Migrant Money

Regional Harmonization of Remittance Policies in the Intergovernmental Authority on Development (IGAD)

SOMALIA PAYMENT INFRASTRUCTURE ASSESSMENT REPORT

April 2023

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ABOUT THIS REPORT

The scope of this report draws from the policy diagnostic assessment in Somalia, which identifies key policy areas that require attention to enhance remittance flows to Somalia, including modernizing payment system infrastructures. In this context, four key areas have been assessed for the development of modern and efficient payment system infrastructures to enhance remittance flows using digital payment channels. They are as follows:

- Availability of access points for sending and receiving remittances, including automated teller machines (ATMs), merchant points of sale (POS), and cash-in/cash-out agents.
- Access to national payment system (NPS) infrastructures by non-bank remittance service providers (RSPs), including mobile network operators (MNOs), money transfer operators (MTOs), and fintechs.
- Interoperability for key retail payment systems and instruments, including POS, mobile money services and agents, although agent interoperability is currently unavailable.
- Connectivity with local, regional, and international hubs, gateways, and multilateral payment platforms.

This report assesses the progress made under each of the four priority areas identified as crucial for NPS infrastructures and provides guidance for future action for public and private stakeholders to improve the digital ecosystem for increased remittance flows through monitored and regulated digital channels.

ACRONYMS

ACH	automated clearing house
AMISOM	African Union Mission in Somalia
AML/CFT	anti-money laundering/combating the financing of terrorism
API	application programming interface
ATM	automated teller machine
AFTRAF	Afreximbank Trade Facilitation Programme
BCP	business continuity plans
CBS	Central Bank of Somalia
CDD	customer due diligence
DRP	disaster recovery plan
EFT	electronic funds transfer
EFTPOS	electronic funds transfer at point of sale
e-KYC	electronic know your customer
FATF	Financial Action Task Force
GDP	gross domestic product
IGAD	Intergovernmental Authority on Development
IOM	International Organization for Migration
IT	information technology
ISO	International Organization for Standardization
KYC	know your customer
MFI	microfinance institution
MFS	mobile financial services
MoMo	mobile money
MNO	mobile network operator
MTB	money transfer business
MTO	money transfer organization
NCA	national communications authority
NGO	non-governmental organization

NID	national identification
NPS	national payment system
P2P	person to person
POS	point of sale
PSP	payment system provider
QR code	quick response code
RSP	remittance service provider
RTGS	real-time gross settlement system
SIM	subscriber identity module
STARS	Somalia Transaction and Reporting System
SWIFT	Society for Worldwide Interbank Financial Telecommunication
PAPPS	Pan-African Payment and Settlement System
UNCDF	United Nations Capital Development Fund
UNHCR	United Nations High Commissioner for Refugees
USSD	unstructured supplementary service data

Remittance market overview

The population of Somalia is estimated at 16.4 million,[1] based on Worldometer's presentation of the United Nations data. Somalia is the fifth-highest country of origin for refugees globally, and more than a million Somali refugees reside in the Horn of Africa and Yemen. Somalia is significant as a country of origin for mixed migration in the region. Conflict, insecurity, poverty, and drought have led to emigration, especially over the past two decades.[2] As Somalia has become relatively more stable in recent years, the number of Somali migrants returning has increased. A lack of infrastructure and livelihood opportunities may result in returnees re-migrating.[3] While instability has limited labour migration to Somalia, foreign assistance organizations and the African Union Mission in Somalia (AMISOM) have brought an inflow of migrant labour.

Furthermore, migrants from the Intergovernmental Authority on Development (IGAD) region and the Middle East work in the hospitality, Information Technology (IT), and construction sectors as domestic workers, teachers, and doctors.[4] Generally speaking, Somali migrants have a reputation for high entrepreneurial skills and have established small businesses in Kenya, Ethiopia, South Africa, and Uganda. In Yemen, they tend to work as farmers, livestock herders, and traders. Somali migrants also work as casual and domestic workers in the IGAD region, Yemen, and the Middle East,[5] investing in the Somali economy.

