



MISFA^{LTD}

Microfinance Investment Support
Facility for Afghanistan



**ANNUAL
REPORT**
MARCH 2023

FINANCE OPPORTUNITIES FOR THE POOR &
UNDERSERVED SMALL AND MEDIUM ENTERPRISES

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ACRONYMS

AMA	Afghanistan Microfinance Association
APS	Afghanistan Payments System
CSPIs	Community Savings Promoting Institutions
DFS	Digital Financial Services
DIME	Development Impact Evaluation Group
EMIs	Electronic Money Institutions
IADC	Italian Agency for Development Cooperation
IFAD	International Fund for Agriculture Development
MFI	Microfinance Institution
MNOs	Mobile Network Operators
OSS	Operational Self-Sufficiency
PAR	Portfolio at Risk
POS	Point of Sale
PSPs	Payment Service Providers
SME	Small and Medium Enterprise
TUP	Targeting the Ultra Poor



BOARD OF DIRECTORS

Mr. Arbab has been working in the development and commercial banking sectors for the past 40 years, with a focus on financial inclusion, SME, Agriculture and digital finance. He has served as Senior Advisor, South Asia with CGAP/World Bank, Regional Director at Enclude, a global advisory firm that is supporting financial inclusion. Before joining Enclude, Mr. Arbab was the Managing Director of the Microfinance Investment Support Facility for Afghanistan (MISFA), an apex institution for the microfinance sector in Afghanistan. He was also a founding member of the management team of the Bank of Khyber in Pakistan's Khyber-Paktunkhwa Province, Head of BOK's small and microfinance division in the mid to late 1990s. In addition, he has served in senior positions with the Aga Khan Rural Support Program and the Agricultural Development Bank of Pakistan. Amjad Arbab has a strong track record of successfully managing multiple donor and commercial projects and institutions in Pakistan and the region and has led diverse teams of international experts and consultants. He holds a Masters in International Relations from The Johns Hopkins University/SAIS, Washington DC as well as a Masters in Political Science from the University of Peshawar.



AMJAD ALI ARBAB
Chairman

Mr. Bijan is a senior banking executive and advisor with more than 16 years of experience in the MSME sector development and 8 years of executive management experience in regulated and non-regulated financial institutions in Latin America, MENA region, East Africa and Eurasia regions.

In addition to his wide-ranging experience and executive knowledge, Bijan has completed numerous specialized training programs including, most recently, the American Bankers Association's Stonier Program at The Wharton Business School, University of Pennsylvania.



Bijan Osburg
Member

Ms. Frances Toomey Mys is a development finance expert with over 25 years' practical and comprehensive international experience building and growing financial institutions' financial and business development services targeted to micro, small and medium-sized enterprises. Ms. Mys is a senior expert in program design, development, implementation and operations of technical assistance, grant programs and fund management for economic development projects. Her experience includes implementing projects funded by DFID, the World Bank/IFC, USAID, and the U.S. Peace Corps. Ms. Mys has an MBA from the University of Cincinnati.



FRANCES TOOMEY MYS
Member

Nasratullah Mahmood is currently serving as General Director of Treasury at Ministry of Finance (MoF). He has served at several senior level positions including the Director of External Affairs at MoF. Mr. Mahmood has strong academic background as well and was a lecturer in Islamic University. In addition, Mr. Mahmood has served in the Board of Directors of several companies including Spinzar Kunduz, Intercontinental Hotel, Kandahar Wool Textile. Mr. Mahmood has an MA in Dawa Usuludin and a BA in Finance from Islamic University, Islamabad.



NASRATULLAH MAHMOOD
Member

Mr. Tamoor Shah Habibi is representing the private sector of the country in this Board. He has been involved in the private sector of Afghanistan for the last 20 years. He is an entrepreneur of the amusement industry by opening the first ever Family Entertainment Center (PLAYZONE) in Gulbahar City Center. He has also been active in dry fruits business and its export outside the country.

Mr. Tamoor Shah Habibi has eight years of experience working with the UN agencies (UNHCR & UNDP) in Afghanistan from 2002 to 2009. Mr. Habibi is holding a master's degree from Kabul University in Public Policy and Administration (MPPA) and has achieved his bachelors in Political Science from the University of Karachi.



TAMoor SHAH HABIBI
Member

CHAIRMAN's MESSAGE

The events of August 2021 leading to the accession of power by the Taliban were a landmark development in the history of Afghanistan. Afghans were already struggling with the adverse economic consequences of the Covid-19 pandemic when the regime change took place, intensifying the severity of the economic impact on the lives of a large majority of the population.

