementation challenges since it became effective on September 6, 2011, ranging from deteriorating security conditions, limited project management and implementation capacity in the implementing agencies - particularly on procurement within the Ministry of Finance and DAB, to the protracted political transitions in government. These challenges had resulted in significant delays in project implementation, delays in procurement of goods and services, and slow disbursement. However, the pace of project implementation has picked up over time, with considerable momentum in the various components and clearance of pending procurement packages. Disbursements have now picked up and are expected to continue to be robust reaching 80 percent of total project funds by end of FY2017. Based on current committed and disbursed amounts, 94 percent of the project funds have been utilized or are committed under ongoing procurement clearances as of end-July, 2016.

11. Collaboration with the IFC has been strong under the parent project. The implementation of the Public Credit Registry (PCR) and Collateral Registry (CR) has been undertaken in partnership with IFC Advisory Services. The hardware and software for the PCR and CR have been financed through project funds, while IFC Advisory Services provided technical assistance to DAB. Such collaboration will be further pursued for the relevant proposed activities.

- **Rationale for the Additional Financing**

12. The proposed Second Additional Financing remains fully aligned with Government priorities and is consistent with the World Bank Group's strategy – Interim Strategy Note 2012–2014 (ISN, Report No. 66862-AF)). Providing a credible system for banking regulation and oversight is an identified priority of the GoIRA, highlighted in the Afghanistan 2017-21 National Peace and Development Framework which was recently presented in Brussels. The second Additional Financing also supports the first pillar of the Interim Strategy Note 2012–2014 (ISN, Report No. 66862-AF): building legitimacy and capacity of institutions, through technical assistance to DAB, and the third pillar of the ISN: inclusive growth and jobs, through building key financial sector infrastructure. The Afghanistan Systematic Country Diagnostic (SCD, report No. 103421) also specifically recognizes the need to strengthen the regulatory and supervisory capacity of DAB as a development priority. The SCD finds that improving banking sector confidence and safeguarding the integrity of the banking sector is an essential condition for stability and will be key for boosting job creation and growth. In addition, the SCD points to the need

² These refer to the Real Time Gross Settlement System (RTGS), Automated Clearing House (ACH) and Centralized Securities Depository (CSD).

to exercise effective regulatory and prudential oversight of the overall financial sector, with a focus on enforcement, to help avoid serious financial crises. The project will support DAB in establishing systems and increasing its capacity to implement reforms that will help DAB in the early detection and monitoring of weak banks.

13. Building strong and credible institutions remain a key objective of the forthcoming Country Partnership Framework (CPF). Credible institutions are seen as key towards government's goals of state building, self-reliance, and building the capacity and accountability of institutions to deliver core services to Afghan people. Given its essential role in the financial industry, DAB is one of the core Afghan institutions that requires continuous support to ensure effective regulation and supervision, along with efficient intermediation of financial resources. To date, the Afghan banking sector has been unable to play its role in financing the country's growth, despite its high liquidity. For banks to assume this role, solid regulatory foundations and robust reform policies to safeguard financial stability are prerequisites that DAB is mandated to establish. The World Bank Group has been playing a leading role on that front through lending as well as advisory services and analytical engagements. The proposed AF continues to lay the necessary foundations and build key blocks for a sound financial sector and efficient infrastructure, to ensure the system's readiness to foster intermediation and enhance financial access.

14. The proposed Additional Financing will help DAB efficiently and effectively undertake its regulatory and oversight functions. The new activities will contribute to stronger internal controls and risk management; the operationalization of an integrated system of advanced business processes and modern information technology architecture; and the strengthening of its institutional capacity. The proposed additional financing intends to increase the sustainability of outcomes achieved to date. The proposed increase in scope would further establish DAB as an effective, transparent and strong financial sector regulator and supervisor.

15. Alternatives Considered: In considering the AF, the possibility of restructuring the existing FSRRP was explored but rejected because (i) existing (uncommitted) project funds are not sufficient to cover the costs of the additional activities and (ii) existing project activities are critical to the PDO. The possibility of a new operation did not appear to be a suitable solution as well, because the proposed additional activities aim to strengthen the outcomes of the parent project for greater sustainability. In addition, the preparation timeline of the Additional Financing instrument will pave the way for better and faster response to the client request and is deemed more appropriate to ensure complementarity between the existing and proposed activities.

16. Lessons learned: The following lessons learned from projects with significant institutional development and/or IT components (Vietnam, Bangladesh³) financed by the World Bank have been taken into account in preparing the proposed Additional Financing:

(i) Commitment from reform-minded senior leadership and strong project ownership from authorities are critical success factors in implementing and sustaining such institutional changes. The project's champion(s) will be amongst others leading the internal change management process and project-related

³ Videoconferences have been held between the Project Implementation Unit (PIU) at DAB, and those within the Bangladesh Bank and the State Bank of Vietnam. These PIUs have been involved in the acquisition and installation of core banking application packages in these two central banks. Discussion have focused on" (i) preparation – features of the ICT platform; (ii) implementation timeline and challenges, as well as change management to accommodate the new processes; and (iii) success factors.

communications. In countries where development partners are present, complementarity and coordination with them is essential.

(ii) The acquisition of state-of-the-art ICT systems should be complemented with technical assistance to support changes to business processes and building implementation capacity. Support for change management in the central bank will be necessary. In addition, the design of an ICT system should involve all of the central bank’s functional departments. Core implementations teams for ICT systems should be comprised of a focal point from all relevant departments.

(iii) Experiences in procurement under the parent project, and from previous similar projects have been factored into the implementation schedule and arrangements.

(iv) In order to address the basic and higher skills gap within DAB, the proposed additional financing will build on the World Bank’s extensive experience in human capacity and skills development in Afghanistan. The capacity building plan for all DAB staff takes into the different training needs (general, job-specific, certifiable). Funding mechanisms and built-in sustainability arrangements also reflect lessons learned from past and ongoing projects.

III. Proposed Changes

17. As further detailed in Annex 2, the proposed additional grant will build on the implementation momentum of the parent project and is seeking to enhance the achievement of its development objectives by extending the scope of the following components, to include new, related activities: (i) Component 1 Strengthening of Da Afghanistan Bank (DAB’s– Afghanistan’s Central Bank) capacity through providing technical assistance (TA) to upgrade the internal audit functions and implement International Financial Reporting Standards (IFRS); (ii) Component 2 through the improvement of internal Information and Communication Technology (ICT) systems of DAB to achieve full automation of core functions, improve operational reliability and enhance efficiencies; and (iii) Component 3 through the roll-out of a comprehensive skills development program for technical and operational DAB staff, in addition to building capacity of relevant departments to facilitate the implementation of the proposed new activities.

18. The Project Development Objective remains unchanged from the first additional financing. In this proposed second additional financing, the results framework has been revised to reflect the increased scope of activities and to ensure that gender issues are adequately reflected. The revised results framework is presented in Annex 1.