The World Bank reported that in 2021, migrant remittance inflows totalled US$1,735 million, i.e., 23.5 percent of the gross domestic product (GDP) of Somalia.[6] High unemployment rates, including youth unemployment[7] and a fragile national economy, create a dependency on remittance flows, especially at the household level. Remittances and Somali migrants have played a key role in the country´s economy. Remittances are used mostly for household, education, and healthcare purposes.

The Government of Somalia's efforts to improve remittance inflows

The Central Bank of Somalia (CBS) amended mobile money regulations in 2020, providing guidelines for new entrants, which included licencing, operations, and reporting.[8] The 2015 regulation for money transfer businesses on anti-money laundering governs remittance

[1] UNFPA – Somalia: https://www.unfpa.org/data/world-population/SO. (Accessed on 28 March 2022)
[2] ILO, 2020. *An Assessment of Labour Migration and Mobility Governance in the IGAD Region: Country report for Somalia*. www.ilo.org/wcmsp5/groups/public/---africa/---ro-abidjan/---sro-addis_ababa/documents/publication/wcms_743318.pdf. (Accessed on 16 September 2021)
[3] Marchand, Katrin, Julia Reinold and Raphael Dias e Silva, 2017. *Study on Migration Routes in the East and Horn of Africa*, pp. 3–4, Maastricht Graduate School of Governance. (Accessed on 16 September 2021)
[4] ILO, 2020. *An Assessment of Labour Migration and Mobility Governance in the IGAD Region: Country report for Somalia*. www.ilo.org/wcmsp5/groups/public/---africa/---ro-abidjan/---sro-addis_ababa/documents/publication/wcms_743318.pdf. (Accessed on 16 September 2021)
[5] Ibid.
[6] KNOMAD, *Remittances Data*. https://www.knomad.org/data/remittances.
[7] In 2019, unemployment rate was estimated at 11.4 percent and youth unemployment rate was estimated at 17 percent. International Labour Organization, (2019). *Employment programs and conflict in Somalia*. (Accessed on 15 September 2022)
[8] CBS, 2020. *Mobile Money Regulations*, Amended 2020. https://centralbank.gov.so/wp-content/uploads/2021/03/Mobile-Money-Regulation-2020_amended.pdf. (Accessed on 4 August 2022)

services in Somalia.[9] The National Communications Authority (NCA) is the regulatory body for the communications sector in Somalia and has so far licensed seven mobile network operators (MNOs),[10] four of which are licensed as mobile money operators.[11] There are also bilateral agreements governing migration in Somalia. For example, in November 2013, a tripartite agreement was signed between the UNHCR and the governments of the Republics of Kenya and Somalia on the voluntary repatriation of Somali refugees living in Kenya.[12] The Government of Somalia recently secured support from the International Monetary Fund (IMF) and World Bank to create a central payment system to help rebuild Somalia's economy.[13]

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[9] CBS, 2018. *Regulation for Money Transfer Business on Anti-Money Laundering*, 2015 (Amended 2018). https://centralbank.gov.so/wp-content/uploads/2019/05/Regulation-For-Money-Transfer-Businesses-on-Anti-Money-Laundering-2015-AMENDED-2018.pdf. (Accessed on 8 August 2022)

[10] NCA, Licensed Operators: https://nca.gov.so/licensed-operators/. (Accessed on 11 August 2022)

[11] CBS, Licensed Mobile Money Service Providers: https://centralbank.gov.so/licensing-supervision-department. (Accessed on 4 May 2023)

[12] ILO, 2020. *An Assessment of Labour Migration and Mobility Governance in the IGAD Region: Country report for Somalia*. www.ilo.org/wcmsp5/groups/public/---africa/---ro-abidjan/---sro-addis_ababa/documents/publication/wcms_743318.pdf. (Accessed on 16 September 2021)