MISFA responded swiftly to the emerging uncertainty by engaging with the stakeholders of the microfinance sector to resume operational activities that were suspended after 15th August 2021 and minimize the impact on the livelihoods of the borrowers. The first step was to get the buy-in of the new government. The response from the government was very clear and their only condition was to transform from conventional (interest-based lending) to a sharia-based financial model that would ensure the government's support and facilitation at all levels. This was a welcome decision by the government and a significant milestone in our endeavors to prevent the microfinance sector from a total collapse and a new hope for our partner microfinance institutions to intensify their efforts to transform their operations on the principles of Sharia-compliant lending.

Despite several challenges, MISFA's partner institutions remained resilient on the ground and adopted innovative ways to avoid the financial collapse of the sector after the suspension of operational activities in August 2021. Their commitment to ensuring the economic well-being of their borrowers was the guiding force to adopting new ways of remaining in contact with their clients and giving them confidence and hope for the future.



I am pleased to inform you that we have come a long way in transforming the microfinance sector of Afghanistan on the principles of Islamic finance models and some of our partner organizations have already started testing their new Islamic product, Murabaha, in the market. The process of transformation was not easy. Apart from mandatory approvals from religious scholars as a prerequisite, it required a complete overhaul of the products, systems, policies, documentation, MIS, and staff training.

Afghans living in poverty -- and those on the brink of it -- prior to the regime change will need a safety net now more than ever to protect them from falling down the abyss of abject poverty. In the event funds are made available by donors, MISFA is in a position to quickly mobilize its partner organizations that implemented the multi-year Access to Finance Project which was successfully implemented in 32 districts of Afghanistan.

On behalf of MISFA's Board of Directors, I would like to express my deep gratitude for the commitment and dedication of MISFA's senior leadership and staff, our Partner Organizations, the Afghanistan Credit Guarantee Fund, and specifically the multilateral donors (the World Bank), for their positive engagement and support that helped the microfinance sector and the institutions stay operational despite struggling with the multitude of security, loss of experienced staff due to the brain drain, environmental and health challenges in the country.

Our heartfelt thanks also go to the donor agencies for their unwavering support of MISFA and we hope they would resume their support at this critical juncture to support hundreds of thousands of vulnerable Afghan men, women, and children.

Sincerely,

Amjad Ali Arbab

Chairman, MISFA Board of Directors

“

“Murabaha Financing of OXUS-Afghanistan helped me purchase the machineries and assets required to expand my business and provide quality service to my clients.”

Parwez Ekhlās

”



MANAGING DIRECTOR's MESSAGE

Afghanistan was coping with the devastating effects of Covid-19 while the regime changes in mid-August 2021 accelerated the economic downturn of the country.

For MISFA, the impact of a sudden shock such as the regime change and global pandemic underlines the importance and urgency of financial inclusion. As a globally accepted development strategy, financial inclusion feeds into local economy stimulation, private sector and market-driven growth, and job generation.

MISFA's focus on institutional strengthening of the development finance sector actors for more than a decade now has proven to be invaluable in building the resilience of institutions mandated to facilitate poor Afghans' access to finance. In the face of a sudden shock, such as the regime change, our MFI partners held up and remained committed to continuing to serve the underserved Micro, Small, and Medium Enterprises (MSMEs).

This annual report underlines the value of MISFA as an apex organization providing the requisite support to partners to facilitate access to finance, even in the face of major disruptions to their operations and their clients. It highlights the capacity-building efforts of MISFA to ensure that its partners (suppliers of microfinance and SME loan products and services) are part of the larger financial ecosystem of Afghanistan. MISFA and the partner institutions are on the way to aligning their business strategies and services with the market realities and recent developments in the legal and political environment of Afghanistan.



All institutions will transform into fully Sharia-compliant organizations offering services to nearly 100% Muslim population of the country. Conventional services were proven to be a key barrier to market penetration and scale-up of the program in rural and religiously sensitive communities across the country.

I would like to take this opportunity to acknowledge the immense support of the World Bank, whose long-standing collaboration with MISFA and the sector, through the Access to Finance project, has been invaluable.

MISFA has also been incredibly fortunate for having a resolute Board of Directors, loyal staff, and a set of dedicated MFI partners committed to serving their clients through the challenges of the past year, and the years prior. Together, MISFA have led the MFIs and the sector to become strong, and the institutions are committed to ensuring that the often underserved low-income population of the country has access to finance.

We look forward to helping a greater number of Afghan men, women, and youth to gain access to finance in the years ahead.

Sincerely,

A blue ink signature of Khalil Baheer, written in a stylized, cursive script.

Khalil Baheer
Managing Director

“By receiving the Murabaha financing from The First MicroFinanceBank Afghanistan; I could double my shop's income (AFN 150,000+). I could improve and invest on my kids' education.”

Safar Ali



INTRODUCTION

This report focuses on MISFA's core programs, Microfinance and SME Lending, and completion of the Access to Finance project.

Section 1 provides an overview of the microfinance sector as represented by the consolidated portfolio of MISFA's implementing partners by end of the reporting year.