19. A summary of the proposed changes is presented in the datasheet below.

Summary of Proposed Changes

The proposed \$20 million second additional financing will maintain the structure of the parent project, and increase the scope of the existing components. New critical activities will be incorporated into the project to contribute to the effectiveness of DAB in regulating and supervision the financial sector. The project paper also seeks the approval for (i) extending the closing date of the project to October 31, 2019; and (ii) revising the results framework to capture the full scope of the project.

Change in Implementing Agency	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Project's Development Objectives	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Results Framework	Yes [<input checked="" type="checkbox"/>] No [<input type="checkbox"/>]
Change in Safeguard Policies Triggered	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change of EA category	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Other Changes to Safeguards	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Legal Covenants	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Loan Closing Date(s)	Yes [<input checked="" type="checkbox"/>] No [<input type="checkbox"/>]
Cancellations Proposed	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Disbursement Arrangements	Yes [<input checked="" type="checkbox"/>] No [<input type="checkbox"/>]
Reallocation between Disbursement Categories	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Disbursement Estimates	Yes [<input checked="" type="checkbox"/>] No [<input type="checkbox"/>]
Change to Components and Cost	Yes [<input checked="" type="checkbox"/>] No [<input type="checkbox"/>]
Change in Institutional Arrangements	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Financial Management	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Procurement	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Implementation Schedule	Yes [<input checked="" type="checkbox"/>] No [<input type="checkbox"/>]
Other Change(s)	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]

Development Objective/Results

Project's Development Objectives

Original PDO

The Project's development objective is to assist DAB to develop actions plans for improved banking supervision and implement a modern national payment system for efficient and transparent payment transactions.

Current PDO

To assist DAB to develop action plans for improved banking supervision and to establish key building blocks of financial sector infrastructure: payment system, movable collateral registry, and public credit registry.

Change in Results Framework

Explanation:

The results framework will be revised to ensure greater consistency with the project's enhanced scope, and to ensure that gender issues are adequately reflected.

Compliance

Covenants - Additional Financing (Financial Sector Rapid Response - Additional Financing - P160073)

Source of Funds	Finance Agreement Reference	Description of Covenants	Date Due	Recurrent	Frequency	Action
IDAT	Section I (A) 5. of the Project Agreement	The Project Implementing Entity shall, by no later than April 30, 2017, carry out a physical asset and financial audit of APS and AIBF, in such scope and detail as the Association shall have reasonably requested.	30-Apr-2017	<input type="checkbox"/>		New

Conditions

Source Of Fund	Name	Type
IDAT	APS: Part (B-3) - Agreement between APS and DAB	Disbursement

Description of Condition

No withdrawal shall be made for payments made for Eligible Expenditures under Category (2) until DAB and APS have entered into the APS Sub-Grant Agreement in accordance with the provisions of Section I.C.1 of the Schedule to the Project Agreement; and

Source Of Fund	Name	Type
IDAT	APS: Part (B-3) - Approval of Sustainability plan	Disbursement

Description of Condition

No withdrawal shall be made for payments made for Eligible Expenditures under Category (2) until the APS Sustainability Plan has been submitted to, and found to be satisfactory by, the Association.

Risk

Risk Category	Rating (H, S, M, L)
1. Political and Governance	High
2. Macroeconomic	High
3. Sector Strategies and Policies	High

4. Technical Design of Project or Program	Substantial
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Substantial
7. Environment and Social	Low
8. Stakeholders	Substantial
9. Other	
OVERALL	Substantial

Finance

Loan Closing Date - Additional Financing (Financial Sector Rapid Response - Additional Financing - P160073)

Source of Funds	Proposed Additional Financing Loan Closing Date
IDA Grant	31-Oct-2019

Loan Closing Date(s) - Parent (Financial Sector Rapid Response Project - P119047)

Explanation:

The closing date of the project has been revised to October 31, 2019 to allow for the implementation of complex IT systems, given the anticipated lengthy procurement and implementation process for the proposed activities.

Ln/Cr/TF	Status	Original Closing Date	Current Closing Date	Proposed Closing Date	Previous Closing Date(s)
IDA-H7320	Effective	30-Jun-2014	30-Jun-2018	31-Oct-2019	30-Jun-2016, 30-Jun-2018
IDA-H8930	Effective	30-Jun-2016	30-Jun-2018	31-Oct-2019	30-Jun-2016, 30-Jun-2018

Allocations - Additional Financing (Financial Sector Rapid Response - Additional Financing - P160073)

Change in Disbursement Arrangements

Explanation:

Disbursement arrangements have been revised to reflect the two new disbursement conditions, related to the support of the Afghanistan Payment Systems (APS), under the proposed additional financing (see text below).

Change in Disbursement Estimates (including all sources of Financing)

Explanation:

The project's total disbursement estimates were revised to reflect the second additional financing amounts and the extended closing to the project to October 31, 2019 (2020Q2).

Expected Disbursements (in USD Million)(including all Sources of Financing)

Fiscal Year	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Annual	5.00	15.00	10.00	0.11	0.00	0.00	0.00	0.00	0.00	0.00
Cumulative	5.00	20.00	30.00	30.11	0.00	0.00	0.00	0.00	0.00	0.00

Source of Fund	Currency	Category of Expenditure	Allocation		Disbursement % (Type Total)
			Proposed	Proposed	Proposed
IDA	XDR	(1) Goods, non-consulting services and consultants' services, Training and Incremental Operating Costs parts A B1 B2 C		13,600,000.00	95.00
IDA	XDR	(2) Goods, non-consulting services and consultants' services, Training and Incremental Operating Costs for Part B3		800,000.00	5.00
		Total:		14,400,000.00	
IDAT	USD	(1) Goods, non-consulting services and consultants' services, Training and Incremental Operating Costs parts A B1 B2 C		19,000,000.00	95.00
IDAT	USD	(2) Goods, non-consulting services and consultants' services, Training and Incremental Operating Costs for Part B3		1,000,000.00	5.00
		Total:		20,000,000.00	

Components

Change to Components and cost

Explanation:

Under the additional financing, the project retains the same structure as the original and first additional financing. The component amounts have been revised to reflect the proposed new activities.

Current Component Name	Proposed Component Name	Current Cost (US\$M)	Proposed Cost (US\$M)	Action
------------------------	-------------------------	----------------------	-----------------------	--------

Strengthening the DAB's capacity	Strengthening the DAB's capacity	8.00	9.00	Revised
Development of the financial sector infrastructure	Development of the financial sector infrastructure	14.70	29.70	Revised
Technical assistance and training for project implementation	DAB Skill Development; Technical Assistance and project implementation	3.00	7.00	Revised
	Total:	25.70	45.70	

Other Change(s)

Implementing Agency Name	Type	Action

Change in Implementation Schedule

Explanation:

The implementation period of the project has been revised, through the proposed extension of the closing date of the parent project to October 31, 2019.

Appraisal Summary

Economic and Financial Analysis

Explanation:

Achieving the project development objectives will contribute to building a stable and resilient financial sector in Afghanistan. All proposed activities aim to significantly strengthen the financial infrastructure in Afghanistan in terms of capacity and Information and Communication Technology (ICT) systems at DAB, with the end-objective of enhanced reliability, consistency, timeliness and disclosure of relevant information on the financial sector. The proposed activities will help DAB in its reporting, regulation, supervision and risk management functions in fine.