[13] Al Jazeera, 2021. *Somalia sets up national payments system as it rebuilds country*. https://www.aljazeera.com/economy/2021/8/10/somalia-sets-up-national-payments-system-as-it-rebuilds-country. (Accessed on 10 August 2022)

KEY STAKEHOLDERS IN THE PAYMENTS AND REMITTANCE MARKET

The Central Bank of Somalia

The Central Bank of Somalia (CBS) was first established in 1968. However, a period of insecurity continued, and the state and all its instruments collapsed in 1991. The CBS was revived in 2011 and was mandated to oversee Somalia's National Payment Systems (NPS). The CBS also drafted an NPS Act and consulted with industry stakeholders to gather feedback from the financial sector. Industry players provided feedback on the NPS Act, which was subsequently forwarded to the national parliament, and is waiting to be passed into law.[14] The draft includes provisions for payment services, as well as the management and operation of payment systems. Although the act has not formally been passed by the parliament, it has been adopted by the Board of the CBS as an interim measure and will continue when the act is passed into law.[15]

Banks

As of 31 April 2022, Somalia had 13 licensed and operational banks.[16] All 13 banks are connected directly to the NPS. Regarding remittances, banks face challenges when trying to establish correspondence banking relationships with cross-border counterparts to access regional and international business due to de-risking practices.

Non-bank remittance service providers

Non-banks are not restricted from connecting directly to the NPS. However, the practice has been to encourage non-banks to work with banking institutions. Money transfer businesses (MTBs) remain the most vital channels sustaining the flow of remittances into the country. There are 12 licensed MTBs.[17] MTBs from neighbouring countries wishing to transfer remittances into Somalia must submit a no-objection letter from the supervising authority of its origin country or wherever it has been working to the CBS. They must also pay a registration fee of $1,000, a license fee of $5,000, and a security deposit of $60,000. There are no minimum capital requirements for MTBs, unlike for banks which must meet all the licensing requirements, which include submission of statutory legal documents such as articles of association, business plans, risk management procedures, AML/CFT compliance procedures, etc. The evaluation is based on the sufficiency of the documents provided. MTBs follow the Financial Institutions Law 2012, the AML/CFT regulation from the AML/CFT Act 2016, the Registration for RSP-Financial Institutions law, licensing regulations, customer identification regulations, operation regulations, and licensing regulations of MTBs.

Mobile money operators

Four mobile money providers are licensed to engage in mobile money operations and have partnered with banks to create financial products. Hormuud Telecom with Salaam Somali Bank provide EVC[18] and mobile money services, and Somlink provides the eBesa product with the

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[14] Responses from CBS representatives during the IGAD workshop (Entebbe, Uganda, 14 to 16 March 2022).
[15] Ibid.
[16] CBS, Licensed Banks: https://centralbank.gov.so/licensed-banks/. (Accessed on 10 April 2022)
[17] UNESCWA, 2020. *Somalia National Development Plan 2020 to 2024*. https://andp.unescwa.org/sites/default/files/2020-10/Somalia%20National%20Development%20Plan%202020%20to%202024.pdf. (Accessed on 5 August 2022)
[18] Hormuud EVC plus is an interoperable mobile platform providing P2P among other digital financial services between Hormuud Telecom and Salaam Somali Bank.

International Bank of Somalia (IBS). Somtel provides the eDahab service, which is interoperable with Dahabshiil. Dahabshiil is an international funds transfer company with its head office in Hargesia. Lastly, Golis Telecom provides the Sahal mobile money product.

Microfinance institutions

Six MFIs operate in Somalia, either as affiliated subsidiaries of commercial banks or registered as non-governmental organizations (NGOs). This includes MicroDahab, IBS Microfinance, MAAL Microfinance, KAABA Microfinance, and Kaah International Microfinance Services (KIMS). MFIs operate despite lacking a legal framework, but CBS has established a board-level resolution outlining the procedures for registering an MFI. The Financial Institutions Law of 2012 only recognizes commercial banks and MTBs as financial institutions, although a draft amendment awaiting the approval of the national parliament will cover MFIs. Given that a large section of the population lives in rural areas and does not have significant access to banking, MFIs could serve as an important remittance channel if they had the opportunity to partner with some of the emerging payment service providers (PSPs) and fintechs.