Section 2 provides a brief update on the MISFA's support to the development finance sector and the completion of the World Bank-funded Access to Finance project and its achievements.

Section 3 talks about the key developments and challenges of the financial sector and the transformation of MISFA and its partner institutions from conventional lenders to Sharia-compliant financial service providers.



ABOUT MISFA

The Microfinance Investment Support Facility for Afghanistan (MISFA) was set up in 2003 at the invitation of the Afghan government — to get donor coordination right from the start and avoid the counter-productive efforts that have emerged from conflicting donor objectives in other post-conflict situations. It was established as a vehicle through which the Afghan Government and international donors could channel technical assistance and funding to build Afghanistan's microfinance sector. MISFA was the first facility of its kind, pooling diverse donor funding mechanisms and converting them into streamlined, flexible support to microfinance institutions in Afghanistan, tailored to local priorities and accompanied by technical assistance and strong performance monitoring.



MISFA's vision is to develop a sustainable, efficient, and commercialized development finance sector stimulating the economic growth in Afghanistan.



MISFA's mission is to be a strong and efficient organization contributing to Afghanistan's economic growth by developing a viable, inclusive financial sector.



Honesty & Integrity: Conduct business adhering to the highest international ethical standards and complying with all applicable Afghan laws and regulations including Sharia principles and guides.

Leadership & Accountability: Reward strong leadership, management and accountability.

Teamwork: Promote positive attitude and teamwork among staff. Recognize and reward outstanding performance of both individual and team efforts.

Commitment to Clients: Through partner MFIs, cover much of Afghanistan, providing inclusive financial services important to the development and wellbeing of clients, their families and communities.

Operational & Economic Success: Mainstream sound operating practices and policies; and establish a total cost-covering financial plan that ensures MISFA's long-term sustainability critical to the economic wellbeing of employees, clients and the microfinance sector.

CORE PROGRAMS

- **Microfinance**
 - MISFA Partners Overview
- **TUP**

OVERVIEW

The microfinance sector went through several consecutive and crippling challenges for the last two years. Following the first and second waves of COVID-19 in 2020 which restricted business activities significantly, the regime change in mid-August 2021 led to complete income loss of the microfinance institutions. A major part of the services provided by MFIs were based on conventional lending principles. The local authorities of the new administration instructed the MFIs in the provinces to collect only the principal and waive the interest on outstanding loans. The MFIs and all financial services providers are obliged to transform their services to Sharia-compliant ones which require significant resources and time.

Despite the critical challenges, MISFA and its partner-MFIs remained steadfast to continue serving the underserved Afghan population specially the Micro, Small and Medium Enterprises (MSMEs).

After the political change in mid-August 2021, MISFA partners (The First Microfinance Bank, FINCA-AF, OXUS-AF, and Mutahid-DFI) were informed by the government authorities in every province to collect the principal amount of the loan only and stop collecting interest on loan and disbursement of new loans.

To maintain operations functional, partners have been utilizing the institution's equity to cover its financial and operating expenses. The equity position of three institutions (FINCA-AF, OXUS-AF, and Mutahid-DFI) was not strong enough to maintain operations functional for a longer period. The financial transactions through commercial banks to and from Afghanistan are restricted and the shareholders of partner institutions are not able to provide grant funds and inject additional equity to support MFIs operations. Therefore, MFIs started payment of cash from the collection of the outstanding portfolio to bear operational costs. This led to minus equity position of some partner institutions.

However, the situation gradually started changing when the first Islamic financing product ‘Murabaha’ was approved by the authorities in September 2022 and the institutions resumed financing the clients immediately.

CURRENT STATUS OF MISFA’S PARTNER INSTITUTIONS:

As of March 2023, MISFA partners managed around 43,964 borrowers through 65 branch offices in 14 provinces of Afghanistan. The outstanding portfolio was AFN 2.9 billion and the quality of the portfolio has significantly deteriorated. The PAR>30 days ratio has increased from 6.4% in June 2021 to 26% in March 2023. After the Regime changes in the country MFIs has started the Islamic Financing service and on March 2023 the Islamic Financing borrowers reached 8,250 with the total amount of AFN 905 million . Borrowers received loans for different enterprises under conventional and Islamic products in the sector of trade and services, agriculture and livestock, housing, handicrafts and manufacturing, and other sectors.