The economic and financial analysis of the parent project, and subsequent AF remains relevant. The project will deliver substantial benefits for the financial sector as a whole, which will trickle down to the population in the long-term. However, due to the nature of benefits expected and the indirect relationship between capacity building supported under the project and the stream of benefits that it is expected to trigger, a standard economic and financial analysis was not carried out. A conventional financial analysis is not applicable given that the project does not directly generate revenues for the beneficiaries. In the same vein, the economic benefits are difficult to quantify.

In summary, through the different components, DAB's capacity will be strengthened through investments in the

physical and human capital. The proposed new activities under component 2 complement well previous activities on the financial sector infrastructure continue to facilitate access to financial services in Afghanistan, through better risk management and information sharing.

Upgrading the ICT Platform at DAB and technical assistance to support the adoption of international standards in internal audit and accounting, the project will contribute to increased efficiency of central bank operations, more effective regulation and supervision of the financial sector, and improved quality of financial information. Ultimately, the FSRRP project is a building block towards gradually restoring the confidence in the banking sector, and DAB's ability to avoid and manage crises would improve. The following benefits are anticipated in the medium and long-term, from the proposed new activities: (i) DAB is able to undertake its core functions and deliver services to the financial sector more efficiently and (ii) capacity building of staff contributes to sustainability of DAB strengthening.

Technical Analysis

Explanation:

The rationale for the proposed additional financing is strong. The project's technical design builds on country and regional context, international good practices, as well as technical work and consultations with stakeholders. The design benefitted from lessons learned from similar projects. The project combines both investments in institutions – DAB, AIBF, APS (to ensure effectiveness, and sustainability) with investments in infrastructure (to ensure efficiency).

Social Analysis

Explanation:

While there are no direct social impacts envisaged under any component of the proposed additional financing, the proposed additional financing will build the capacity of key DAB staff (component 3). Special attention will be paid to the gender impact of capacity-building in the financial sector. The results framework will monitor training for key DAB female staff, as well as commercial bank female staff trained through AIBF. It is also envisaged that the investment in the financial infrastructure of the financial system will in the long-term contribute to better access to financial services and outreach to the underserved population.

Environmental Analysis

Explanation:

No environmental impacts are envisaged under the proposed Additional Financing. The proposed additional financing would only provide technical assistance, capacity building, acquisition and installation of equipment, and financial support towards the operations of the Afghanistan Institute of Banking and Finance, as well as the Afghanistan Payment Systems.

Risk

Explanation:

The overall risk rating is “Substantial” to reflect the fragile country context, and based on the high political and governance risks and substantial risk for technical design, institutional capacity for implementation and sustainability.

Political and governance, Macroeconomic and stakeholder risks are high because of the country's fragile security

environment, limited government capacity especially at the sub-national levels, overall fiscal uncertainties and the declining foreign aid budget. Fragility and conflict continue to be critical threats to personal safety, public service delivery, and private investments. Given a unity government, the risk of political instability remains high both from within the coalition and from outside. The Government has signaled commitment to reforms in the financial sector; promotion of financial inclusion is also high in the country's agenda. The recently approved ECF with the IMF is further evidence to this commitment to reforms. The government is committed to reforms, improving governance, and tackling corruption, but these actions could also increase political uncertainty.

The main (project-related) risks of this Additional Financing relate to technical design, and weak institutional capacity. More specifically, possible implementation risks identified at appraisal stage are implementation delays due to limited implementation capacity at DAB and long procurement processes. These risks are appropriately mitigated through advance preparation of procurement packages for enhanced implementation readiness, training of relevant DAB departments responsible for the implementation of important activities and provision of implementation and procurement support to the PIC. The AF will also build on the experience achieved in the parent project, which has achieved significant momentum through the recent clearing of large procurement packages. Another key risk is the reduced commitment from DAB management to strengthen capacity which could also hamper project implementation. This risk is also mitigated by the close collaboration with the DAB and IMF, and the project's approach of focusing efforts on areas in which there is strong ownership and incremental results can be sought. With regards to the implementation of a training program for DAB staff, a primary risk relate to the effectiveness of the training in building capacity at DAB. Built-in features such as trained staff retention policy and regular monitoring are anticipated mitigation measures.

20. Implementation arrangements: PIU arrangements under the parent project remain unchanged in the proposed additional financing. Under these arrangements, the Project Implementation Cell (PIC) at DAB will continue to be responsible for the project implementation. Operating costs for APS and AIBF that will be funded through the project, will be paid by the PIC at DAB. Currently, the PIC at DAB comprises of: a Project Director, a Deputy Project Director, a Project Coordinator, a Procurement Specialist, two Financial Management officers and one Financial Assistant. The recruitment of a procurement consultant is being finalized: the procurement consultant will support the PIC with the large upcoming procurement packages in the first year of the project. A project contract management specialist will also be recruited within the PIC.

21. The Project Steering Committee (PSC) that was established for the parent project will continue to oversee the implementation of the proposed additional financing. The PSC is chaired by the DAB Governor or by the DAB First Deputy Governor and will meet at least twice a year. The PSC includes all relevant directors of the involved departments at DAB as well as the AIBF and APS and the FSRRP project director.

22. Procurement. The procurement under the parent project is performed by the PIC which will still remain in place for the additional financing period, and the same procurement arrangements will remain in place. Procurement arrangements for the parent and additional financing will continue to be carried out in accordance with the World Bank's procurement guidelines. The performance of procurement under the parent project is rated "Moderately Satisfactory". A revised procurement plan for the proposed Additional Financing is available.

23. **Financial management (FM).** There are no changes proposed to the FM arrangements. The proposed additional financing will be implemented by a Project Implementation Entity currently in place. Based on the assessment, the fiduciary risk rating remains as “Substantial”. The current FM staffing in the Project Implementation Entity is adequate with sufficient expertise to handle the FM aspects of the project under the additional financing period. The project staff could benefit from capacity building in the areas of financial management, procurement, general project management, and operational controls.

24. The project follows cash basis of accounting, which is in line with the accounting basis followed by the MoF. Given the centralized system of Accounting and Record keeping maintained by the MOF, the project maintains a parallel record in the form of excel cash book for all its transactions. The project has started the implementation of off-the-shelf accounting software (Quick Books) and currently it is maintaining all its record in the Quick Books. The aspects of budgeting, accounting, reporting, funds flow, internal controls (including internal audit) and external audit will remain the same. The FM arrangements and FM are overall Satisfactory.

25. During project appraisal, it was agreed that the project will introduce two disbursement conditions related to the support of the Afghanistan Payment Systems (APS), under the proposed additional financing (see Annex 2 for further details on support to APS). First, the proposed additional financing will start providing support to APS, once APS has submitted a sustainability plan that has been approved by DAB and the World Bank. Second, DAB and APS will enter into a sub-grant agreement, which will define, inter alia, DAB and APS’ roles and responsibilities, and the proposed financial support to APS operations. This financial support will be conditional upon progress towards the sustainability of APS, to be assessed against specific targets and milestones, as set out in the sustainability plan and the sub-grant agreement. It was also agreed that support to APS will be extended for two years and made on a declining basis during the third year. The sustainability plan is currently being developed by APS.