Agents

Given that there are no specific regulations for agents, MTBs must self-regulate. For example, Dahabshiil provides its agents with licenses.

NATIONAL PAYMENT SYSTEMS INFRASTRUCTURES

The CBS launched the national payments system on 15 July 2021. All 13 banks participate directly in the NPS.

Large-value payments systems

The large value payment system comprises a real-time gross settlement system (RTGS) and an automated clearing house (ACH). Collectively, they make up the Somalia Transaction and Reporting System (STARS). The CBS permits only banks to participate directly in the NPS. The Payments Division of the CBS has trained banks on STARS payment system operations. Non-banks do not participate directly in the NPS. The CBS mainly uses the ACH for bulk payments of civil servants' wages, with, on average, fewer than 1,000 transactions processed monthly. All 13 licensed banks also participate in the RTGS, including the CBS, which fully owns the RTGS and ACH.

Retail/low-value payment systems

The CBS has plans to implement a national retail payments switch in the future. The national retail payments switch will be implemented as a public-private partnership (PPP) between the national government, owning 51 percent, and the private sector (commercial banks), owning 49 percent.

Private-owned retail payment systems

Four licenced mobile money providers and 13 commercial banks run proprietary private retail payment systems that enable cash-out access points such as ATMs and POS. The banks and mobile money operators maintain and operate their private networks and offer digital financial services, including transfers, bill payments, loans, etc. There is some interoperability between the different institutions, especially banks and MNO mobile wallets.

Personal identification cards

Somalia does not have a single national identification (NID) card but rather several fragmented identity initiatives, including the Benadir ID card, Puntland ID, passports, local electoral lists, and Somali national registration. This presents challenges to MTBs when conducting customer verification. The existing payment infrastructure is not integrated with identity systems, making it costly for customers to open accounts and use financial services.

Automatic teller machines, point of sale terminals, and cards

There is no current data on the number of ATMs and POS in Somalia.

REMITTANCE-LINKED PRODUCTS AND SERVICES

Somalia is listed as a high-risk jurisdiction. Banks struggle to handle remittances since they experience challenges with correspondent banking. Somali-based banks use intermediary banks to offer SWIFT services. However, MTBs can send money directly. For example, Dahabshiil in Canada can send money to Dhabshill in Somalia.

In recent years, changes in banking regulations and security procedures have impacted MTOs, and the cost and access to money transfers have influenced remittance flows from Europe and the United States. Remittance services to Somalia have also been severely impacted by bank de-risking. It is becoming increasingly difficult for MTBs to open bank accounts, even though these are a prerequisite for them to operate. This is due to bank de-risking, defined by the Financial Action Task Force (FATF) as financial institutions terminating or restricting business relationships with customers or customer groups to avoid risks in line with the FATF's risk-based approach. The reputation of MTBs suffered from the 9/11 attacks, after which the US Government terminated the activities of Al-Barakaat, an RSP serving the Somali community.[19]

There are no licensed foreign exchange providers or licensing frameworks for forex bureaux. Even banks do not exchange foreign currency, and the economy is dollarized.

[19] Studsgaard, Veronica, and Melissa Erisen, 2021. *The Somali Remittance Ecosystem: Developments and their social impact*. The International Association of Money Transfer Networks: https://www.iamtn-network.org/_files/ugd/264549_21fdcca3544043238cd1f53f9ff888f2.pdf. (Accessed in February 2022)

ASSESSMENT OF THE PAYMENT SYSTEMS INFRASTRUCTURE FOR DIGITAL REMITTANCES

This section assesses progress made by CBS and market stakeholders in the four key areas identified in the scope of the study to address the NPS infrastructure gaps and remaining challenges.