Following is the MISFA partners' portfolio update as of March 2023

	FMFB-A		OXUS-A		Mutahid	
	June 21	March 23	June 21	March 23	June 21	March 23
No of Conventional borrowers	56,859	26,509	26,150	15,387	17,429	2,068
Outstanding Conventional portfolio	5.6 billions	2.1 billions	1.2 billions	721 millions	506.6 millions	45.5 millions
No. of loans disbursed cumulative	713,600	716,686	235,471	244,735	136,669	138,879
Amount of Conventional loans disbursed cumulative	74 billions	74.8 billions	12.8 billions	13.4 billions	6.9 billions	7 billions
Amount of ISLAMIC disbursed cumulative	Nill	318 millions	Nill	443 millions	Nill	42.7 millions
Conventional Portfolio PAR>30 days	5.0%	18.35%	4.3%	47.84%	4.7%	24.32%
No. of Islamic Financing	Nill	2,295	Nill	5,039	Nill	915
Amount of Islamic Financing	Nill	290.5 millions	Nill	360.4 millions	Nill	34.4 millions
Islamic Finance PAR>30 days	Nill	0%	Nill	0%	Nill	0%

OXUS-A

As of March 2023, OXUS-Afghanistan (OXUS-A) maintained an outreach of around 15,387 active borrowers with a gross loan portfolio of AFN 721 million. OXUS has already implemented Murabaha Islamic product. Immediately, after the regime change in Afghanistan on August-2021, OAF focused on developing Islamic products to provide Islamic services to its clients. Consequently, OAF developed a new Islamic product (Murabaha) which is one of the most popular and productive Islamic financing products.

OXUS-A resumed its operation initially only with Murabaha Financing staying within the framework provided by the Afghanistan Academy of Science and approval of Afghanistan Supreme Court.

OXUS-A recruited a professional Sharia advisor to review all the related financing activities that should be executed in accordance with the Sharia law. OXUS-Afghanistan has also conducted several training sessions for its key employees for better implementation of Sharia Financing.

Under the Murabaha Financing, the following products have been designed & developed.

- Medium Enterprise Murabaha Agreement
- Small Business Murabaha Agreement
- Gold Collateral Murabaha Agreement
- Mobile Business Murabaha Agreement
- Agriculture /Livestock Murabaha Agreement
- Salary Murabaha Agreement
- Women Murabaha Group Agreement

Establishment of Sharia Board:

The Sharia Board of OXUS-A is a body established in 2022 for the determination of Islamic law and principles for the purposes of Islamic financial business. The Sharia Board mandates to determine the relevant Islamic law on any financial matter and issues, as well as to advise the company concerned on any Shariah issues relating to Islamic financial business operations, activities, or transactions.

FMFB-A

The First MicroFinanceBank-Afghanistan (FMFB-A) is MISFA's largest partner. As of March 2023, it maintained an outreach to more than 26,500 active borrowers with gross loan portfolio of AFN 2.1 billion. On 2021, The First Microfinance Bank-Afghanistan ("FMFB-A" or the "Bank") was granted a partial approval from Da Afghanistan Bank ("DAB") to set up Islamic Banking operation and offer Shariah compliant products and services. It worth mentioning that FMFB-A has completed transformation from conventional model of banking to Full-fledged Islamic Banking. FMFB-A commenced Islamic financing on October 2022 and as of March, disbursed 2,295 financing amounting AFN 419 Million or equivalent to USD 4.7 Million.

FMFB-A developed a number of asset and liability side products while some financing products namely Salam and Istisna are in que and will be soon sent to DAB for approval. FMFB-A has a Sharia Board and Islamic Finance department responsible for compliance of the bank's operations with Sharia rules and regulation.

MUTAHID-DFI

Mutahid-Development Finance Institution (Mutahid-DFI) maintained an outreach of more than 2,068 active borrowers with gross loan portfolio of AFN 45 million. Similar to OXUS-A, Mutahid-DFI has already implemented Murabaha Islamic product.

In August 2021 with the new government taking over in Afghanistan, Mutahid resumed its operations and started work to transform its model into a fully Shariah compliant one in-line with the directives of Islamic Emirate of Afghanistan. To reinforce its team and in order to have coherent discussions on development of Shariah products and required operational processes, Mutahid on-boarded a Sharia Officer with necessary qualifications and experience in Islamic jurisprudence. With the necessary approvals and certifications in place, Mutahid commenced marketing of Murabaha product to its target market and from September 2022 formal Murabaha financing was started through 4 branches (3 in Kabul and 1 in Mazar).