26. Eligible expenditures to be funded for APS under the proposed additional financing will be agreed upon between DAB, APS and the World Bank, once the sustainability plan is reviewed and approved. Eligibility criteria as well as fiduciary arrangements for these expenditures will be defined in the project’s existing Financial Management Manual, which will be revised as necessary. Support to APS will be included the project’s Annual Work Plans that will be prepared by DAB and approved by the World Bank.

27. A dated covenant has been introduced for the additional financing. Given the previous support to APS and AIBF under the parent project, it was agreed, during project preparation that a physical asset and financial audit of both APS and AIBF will be undertaken by DAB within the first six months of approval of the proposed additional financing.

28. The project will continue to use the transaction-based disbursement procedures. . The existing DA at the Central bank of Afghanistan will also be used for the additional financing. The designated account will receive an initial advance equivalent to US\$ 2,600,000 upon project effectiveness. In addition to advances to the designated account, other disbursement methods will be available for use under the project, such as the direct payment, reimbursement, and special commitment methods. Further instructions on the withdrawal of proceeds will be outlined in the disbursement letter.

29. The table below sets out the expenditure categories to be financed out of the IDA Grant. This table takes into account the prevailing Country Financing parameter in setting out the financing levels. In accordance with Bank standard procurement requirements, contracts will continue to be approved “all taxes included” for local expenditures.

Category	Amount of the Grant Allocated (expressed in US\$)	Percentage of Expenditures to be Financed (inclusive of Taxes)
(1) Goods, non-consulting services and consultants’ services, Training and Incremental Operating Costs for Components 1, 2 and 3 except for Sub-Component 2.vi	19,000,000	100%
(2) Goods, non-consulting services and consultants’ services, Training and Incremental Operating Costs for Component 2.vi	1,000,000	100%
TOTAL AMOUNT	20,000,000	

V. World Bank Grievance Redress

30. Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB’s Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB’s independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank’s attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank’s corporate Grievance Redress Service (GRS), please visit <http://www.worldbank.org/GRS>. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

ANNEX 1: RESULTS FRAMEWORK

Project Name:	Financial Sector Rapid Response - Additional Financing (P160073)	Project Stage:	Additional Financing	Status:	DRAFT
Team Leader(s):	Ahmed Mohamed Tawfick Rostom	Requesting Unit:	SACKB	Created by: Aminata Ndiaye on 20-Jun-2016	
Product Line:	IBRD/IDA	Responsible Unit:	GFM06	Modified by: Aminata Ndiaye on 19-Sep-2016	
Country:	Afghanistan	Approval FY:	2017		
Region:	SOUTH ASIA	Lending Instrument:	Investment Project Financing		
Parent Project ID:	P119047	Parent Project Name:	Financial Sector Rapid Response Project (P119047)		

Project Development Objectives

Original Project Development Objective - Parent:

The Project's development objective is to assist DAB to develop actions plans for improved banking supervision and implement a modern national payment system for efficient and transparent payment transactions.

Current Project Development Objective - Parent:

To assist DAB to develop action plans for improved banking supervision and to establish key building blocks of financial sector infrastructure: payment system, movable collateral registry, and public credit registry.

Results

Core sector indicators are considered: Yes

Results reporting level: Project Level

Project Development Objective Indicators

Status	Indicator Name	Core	Unit of Measure		Baseline	Actual(Current)	End Target
Revised	Actions plans developed, with initial implementation monitored, for the ten banks audited	<input type="checkbox"/>	Text	Value	No action plan	Targeted TA on banking supervision under procurement	Action plans under implementation
				Date	01-Aug-2011	07-Oct-2015	31-Oct-2019
				Comment			
Revised	Payment system conforms to international norms	<input type="checkbox"/>	Text	Value	Not conform	Not conform	Substantially Conform
				Date	01-Aug-2011	07-Oct-2015	31-Oct-2019
				Comment			

Intermediate Results Indicators

Status	Indicator Name	Core	Unit of Measure		Baseline	Actual(Current)	End Target
No Change	Audit reports completed highlighting strengths and weaknesses of each bank	<input type="checkbox"/>	Text	Value	No audit reports to international standards	Audits completed	Audits completed
				Date	01-Aug-2011	07-Oct-2015	30-Jun-2016
				Comment			
Revised	RTGS operational and transactions settled in real time by end of project	<input type="checkbox"/>	Text Sub Type Breakdown	Value	No RTGS	No RTGS	RTGS goes live
				Date	01-Aug-2011	07-Oct-2015	31-Oct-2019
				Comment			
Revised	Number of commercial banks' staff trained in AIBF reaches 4,500 by end of project	<input type="checkbox"/>	Text Sub Type Breakdown	Value	1017	4850	6000
				Date	01-Aug-2011	16-Aug-2016	31-Oct-2019
				Comment			
New	of which the number of female commercial bank staff trained	<input type="checkbox"/>	Text Sub Type Breakdown	Value	243	1015	1200
				Date	31-Dec-2011	16-Aug-2016	31-Oct-2019
				Comment			
New	Increased transparency through the adoption of international central bank accounting and auditing standards	<input type="checkbox"/>	Text	Value	Financial statements prepared based on local accounting standards		DAB financial statements for the year ended in 2018 prepared in accordance with IFRS (as applicable in 2016)
				Date	16-Aug-2016		31-Oct-2019
				Comment			
Revised	Effective Financial Supervision Department (FSD) organization with training processes in place to ensure sustainable capacity development	<input type="checkbox"/>	Text	Value	Revised FSD organization approved by DAB	Procurement of TA for Financial Supervision Department underway	Continuous implementation of action plan
				Date	01-Nov-2013	02-Jun-2015	31-Oct-2019
				Comment			
New	Percentage increase in the number of on-site	<input type="checkbox"/>	Number Sub Type	Value	0.00		10.00

	and off-site examinations by the department		Supplemental				
Revised	Approval by DAB of financial sector regulations ensuring consistency with international standards	<input type="checkbox"/>	Text	Value	Afghanistan financial sector regulations not fully aligned with international standards	A new banking law and AML/CFT regulations were approved. TA for Financial Supervision Department under procurement	Key regulations approved
				Date	01-Nov-2013	16-Aug-2016	31-Oct-2019
				Comment			
Revised	Interbank payment	<input type="checkbox"/>	Text	Value	T+1 for Kabul area and T+3 for other areas	T+1 for Kabul area and T+3 for other areas	Same day all over Afghanistan
				Date	01-Aug-2011	16-Aug-2016	31-Oct-2019
				Comment			
Revised	Card payment system	<input type="checkbox"/>	Text	Value	No interbank card system	Implementation of interbank card system underway. The Afghan Payment system platform was inaugurated on April 26, 2016. Discussions ongoing to increase number of participants (6 banks)	System goes live and, on an ongoing basis, processes over 80% of domestic interbank/inter-institution payment card and mobile money transactions
				Date	01-Aug-2011	16-Aug-2016	31-Oct-2019
				Comment			
Revised	Rating of national payment system	<input type="checkbox"/>	Text	Value	Low: a, e, f; Med-low: d; n.a. b, c	Low: a, e, f; Med-low: d; n.a. b, c	Med-High: a, b, d, f; Med-Low: c, e
				Date	01-Aug-2011	16-Aug-2016	31-Oct-2019