Retail payment access points for sending and receiving remittances

Context

The usefulness of transaction accounts for payments and remittances is enhanced by a broad network of access points with wide geographical coverage and by offering a variety of interoperable access channels.[20] The existence of a national-level retail payment infrastructure, including the ACH, payment cards, and mobile money switches, can expand the network of access points (e.g., ATMs, POS, branches, or agent networks) for individual customers. Such centralized payment infrastructures act as hubs for processing interbank transactions, improving interoperability and exhibiting positive network externalities for all system participants. Any branch of a bank or other PSP participating in the ACH or switch can be used to transfer funds to a customer of another ACH or switch participant, supporting countrywide reachability, even if a particular bank does not have access points deployed in specific regions. The success of digital remittance services that use retail payment systems depends on customer service and access points' availability, quality, and reliability.

Situation in Somalia

As of 31 March 2022, there was no operational retail payment switch infrastructure in Somalia as part of the NPS. An interoperable retail payments switch would support domestic ATM and POS networks that serve as access points. Each bank implements standalone ATMs and POS, which are not interoperable across brand names. An interoperable retail payment switch will enable several players to integrate with the retail payments ecosystem using standard open APIs and standard message formats. Together with an agent network, and interoperable POS devices, access point distribution can be improved.

Recommendations

The following recommendations could be considered to improve access points for remittances:

1. **The CBS could develop targets for increasing the number of access points for remittances.** This could be implemented by working with the private sector to meet these targets (e.g., additional access points in rural areas within the next two to three years). Expanding the geographic reach of access points, particularly in rural and remote areas where coverage is low, would improve last-mile distribution channels and encourage customers to send and receive remittances through regulated channels. For this purpose, the CBS can establish concrete, time-bound targets for increasing the number of ATMs, POS and cash-in/cash-out agent locations. This initiative could be carried out in partnership and consultation with the industry.

[20] World Bank, 2017. *Payment Aspects of Financial Inclusion (PAFI)*. www.worldbank.org/en/topic/financialinclusion/brief/pafi-task-force-and-report.

2. **The CBS could target increased use cases for digital financial services (DFS) by improving availability and coverage, including use cases for women.** Bill payments, POS, and quick response (QR) code-based acceptance for card-based purchase transactions are restricted to customers with bank accounts. Remittance recipients sometimes need the same use cases as bill payments and QR codes. However, when visiting a bank or cash-out agent, the service required is usually cashing out. The CBS could improve DFS uptake of DFS by increasing the use cases available. In addition to providing interoperability (as discussed below), developing the POS and QR code infrastructure at the merchant and bank-agent levels could increase the number of distribution points for remittances and improve banking services for remittance recipients by providing them with access to low-cost electronic payments, eliminating the need to withdraw cash. QR-code technology for growing merchant acceptance can be cost-effective and quick as merchants and customers require little or no technical knowledge. Standardization of the QR code format is needed for fostering interoperability and uptake, and should be required and enforced by the CBS or national government. In collaboration with RSPs, the national government could devise a comprehensive plan to encourage recipients to use formal and regulated channels, depositing funds directly into bank accounts or mobile wallets, and encourage the development of various use cases for digital payments that can be offered to customers at a low cost directly from their accounts (e.g., bill payments, payment of government services, and so on). As part of incentivization efforts, inflowing remittances to bank accounts could earn a marginally higher interest rate (e.g., 0.5 percent), which may be an incentive to retain part of the money in the bank accounts. This, in turn, would improve the interaction between low-income remittance recipients and regulated financial institutions.

3. **The CBS could consider promoting shared infrastructure to increase the number of access points.** Shared infrastructure, such as POS, would enable agents to serve customers from more than one bank or mobile money institution, improving the reach of financial services. In this situation, rural areas would be served optimally as a few agents with interoperable POS could serve customers in rural areas. The three licensed MNOs must partner with a bank to provide mobile financial services. It is, therefore, essential that the retail payments infrastructure is interoperable with mobile money. This will all be possible once a retail payments switch is in place. Having shared infrastructure for all payment infrastructures could foster product development as innovators could focus on specific initiatives and avoid some of the capital and operational costs of independently setting up infrastructure.