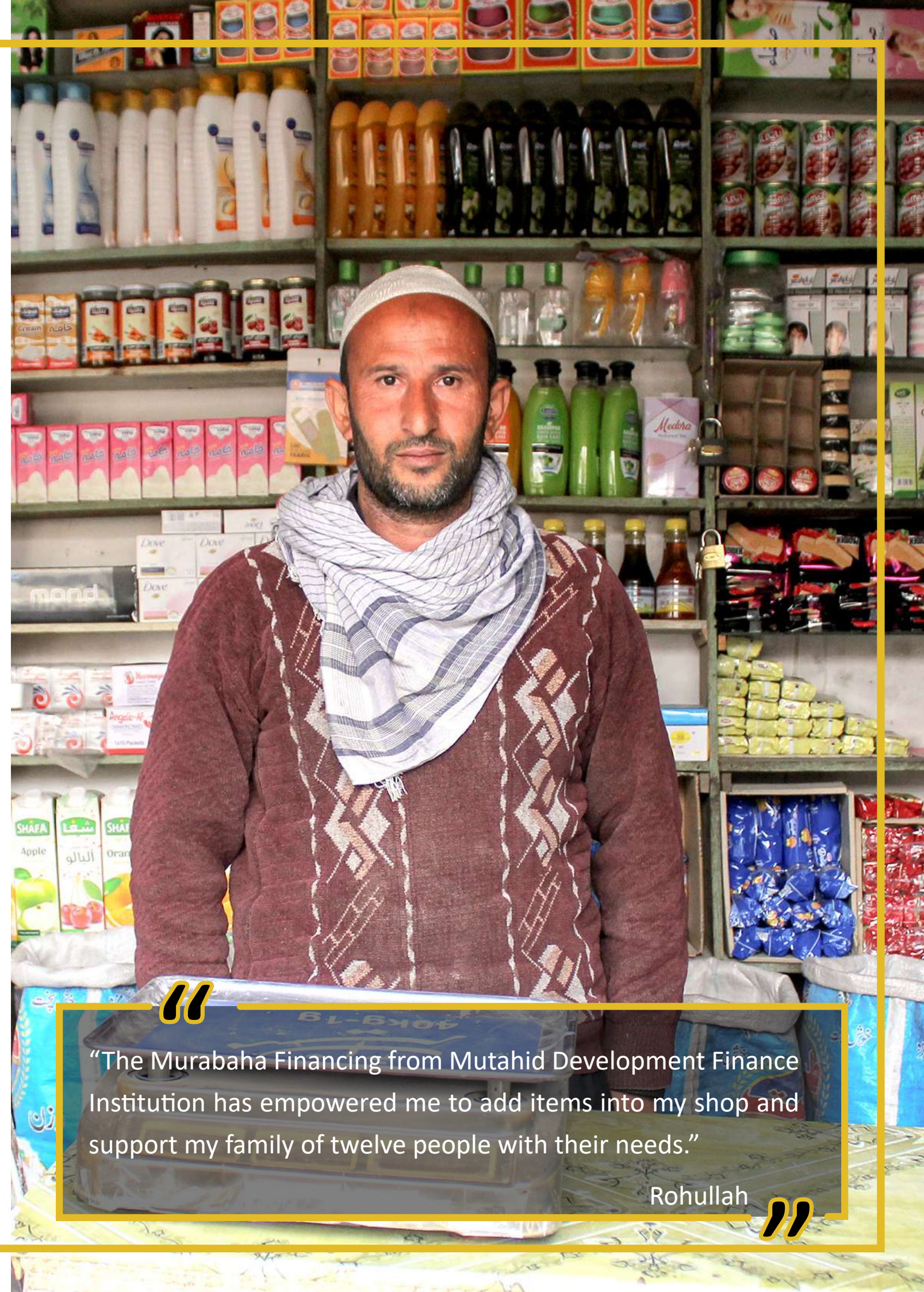
After successful launch of Murabaha Financing in September 2022 and continued financing operations to date, Mutahid now plans to develop other demand driven Islamic financing products in order to offer a menu of services to its clients as per their needs and requirements.

COMPLETION OF THE ACCESS TO FINANCE PROJECT

The project was aimed to support and complement the Government of Afghanistan's efforts to develop and implement a financial sector development strategy that focuses on increasing access to finance – moving beyond the Kabul Bank crisis. The strategy was also to aim at ensuring a stronger coherence between the various ongoing efforts to increase access to finance in Afghanistan. The project complemented the other World Bank initiatives and other donors' programs focusing on increasing access to financial and non-financial services to MSMEs (such as the Afghanistan Rural Enterprises Development Program, Afghanistan New Market Development Project, and IFC Business Edge program).

MISFA was in charge of Component-1 of the project (Improving access to financial services for micro and small enterprises). This component aimed to provide continuing support to the microfinance sector through MISFA, as well as, supporting MISFA to take on a broader role as a catalyst for innovations to increase access and usage of financial services from the lower end of the market (notably micro and small enterprises) as per its new strategic plan.

The pandemic that started in the first quarter of 2021 had an adverse impact on the outstanding microfinance portfolio of the MISFA partners. From April 2020 till October 2020, the outstanding microfinance portfolio showed a decreasing trend. Since November 2020, the sector has been slowly and gradually getting its momentum back. On June 30, 2021, the outstanding microfinance portfolio stood at USD 107 million, which is above the end target for the Access to Finance project.



“The Murabaha Financing from Mutahid Development Finance Institution has empowered me to add items into my shop and support my family of twelve people with their needs.”