				Comment			
Revised	Increase in the number of credit reports sent by the Public Credit Registry to commercial banks	<input type="checkbox"/>	Number	Value	0.00	115000.00	250000.00
				Date	01-Nov-2013	31-Mar-2016	31-Oct-2019
				Comment		As of end-March 2016, DAB indicated more than 115,000 credit records have been registered in the PCR system, of which around 40% records are for women.	
Revised	Increase in the number of items of collateral registered in the Collateral Registry	<input type="checkbox"/>	Number	Value	815.00	5828.00	10,000.00
				Date	01-Nov-2013	30-Jun-2016	31-Oct-2019
				Comment			
New	Enhanced operational efficiency of DAB staff: percentage reduction in time spent to prepare DAB balance sheet	<input type="checkbox"/>	Text	Value	0		80%
				Date	16-Aug-2016		31-Oct-2019
				Comment			
New	DAB training - Number of key DAB staff trained	<input type="checkbox"/>	Text	Value	0		1443
				Date	16-Aug-2016		31-Oct-2019
				Comment	central banking curriculum to be rolled out under the project		all eligible DAB key staff (as of September 2016)
New	Number of DAB staff who have completed or enrolled into a Bachelor's or Master's program	<input type="checkbox"/>	Number Sub Type Supplemental	Value	88.00		250.00
New	DAB training - Percentage of eligible staff in critical functions who completed specialized, professional training sessions	<input type="checkbox"/>	Percentage Sub Type Supplemental	Value	0.00		50.00

New	Number of key DAB female staff trained under the project	<input type="checkbox"/>	Text	Value	0		172
				Date	16-Aug-2016		31-Oct-2019
				Comment			172 key DAB staff are women (as of 08/16/2016)
New	Improved sustainability of APS and AIBF	<input type="checkbox"/>	Percentage	Value	0.00		50.00
				Date	16-Aug-2016		31-Oct-2019
				Comment			

Further information on results framework:

Indicator	Additional description	Proposed changes
Actions plans developed, with initial implementation monitored, for the ten banks audited	action plans developed based on the findings of the audits, with support and oversight of DAB	End-target date revised to reflect proposed closing date of October 31, 2019.
Payment system conforms to international norms	Payment system conforms to international norms (as established by Bank for International Settlements, BIS, and PSDG, World Bank) by end of project, contributing to safety and efficiency of the financial sector	End-target date revised to reflect proposed closing date of October 31, 2019. End-target revised to read “substantially conform”, from “conform” to reflect technical discussions during preparation of additional financing.
Audit reports completed highlighting strengths and weaknesses of each bank	Audit reports (according to international standards) completed highlighting strengths and weaknesses of each bank	No Change
RTGS operational and transactions settled in real time by end of project		End-target date revised to reflect proposed closing date of October 31, 2019. End-target clarified. New target is “RTGS goes live”, from “RTGS operational”
Number of commercial banks’ staff trained in AIBF reaches 4,500 by end of project		End-target date revised to reflect proposed closing date of October 31, 2019. End-target increased from 4,500 to 6,000 (because it has been already exceeded)
of which the number of female commercial bank staff trained		New gender-specific indicator added. Previous reporting of female staff was under the indicator above, into parenthesis. This dedicated indicator was added to signal efforts towards gender in capacity-building.
Increased transparency through the adoption of international central bank accounting and auditing standards	Preparation of DAB financial statements	New indicator, related to AF activities under component 1

Indicator	Additional description	Proposed changes
Effective Financial Supervision Department (FSD) organization with training processes in place to ensure sustainable capacity development	Status of implementation of action plan, approved by DAB	End-target date revised to reflect proposed closing date of October 31, 2019.
Percentage increase in the number of on-site and off-site examinations by the department		New indicator, to reflect TA provided to the FSD under the parent project.
Approval by DAB of financial sector regulations ensuring consistency with international standards		End-target date revised to reflect proposed closing date of October 31, 2019.
Interbank payment	Improvement in timeline for interbank payment to (at the end of project) same day all-over Afghanistan	End-target date revised to reflect proposed closing date of October 31, 2019.
Card payment system	Card payment system established and operational by end of project; system provides full interoperability for all domestic card payments and also support mobile payments	End-target date revised to reflect proposed closing date of October 31, 2019. End-target clarified then refined to be more outcome. Previous target: "System operational". Now it reads: System goes live and, on an ongoing basis, processes over 80% of domestic interbank/inter-institution payment card and mobile money transactions"
Rating of national payment system	At the end of the project, the rating of the national payment system as measured by the indicators developed by the World Bank Payment Systems Development Group (PSDG) would have a rating of Medium-High for indicators a, b, d and f, and medium-low for indicators c and e. a. Legal and Regulatory framework b. System design and policies for large value payment systems c. Usage of large-value payment systems d. Retail payments infrastructure and policies for retail payment systems e. Efficiency of retail payment instruments and extensiveness of usage of non-cash payment instruments f. Oversight functions	End-target date revised to reflect proposed closing date of October 31, 2019

Indicator	Additional description	Proposed changes
Increase in the number of credit reports sent by the Public Credit Registry to commercial banks		End-target date revised to reflect proposed closing date of October 31, 2019. End-target increased from 115,000 to 250,000 (because it has been already exceeded)
Increase in the number of items of collateral registered in the Collateral Registry		End-target date revised to reflect proposed closing date of October 31, 2019. End-target increased from 2,000 to 10,000 (because it has been already exceeded)
Enhanced operational efficiency of DAB staff : percentage reduction in time spent to prepare DAB balance sheet		New indicator to reflect ICT systems upgrade under the AF (component 2)
DAB training - Number of key DAB staff trained		New indicator to reflect skill development under the AF (component 3)
Number of DAB staff who have completed or enrolled into a Bachelor's or Master's program		New indicator to reflect skill development under the AF (component 3)
DAB training - Percentage of eligible staff in critical functions who completed specialized, professional training sessions		New indicator to reflect skill development under the AF (component 3)
Number of key DAB female staff trained under the project		New indicator to reflect skill development under the AF (component 3) – gender-specific indicator. Target is that all DAB key staff who are female are trained,
Improved sustainability of APS and AIBF	Percentage of operating costs covered by their own operations (and not by the project)	New indicator to reflect implementation of sustainability plan and support to institutions (component 2)

ANNEX 2: DETAILED DESCRIPTION OF MODIFIED OR NEW PROJECT ACTIVITIES

Component 1: Strengthening of DAB's capacity (US\$ 1 million)

1. Building upon outcomes achieved in the parent project with regards to enhanced transparency and stability in the banking sector, the AF aims to provide TA to DAB to implement risk-based internal audit and IFRS standards on its own operations, critical for enhancing transparency and oversight within DAB.

i. Adoption of Risk-Based Internal Audit (RBIA)

2. The internal audit function has a vital and prominent relevance, particularly in the regulatory space. It involves an independent review of risk management practices within various departments in the organization through conducting RBIA and providing assurance to the Board that the overall governance framework, including the risk governance and internal control framework, is effective.

3. Currently, the Comptroller General's Office (CGO) is performing professionally under the described standards in the manual (policies and standards). The CGO undertakes annually the audit of all 70 units –all departments, city branches, and provincial representative offices. However, audit policies and standards as well as the audit methodology were developed under a TA that was provided to DAB in 2010 and has been barely updated since, to adapt to the evolving nature of risks in DAB's operations. Updating of the internal audit function within DAB is critical to ensure the reliability and integrity of the key functions of DAB and ascertain that various internal departments are consistently working to meet their set objectives. Moreover, the Safeguard Assessment of DAB conducted under the IMF's Staff Monitoring Program (SMP) recommended that DAB switch to RBIA rather than compliance-based audit to foster the institutional efficiency, enable reliable management of internal risks and promote good governance.

4. The proposed Technical Assistance (TA) is aligned with the recommendation of the IMF's SMP. The proposed TA will support DAB's Comptroller General's Office in developing and implementing a road map for sound internal control systems, and fully adopting international good practices. In a first phase of the engagement, TA will be provided to the CGO to implement RBIA through the recruitment of a consultancy firm that would: (i) undertake a diagnostic review of the departments before, (ii) support the updating of relevant regulations, manuals and policies, (iii) develop a transition plan towards RBIA and (iv) build capacity of staff as well as re-structure the unit, if needed. As a final deliverable, the firm will also help the CGO draft the RFP for the automation of the internal audit function, to achieve the overall objective of modernizing the internal audit function and optimizing management of internal risk (see below).

ii. Adoption of IFRS standards

5. DAB's leadership expressed the need to further develop the accounting framework of the central bank, as a significant step towards independence of the central bank, greater transparency on the financial performance of the central bank and financial stability. The adoption of an internationally recognized accounting and reporting framework would support DAB's transparency and accountability efforts. This framework is also important as it determines the calculation of the profit available for distribution to its shareholders and, thus, the retained profits at disposal for a buffer against potential future losses. It also reflects the financial strength of the central bank and its ability to conduct an effective monetary policy, since policy measures can expose central banks to risks of substantial losses.

6. The proposed TA will provide support to DAB to adopt IFRS in reporting its operations and performance in a robust and transparent manner that is compliant with relevant international standards. It will also be linked to investments in DAB's ICT infrastructure through the modernization CBS that is proposed under component 2 below. An assessment exercise will be undertaken to assess the current practices and business process of DAB's accounting department and lay foundation for the adoption of the IFRS. The procurement of this activity will be soon initiated; TORs are currently being finalized.

Component 2: Development of the Financial Sector Infrastructure (US\$ 15 million)

7. With the AF, this component aims to further strengthen DAB's capacity through upgrading of ICT infrastructure, while consolidating achievements in improving the overall financial sector infrastructure. The main outputs of this component will be delivered through (a) consultant support to design and implement ICT systems and (b) supply and installation of hardware and software including system integration services. The proposed AF will enhance the market infrastructure for reliable, safe and efficient financial transactions.

i. Acquisition and installation of Core Banking System (CBS), Enterprise Resource Planning (ERP) and Data Warehouse

8. The current Core Banking Solution was provided by Virmati Software & Telecommunication Company in 2007 – funded by donors – for the automation of DAB's core operations. DAB has however noted that the existing solution was designed for commercial banking, and after its customization for central banking operations, the solution has started running functional errors.

9. The parent FSRRP had initially intended to finance upgrades to the existing solution to adjust to the expanded scope of activities at DAB. However, given the operational issues encountered with the current Virmati system, DAB has requested the purchase of a full core banking application package rather than an ad-hoc upgrade, given the heightened risks of multiple rounds of customization of the system.

10. The new core banking application is intended to support DAB in achieving its objectives of:

- i. Conducting monetary policy for maintaining price and exchange rate stability in Afghanistan
- ii. Advising the Government generally on the financial matters
- iii. Supervising all commercial banks efficiently
- iv. Promoting price stability for the National Currency
- v. Managing Afghanistan's Foreign Exchange Reserves
- vi. Optimizing the returns of Financial Assets through prudent investment practices
- vii. Supporting the development of Financial Markets in Afghanistan
- viii. Collecting, compiling, disseminating and publishing statistics

11. The AF will provide support to DAB to design and build a centralized Information Communication Technology (ICT) platform based on international ICT standards for its internal systems: by the end of the project, a new core banking system (CBS), ERP and Data Warehouse will be delivered. The new Financial System should be designed to improve DAB's operations securities, payments and settlement system, vault management (it will support the entire currency life-cycle through stock management logic

such as: Importation of Currency, Adaptation of currency Deposit, Currency Sorting, Stock movements, Currency Destruction, etc), the Treasury, Cash Reserve Ratio; the enterprise General Ledger, account system and service delivery. It is also expected to improve the management of foreign exchange, banks and government accounts. In addition, the ERP will enhance the management of external payment processing, financial and accounting and the supply chain, while enabling full integration with stakeholder organizations.

12. The cost for back-up systems and also in Disaster Recovery (DR) site is also part of the scope of the proposed activity. The DAB already has a back-up and DR data center and this project will finance some upgrades to those and also all systems purchased will have capability to run for any of the three sites. Such infrastructure is essential given the country context (including vulnerability to natural disasters) and will serve the country well in the future.

13. The initial draft of the specifications and bid documents, which includes the relevant departments at DAB is in advanced stage of preparation, proactively drafted by DAB. Moreover, as part of the readiness for formal appraisal, it was agreed that the technical team at DAB will draft a detailed technical memo to outline the need for a new CBS and highlight the business needs, deficiencies in the current system and related operational risk and internal plans to ensure smooth operationalization of the new system. This memo was presented to DAB's executive board for endorsement to ensure ownership and commitment at the highest levels.

ii. Automation of DAB's Internal Audit System

14. The proposed TA on developing RBIA is meant to introduce a systematic and disciplined approach to evaluate and improve the effectiveness of the DAB's governance, risk management and internal control. This is to be complemented with automating the internal audit function and acquiring the relevant IT infrastructure that will enable efficient monitoring, tracking and analysis of various operational risks as well as facilitating the follow up of audit findings, actions and recommendations and eventually building up an institutional memory for lessons learned for future reference.

iii. Automation of Financial Intelligence Unit (standard database)

15. The Financial Transactions and Reports Analysis Center of Afghanistan (FinTRACA) was established as a Financial Intelligence Unit (FIU) pursuant to anti money laundering and proceeds of crime law by a decree in 2004. Currently FinTRACA has six sections (Analysis, Compliance, Coordination and Cooperation, Regional, Information Technology and Administration) and its mandate and statutory duties are to receive, analyze reportable financial transactions, investigate and disseminate financial intelligence to law enforcement agencies and international partners to assist combating money laundering (ML) and financing of terrorism (FT). FinTRACA is also mandated to analyze data pursuant to the AML/PC law, in order to provide strategic intelligence including statistics, trends and typologies aimed to increase awareness of the general public, financial entities, international partners and government officials of ML/TF trends in Afghanistan.