Rohullah

ACHIEVEMENTS OF THE PROJECT

As a few highlights, of the Access to Finance project:

- Piloted digitization of lending using tablets
- Pre and post-harvest financing
- Women-only branch opening
- Shariah-compliant microfinance products
- Technical services to housing microfinance clients
- Supported the establishment of SME departments
- Feasibility assessment for one MFI to become deposit-taking (DMFI)
- Integration with payment switch (APS)
- Contributed to institutional strengthening (risk management, internal audit, IT systems)
- Financial institutions introduced new processes, policies, or products to improve financial services for households and MSMEs
- More than 88,000 beneficiaries got benefited from the project directly
- 89% of the beneficiaries were females

The project funded more than 50 innovation or system strengthening initiatives of MFIs and Banks. The initiatives had to go through a rigorous selection process and eligibility criteria including the sustainability of the outcomes and impacts after the project completion.

TARGETING THE ULTRA POOR (TUP)

TUP is a grant based program tailor made to help the ultra-poor households escape abject poverty by providing them a comprehensive package of inputs over a period of two years. Microfinance cannot reach the ultra-poor as they do not have the required skill set to get involved into any income-generating activities. Through this intervention, the ultra-poor can graduate to the next level where they become potential eligible clients for the MFIs. This program provides a platform to create more potential market for the MFIs and thus strongly supporting the financial inclusion agenda for Afghanistan. The program input include:

- Subsistence allowance
- Asset transfer

- Financial literacy training
- Social development
- Essential healthcare
- Linkage with financial service providers

- TUP was first piloted in Bamyan province targeting a total of 400 ultra-poor households followed by another pilot in Badakhshan supporting 1,360 households. The successful completion of the project in Bamyan and Badakhshan provinces, the donor agencies primarily World Bank and Italian Agency for Development Cooperation (IADC) supported the scale up of the program. MISFA managed to uplift a total of 16,183 households suffering from abject poverty.

The table below summarizes the TUP projects implemented by MISFA:

SN	Province	Graduation %	No.of female beneficiaries	Funded by	Status	No. of beneficiaries
1	Bamyan	85%	100%	IFAD	Completed	400
2	Badakhshan	81%	100%	IFAD	Completed	800
3	Badakhshan	84%	100%	IFAD	Completed	560
4	Herat	91%	100%	ISAME	Completed	1,725
5	Takhar	90%	100%	WB	Completed	1,500
6	Mazar	85%	92%	WB	Completed	1,500
7	Kunar	87%	34%	WB	Completed	1,000
8	Laghman	85%	46%	WB	Completed	1,000
9	Kabul	72%	100%	WB	Completed	1,500
10	Kandahar	85%	100%	WB	Completed	1,000
11	Nangarhar	89%	100%	WB	Completed	3,060
12	Parwan	90%	100%	WB	Completed	2,138
Total						16,183

The overarching goal of the project is to reduce the vulnerability and improve the livelihood, income, food security, and nutritional status of poor and vulnerable rural households on a sustainable basis.

As program results (graduation rate) and impact evaluations demonstrate, the TUP has been successful at lifting beneficiary households out of poverty in eleven provinces, and providing assets, training and coaching to sustain livelihoods.

The key impact of the program is ability to save and re-invest revenues. The impact evaluations show that even a year after the program ended, the program's impact is sustained in terms of higher household food consumption, reduced poverty, enhanced savings behavior and women's economic empowerment.

TUP is a well-researched concept in Afghanistan. The impacts of TUP project in Balkh province was studied by **Development Impact Evaluation (DIME) department of World Bank** through a Randomized Control Trial (RCT). Furthermore, the economic impact of the TUP project in Bamyan province was evaluated by the ministry of economy five years after its completion. Below is a summary of the findings of both studies:

TUP Impact Evaluation by DIME team, Balkh province:

The impacts reported in this study are the largest of any TUP program evaluated to date comparing to best performing programs in Ethiopia, India and Bangladesh.

- Internal Rate of Return is 26%, above the return reported for India (24%) and Bangladesh (22%)
- Large impact on psychological well-being and women's empowerment.
- TUP program was successful in delivering all the components of the TUP package to the target households.
- Support the potential of 'big-push' time-limited large investments that combine capital and human capital interventions.

DIME team continued the evaluation and completed a consumption survey on mid-2021 and the report is expected to be released in mid-2023.

TUP Impact Evaluation by Ministry of Economy, Bamyan province

Indicator	Impact
Livestock Growth	794 Cows, 810 Goats and 5,147 Sheeps
Revenue	Beneficiaries accumulated annual income through TUP accounted for AFN 47.38 Million from total investment of AFN 43.90 Million
Jobs & Income Penetration	Generated 873 jobs of eight hours per day
Food Security	Food Security for 2,800 direct beneficiaries
Poverty Reduction	1,961 individuals graduated from extreme poverty

A total of 400 families were identified to participate in TUP. Livestock distributed: 192 cows, 73 goats and 850 sheep.

KEY ACHIEVEMENTS:

- **Saving the MFIs by enabling them to resume offering Islamic financial services:**

With the regime change in mid-August 2021, MFIs stopped disbursing conventional loans and collecting interest on the outstanding conventional portfolio, resulting in a complete loss of income. MFIs had to develop Sharia-compliant products and obtain regulatory approval before offering their services. MISFA and MFIs worked together to get the Murabaha product approved by the Islamic Banking and Contemporary Issues Research Centre (IBCIRC) at the Academy of Sciences. Although MFI's Murabaha product was fully compliant with the guidance issued by IBCIRC, final approval required review of the product by higher authorities in Kandahar.

To avoid MFI bankruptcy and respond to the high demand for financial services in the market, MISFA submitted the Murabaha product to the Dar-ul-Ifta of the Supreme Court and obtained a fatwa (decision) confirming the compatibility of the proposed Murabaha services with Shariah and allowing MFIs to resume offering Shariah-compliant financial services that could both support MSMEs and generate income for institutions. If MISFA did not consider a creative approach and approval mechanism, the MFIs' fate was sealed. The MFIs have significantly expanded their Islamic finance portfolio and are on the verge of becoming operationally self-sustaining.

- **Advocacy for the microfinance sector:**

MISFA continued to advocate for the microfinance sector, arranging a series of high-level meetings with donor agencies such as UNAMA, UNDP, UNCDF, the World Bank, IADC, and others to ensure the donors about MFI survival and inform them about the role of Islamic microfinance in economic recovery, and the donor support needed. As a result of MISFA's advocacy efforts, microfinance is now high on the donor agenda and widely discussed.

MISFA has submitted several concepts and proposals to the various donor agencies, some of which are in the approval phase. The World Bank has agreed to support the MFIs by waiving loans for women clients to the tune of about seven million U.S. dollars, and the UNDP would help the MFIs with capacity building.

- **Elaboration of the strategic plan:**

In response to changes in the political, economic, social and technological (PEST) environment of the market, MISFA has developed a 3-year strategic plan. MISFA's strategic plan for the period 2023 - 2025 was formulated based on the realities of the operating environment, the immediate needs of the institutions and partner DFIs, and most importantly, the needs and expectations of the target segments (extremely poor households, micro, small and medium enterprises (MSMEs)). MISFA would mobilize all its resources toward its overarching goal: Promoting an enabling environment for the development of stronger and effective financial institutions with a focus on market-oriented products/services and delivery models in order to increase outreach and gear the sector towards inclusive finance.

- **Increasing efficiency:**

In response to the changes, MISFA waived more than ANF 192 million (\$2.4 million) in interest receivable from MFIs. A similar decision was made regarding term deposits in various banks. Therefore, in order to accommodate drastic reduction of its income, MISFA has carefully reviewed its operating expenses and improved its efficiency by almost 40%.

TRANSFORMATION OF MISFA

MISFA's mission as an apex institution is to facilitate and support the provision of financial services to rural and urban households through retail microfinance service providers. To proactively demand to the legal changes in regards to conversion of all the financial services into Sharia-compliant; MISFA transformed into a fully Sharia-compliant institution.

MISFA hired Qazi Shariah Consultancy in October 2022, in order to execute / monitor the Transformation of MISFA into a Sharia-compliant institution.

The Consultant reviewed MISFA's Existing Products, developed the Shariah Compliant Wholesale Financing Product, the Pool Management system, reviewed the Existing Documents of MISFA, developed Shariah Governance Framework, the Guidelines for the Treatment of Existing Interest-based Investment Portfolio of MISFA, Charity Policy and trained the concerned staff.

A set of approved products developed based on the Islamic finance principles that meet the requirements of a wholesale lending institution and microfinance service providers as alternatives to MISFA's current conventional loans to MFIs.

The consultant has developed the Mudaraba mode of Wholesale Financing and Pool Management framework with the help of the guidelines contained in AAOIFI Shariah Standards, the Islamic banking regulation of DAB regarding profit and loss distribution and pool management, the international best practices, and local regulatory and industry requirements.

Considering these basic Shariah financing requirements, MISFA has ensured compliance of its own and MFIs operations with Shariah rules. The consultant introduced Shariah compliance and Shariah corporate governance standards in the performance standards of MISFA to be used for assessment of MFIs considering the compliance structure of their organization. In addition to Board of Directors, MISFA has added a Sharia Board into its governance structure to ensure the full compliance of its operations with Sharia rules and requirements.

THE CHALLENGES OF MICROFINANCE SECTOR

The already fragile and donors-dependent economy of Afghanistan was hit hard by a number of natural and man-made challenges including COVID-19 pandemic, drought, insecurity and finally the regime change in mid-August 2021.