16. FinTRACA receives around 130,000 Large Cash Transaction Reports (LCTRS), 30 Suspicious Transactions Reports (STRs) and 50 cash declaration forms from airports on monthly basis in paper form from money service businesses and foreign exchange dealers and from banks through email. These are then manually transferred to a Microsoft Access Database through upload or data entry. The whole process

is very time consuming, prone to errors and not scalable. The time of the FIU staff is now to large extent consumed in the operational aspects and they are unable to dedicate adequate time for the analysis of these filings. The database further lacks tools for supporting detailed analysis. Moreover, FinTRACA will also start receiving cash declaration forms from land borders and tax authorities in near future.

17. The current ICT system is constrained by its inability to recognize the red flags, cannot make real time backup and will not run smoothly when the scope of FinTRACA expands. Against this background, the proposed new activity would support the provision of a comprehensive package of IT services and Technical Assistance in support of the full automation of the department, in an effort to strengthen the AML/CFT reporting and analysis infrastructure in Afghanistan and provide FinTRACA adequate space to focus on analysis and investigation.

18. The FIU department, which would receive from UNODC the GoML-2 software free of charge, has requested to receive support from the project to customize, install and build staff's capacity to utilize the new software. FinTRACA staff would also be enrolled into professional training and certification program, including those delivered by anti-money laundering associations. Before proceeding with the implementation of this activity, DAB, World Bank and UNODC will meet to coordinate support, avoid duplications and seek synergies and complementarity of activities financed.

iv. Automation of off-site supervision (Financial Supervision Department, FSD)

19. Complementarily with technical assistance (TA) that would be provided under component 1 of the parent project, the additional financing would support the acquisition and installation of software and hardware required for the automation of off-site supervision by the FSD. The consultancy firm currently being recruited for TA to FSD under the parent project would assist the FSD in drafting the RFP for this proposed new activity, and provide all TA required to implement this activity.

v. Attending DAB's Information Technology Security Assessment Recommendations (to be informed by the diagnosis conducted under the parent project)

20. This activity will support the DAB to enhance its ICT Governance and risk management practices through capacity building, certification of its infrastructure and processes against international standards and implementation of ICT Governance and risk management practices. The lack of attention to this, will expose the DAB to significant ICT and cyber security risk. The needs in this area will be informed by a study being undertaken by the DAB on the current status of its ICT security and risk management. The APS could also be included in the scope of this component. TORs for this diagnosis are being finalized.

vi. Financial Support to APS and AIBF Operating Costs

21. This activity is meant to provide the financial support to Afghanistan Payment System (APS) and Afghanistan Institute of Banking and Finance (AIBF) during two years to properly function as viable entities. The World Bank support would be provided on declining basis during the third year.

22. With regards to APS, the Government request letter explicitly requested Bank support to APS operations for two years.

23. *Background:* The national card and mobile payment switch is a key component of the modernization of the national payment system. Once fully operational, it will serve its potential participants in terms of being able to bring their Automated Teller Machines (ATMs), Point of Sale (POS) terminals, agents, mobile money accounts and cards on to the Afghanistan Payment System (APS) platform that is anchoring this infrastructure. APS is aimed to enhance the efficiency of electronic payments, reducing transaction costs and fostering financial intermediation through offering interoperability to financial intermediaries and retailers to facilitate electronic and card payments. All technical operational requirements and testing were concluded by APS and it was officially inaugurated by DAB's Governor on April 26, 2016. There are currently 5 participating banks in APS and another two banks and a mobile operator are in discussion to join the platform. However, APS is still running low on liquid assets as the current scale of operations is not a sustainable source of income. As a result of this, the APS is falling back on paying staff salaries and rent for its current premises and requires financial support for this crucial piece of market infrastructure to perform its functions until operations volume picks and create adequate revenues to cover APS operating costs.

24. The proposed additional financing will include a review of APS' operating rules and procedures, pricing structure and that APS has a feasible business plan that would help it become sustainable within the coming two years' timeframe. A sustainability plan for APS will be prepared under the ongoing USAID project. The plan will comprise a review of APS to ensure that it remains fully operational and financial projections and models that would allow APS to be fully sustainable in three years.

25. In addition, the AF could provide support to APS to relocate to a secure, more cost-effective location that would be secured by a long term-lease. Construction building would be financed neither by the FSRRP Second Additional financing nor by USAID FAIDA (and its successor) due to category exclusions in both institutions and therefore discussions will focus on already established buildings. APS' current rental expenses (rounding to USD 3,000 per month) are expensive, and, as such, a long-term leasing alternative could be the best solution given the constraints on eligible expenditures under these World Bank and USAID projects, the sustainability outlook for APS operations, and the current low shareholding basis of APS as well as the long time needed to have any infrastructure built by APS members.

26. It is proposed that this additional financing will partially fund operations of APS. Eligible operating costs would include, for example, but not be limited to: (i) a long-term building lease for APS headquarters in Kabul, (ii) salaries of some key staff, provided they comply with CBR scale, and (iii) other recurring costs (e.g. software licenses). It was agreed that no disruption will be caused during the move of APS from its current location to its new premises. It was also agreed that APS would hold discussions with state-owned Pashtany Bank and Bank-e- Millie, who are currently shareholders of APS, to request available buildings for leasing.

27. Eligible expenditures to be funded for APS under this project component will be agreed upon between DAB, APS and the World Bank (and coordinated with USAID), once the sustainability plan is reviewed and approved. Eligibility criteria as well as fiduciary arrangements for these expenditures will be defined in the project's existing Financial Management Manual, which will be revised if and as necessary. Support to APS will be included the project's Annual Work Plans that will be prepared by DAB and approved by the World Bank. It was also agreed that support to APS will be extended for two

years and made on a declining basis during the third year. APS is currently developing the sustainability plan with support from USAID.

28. With regards to AIBF, the central bank leadership requested that the proposed additional financing provide support to AIBF to fully implement the Organizational Capacity Action Plan that the parent project delivered and was subsequently adopted by AIBF Board.

29. *Background:* In September 2015, AIBF's Organizational Capacity Assessment report was finalized and presented to DAB's Board of Directors. The report provided a detailed action plan for enhancing AIBF's governance and proposed a more reliable organizational structure that would be supported by a set of bi-laws and rigor internal guidelines to ensure the sustainability and independence of AIBF. With the hiring of the new Director, the Bank resumed support to AIBF and released the committed funds to support the institute in its technical and operational aspects. AIBF resumed its operation in January 2016 and was able to offer 41 training sessions to 359 participants from the banking industry in accordance to a well-defined business plan. AIBF will continue to work to prove its relevance through close coordination with the industry to make sure it responds to rising needs in priority business areas.