The political events of August 2021, triggered a complex economic crisis, including the cessation of international aid; major disruption to basic services that had previously depended on international aid support; a loss of hard-currency aid inflows; loss of access to the overseas assets of the central bank; the cessation of international payments by correspondent banks; loss of central bank access to supplies of Afghani and USD cash notes ceased, creating a liquidity crisis in the banking system, constraining firms' and households' access to working capital and savings held in commercial banks; rapid decline in investment confidence, given pervasive uncertainty and fear; and loss of human capital, as tens of thousands of highly-skilled Afghans fled the country.

The economy of Afghanistan is predicted to drive toward universal poverty with an estimated 95-97% poverty rate in 2022. The number of people requiring humanitarian support was 18.4 million in July 2021 while this was 50% less in mid-2020 and is increasing rapidly due to regime change in August 2021.

The microfinance sector in Afghanistan plays an important role in the social and economic development of low-income people by enabling them to earn a livelihood. The sector that constitutes MISFA as an apex wholesale lending institution and microfinance institutions (MFIs) has been operating for almost two decades with a significant client outreach. MISFA Partner MFIs have disbursed over 2.9 million micro, small, and medium-sized loans totaling AFN 113.4 billion in various sectors.

The regime change in August 2021 had an immediate financial impact on the microfinance sector. MFIs were prohibited from collecting interest on outstanding conventional loans. This restriction had an adverse impact on the survival of the MFIs with a resultant ripple effect on the population served by the sector. Also, MFIs were ordered to stop new loan disbursement as they were not in line with Sharia and were only allowed to collect principal amounts of the loans. Under such unexpected circumstances, Islamic financing offerings provided by several MFIs were also halted & subjected to review by the new administration.

On the other hand, the regime change has created a new opportunity for MFIs. Previously, access to microfinance services was limited to cities and rural areas that were considered not secure. With the new security improvement, MFIs now have an opportunity to expand their outreach nationwide by increasing their branches and using branchless/digital services. In light of the new changes and opportunities to establish an Islamic microfinance system, MFIs could broaden financial inclusion in the country.

CONCLUDING REMARKS

Despite critical challenges and economic downturn, MISFA and its partner institutions survived the shocks without any tangible support from donor agencies and continued to serve the underserved population. While on one hand, the MFIs were struggling to recover their outstanding portfolio; on the other hand, they responded effectively to the political and legal changes in the country requiring the financial institutions to transform to Sharia-compliant bodies. MISFA partner institutions resumed Sharia-complaint financing on the last quarter of 2022 and achieved significant portfolio growth in a short span of time.

Although, the MFIs seems to be on the right track of recovery and growing a clean Sharia-compliant portfolio, it would take them longer to fully revive and get back to pre-August 2021 status if the donor agencies and international community do not step in and extend hand to support the MFIs who are playing vital role in the economic development of the country.


In addition to microfinance, MISFA is also looking forward to work with the international community to scale up its landmark Targeting the Ultra-Poor project as it is more relevant now with over 90% poverty rate than any other time.

For an inclusive finance, MISFA invites the stakeholders for effective collaboration in order to overcome the challenges and weather the storm confidently and assures that MISFA would continue the journey along with its partner institutions even if our international counterparts do not come over to assist.


FINANCIAL OVERVIEW

MISFA Ltd. Overall Financial Summary April 1, 2003 to December 21, 2022		April 01, 2003 to December 21, 2022
INCOME STATEMENT		AFN'000
Interest & similar income		5,917,077
Operating grants		264,463
Other income		70,161
Total operating income		6,251,702
Administrative & other expenses		(4,235,089)
Operating profit / (loss)		2,016,613
Income tax expense on taxable profits		(343,276)
Operating profit / (loss) after tax		1,673,337
Grant income (grants for loan funds or MFI grants)		13,807,153
Exchange gain / (loss)		47,152
Grant expenditure (grants to MFIs for operating or equity)		(5,707,323)
Provision against loans and advances to MFIs & Banks		(2,393,077)
Provision for MFI shut-down costs		(39,638)
Finance cost (For IDA Credit)		(370,546)
TOTAL COMPREHENSIVE INCOME		7,017,057
CASH FLOW		
Inflows:		
Total comprehensive income		1,217,561
Share capital		100
Long-term loans		-
Total inflows		1,217,661
Outflows:		
Net Loans and advances to MFIs & Banks		2,200,691
Loan note investments in MFIs		-
Investments		-
Operating fixed assets		(3,903)
Working capital (amounts receivable)		2,147,173
Total outflows		4,343,961
NET CASH FLOW		5,561,622
Opening cash & bank balances		-
CLOSING CASH & BANK BALANCES		5,561,622
Source: MISFA audited financial statements covering the period April 1 2003 to December 21, 2022		



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