30. Under the additional financing, support will be provided to: (i) Review AIBF's organizational assessment report, and implementation progress; proposing amendments to enhance its scope, if necessary; (ii) prepare a sustainability plan (business strategy and action plan; and transition arrangements for AIBF to be fully financially sustainable in three years); and (iii) prepare a detailed set of outlines for courses that AIBF would be able to deliver (core banking, commercial banking and selected specialized professional training) in coordination with DAB HR department and the Afghan Banking Association, under component 3 of the proposed additional financing – see below.

vii. Acquisition and installation of Video Conference Equipment at DAB

31. This activity is needed as part of the remote connectivity arrangements with DAB that would facilitate connectivity within and outside Afghanistan including World Bank offices. The use of VC facility is usually leveraged in cases of heightened security situations and limited movement of donors' community as an efficient channel for communicating with our counterparts. It will also facilitate distance learning and capacity building activities with DAB that could not be held face to face in Kabul.

Component 3: DAB Skill Development; Technical Assistance and project implementation (US\$ 4 million)

i. Skill Development of Staff in DAB's Core Functions:

32. The proposed sub-component is meant to help DAB with a robust skill development and retention policies through investing in staff in core operational functions and creating an incentive and developing a career for able and competent staff, This will be achieved through a combination of intensive skill development, on-the-job learning (i.e. learning-by-doing process), off-the-job learning, as well as

medium-term systematic staff training based on a comprehensive needs assessment and human resources development plan that DAB has prepared (under finalization).

33. These activities will be carried out through short, medium and long-term consulting services and staff training that will be identified by DAB’s HR Department and pursued on two key tracks: (i) higher education and learning track to support DAB’s Higher Education Initiative 2020; and (ii) professional development training courses in key technical areas relating to DAB’s core functions.

a. **Professional Development Training Courses:** will be delivered to relevant DAB staff through AIBF (whose operationalization is supported by the project). At this stage, it is expected that capacity building will be tailored at two levels:

- For all DAB’s professional/technical staff, AIBF will provide a foundational training course on Central Banking Core Curriculum which will cover basic central banking functions and provide knowledge of commercial banks operations to familiarize staff with the dynamics of banking operations.
- For specialists, highly specialized training will be provided by renowned experts in their field to upgrade their technical skills. This includes areas such as risk management, off-site supervision, Basel Core Principles, regulating e-money and electronic transactions, consumer protection, etc.

b. **Higher Education and Learning Track (DAB’s Higher Education Initiative 2020):** Skills development and low technical capacity remain key constraints to institutional efficiency in Afghanistan in general. As per the below table – that provides the current distribution of DAB staff by highest degree obtained – over 60 percent of DAB staff in core functions do not hold a Bachelor’s degree.

Highest Degree obtained	Number of DAB staff	Of which, Core Function Employees (non-support staff)		
Baccalaureate	801	638	80%	62 women
Post-Baccalaureate	232	215	93%	40 women
Bachelor of Arts (BA)	590	590	100%	70 women
Total DAB Staff	1,623	1,443	89%	172 women

**Baccalaureate refers to secondary school level*

34. As part of the Higher Education initiative, 88 DAB staff (of which 7 are women) have been enrolled into bachelor’s and master’s programs (51 bachelor’s and 37 master’s). DAB operates on a tuition reimbursement basis for enrolled staff, based on evidence of satisfactory completion of a course and presentation of a receipt reflecting the amount of tuition paid.

35. To date, 62 out of 88 enrolled DAB staff have completed their studies through this initiative and have signed a five-year bond policy with DAB; only 3 of these 62 (i.e. 5 percent) have left DAB since. In

the current bond policy, employees who leave DAB before end of the 5 years would be required to fully reimburse to DAB any tuition expenses from their retirement account.

36. The educational and learning track will be pursued in leading Afghan universities. The World Bank will work with DAB to ensure that clear and transparent criteria are in place to identify a pool of universities that provide high quality education is in place. Moreover, eligibility criteria for DAB staff are also being prepared (e.g. age, professional grade, etc.), with due attention to female participation. DAB has prepared a draft policy note for the implementation of this high education initiative. The note, after review by the World Bank, will be presented to DAB's executive board for endorsement. The World Bank will review DAB's current training policies as relevant to this activity and adjust these based on the experience of other projects under implementation in Afghanistan and elsewhere.

ii. Technical Assistance and Capacity Building for Project Implementation

37. Building on the success of the parent project to provide TA and support building DAB's staff capacity in technical areas that facilitate project implementation particularly ICT and financial infrastructure, the proposed activity is intended to provide the required resources to grant successful implementation of the remaining activities from the parent project as well as the proposed new activities under AF. This activity will also cover Project Implementation Cell's operational expenses, training and workshops.

Summary of proposed project components, compared with original financing and first additional financing.

Components under original financing	Budget (US\$ mil)	Components under first additional financing, and additional activities	Revised Budget, after first AF (US\$ mil)	Components under proposed second additional financing, and additional activities	Revised budget (US\$ mil)
		1. Strengthening of DAB's capacity	8	1. Strengthening of DAB's capacity	9
1. Audits of ten commercial banks	3.5	- Audits of ten commercial banks	3.5	Scope of first additional financing	8
		<i>Additional activities:</i> - Stock taking on capacity building efforts on financial supervision over the last 10 years and development and implementation of a capacity building plan to sustainably strengthen the Financial Supervision Department - Review of banking regulation framework - Development and implementation of action plans following audits of commercial banks	+4.5	<i>Additional activities</i> - Adoption of Risk-Based Internal Audit - Adoption of IFRS standards	+1
		2. Development of the financial sector infrastructure	14.2	2. Development of the financial sector infrastructure	29.7
2. Modernization of the national payment system	11	Modernization of the national payment system (mobile / card switch, RTGS/ACH/CSD)	11	Scope of first additional financing, as revised after restructuring for components relocation [⊥]	14.7 [⊥]
3. Support to the development of the Afghanistan Institute of Banking and Finance	1	Support to the development of the Afghanistan Institute of Banking and Finance	1	<i>Additional activities</i> - Acquisition and installation of Core Banking System (CBS), Enterprise Resource Planning (ERP) and Data Warehouse	+15
		<i>Additional activities:</i> - Support to the establishment of Public Credit Registry	+2.2	- Automation of DAB's Internal Audit System - Automation of Financial Intelligence Unit - Automation of off-site supervision - Attending DAB's Information Technology Security Assessment Recommendations - Financial Support to APS and AIBF Operating Costs - Acquisition and installation of Video Conference Equipment	

4. Technical assistance and training for project implementation	3	3. Technical assistance and training for project implementation	3	3. Skill development, Technical assistance and training for project implementation	7
				Scope of first additional financing,	3
				<i>Additional activities - Skill Development of Staff in DAB's Core Functions</i>	+4
<i>5. Unallocated</i>	<i>0.5</i>	<i>5. Unallocated</i> [⊥]	<i>0.5</i> [⊥]		
TOTAL	19	TOTAL	25.7= 19+4.5+2 .2	TOTAL	45.7=25. 7+1+15 +4