Access to national payment infrastructures by non-bank remittance service providers

Context

According to the Financial Stability Board (FSB) Stage Two Report,[21] "there are clear advantages to promoting direct access to the national payment infrastructures by non-bank RSPs as this reduces the costs for remittances transfers and time it takes to settle these transactions. Lowering barriers to access improves the possibility for PSPs and payment infrastructures to become direct members of multiple payment systems across different jurisdictions. Similar access requirements in different payment systems can encourage PSPs to become global payment players, serving many jurisdictions. The targeted outcome would be lower cost and higher speed in cross-border payments with lower credit and liquidity risks."

[21] Building Block 10 describes the importance of direct access. Committee on Payments and Market Infrastructures, 2020. *Enhancing Cross-Border Payments: Building blocks of a global roadmap*. http://www.bis.org/cpmi/publ/d193.pdf.

Situation in Somalia

Non-banks are not restricted from connecting directly to the NPS. However, the practice has been to encourage non-banks to work with banking institutions.

Somalia has several fragmented identity initiatives, including the Benadir ID card, Puntland ID, Passports, local electoral lists, and Somali national registration. The lack of a national ID and robust identification system makes it hard and costly to securely identify beneficiaries, a major prerequisite for gaining access to digital forms of payments. The inability to promptly confirm the beneficiary's identity causes delays and increases costs.

Recommendations

The following recommendations could be considered to improve the quality of access to NPS infrastructures:

1. **The CBS could consider enabling non-bank RSPs to access the payment systems directly.** This could be done using a tiered approach, considering different criteria such as the volume of transactions, geographical reach, or serving a key sector in the government's development strategy. Non-bank RSPs could improve the uptake and geographic reach of retail payment systems, and banks and non-banks could compete or complement each other depending on the provided remittance product. Unbanked individuals could use non-bank services as an alternative to payment instruments offered by banks. In other situations, non-banks could contribute expertise that the incumbents lack, and cooperate with banks to provide innovative services such as mobile payments. Banks have various DFS that they could entrust to non-bank institutions, such as insurance, loans, investments, etc. Since MNOs with mobile money licences already cooperate with banks, the CBS could strengthen existing cooperation by providing an enabling environment.

2. **The CBS could encourage banks and non-banks to adopt shared infrastructure** to reduce the cost of implementing access points in rural areas in Somalia.

3. **The CBS could implement financial/digital IDs in the financial sector.** Digital ID, e-KYC, and credit-scoring infrastructures will speed up the digitalization of remittance services.

4. **The CBS could build resilience in critical retail NPS infrastructures.** The impact of operational incidents could be mitigated, in principle, by building resilience that withstands service disruptions and supports effective business continuity plans (BCPs) and disaster recovery plans (DRPs). NPS system operators could be required to carry out the following: (i) adopt rigorous risk management procedures in line with global best practices to identify and mitigate operational risks, including cyber-resilience; (ii) incorporate appropriate redundancy and business continuity arrangements to ensure the timely recovery of the services in the event of a major disruption; and (iii) establish procedures for promptly alerting stakeholders to operational incidents. Furthermore, the CBS could consider conducting periodic, regular disaster recovery drills (both announced and unscheduled) to ensure the effectiveness and resilience of the NPS and its participants. This should be based on guidance developed by the Committee on Payments and Market Infrastructures (CPMI) on cyber-resilience[22] and other global best practices.

[22] Bank for International Settlements and International Organization of Securities Commissions, 2016. *Guidance on Cyber Resilience for Financial Market Infrastructures*. www.bis.org/cpmi/publ/d146.pdf.

Interoperability and interconnectivity of domestic and regional payment infrastructures

Context

Interoperability is one of the most desirable characteristics of payments and financial market infrastructures to ensure infrastructure-sharing and the widespread availability of digital financial service access points. While the widespread availability of digital solutions for remittances, payments, savings, and credit gives people access to financial services, payment interoperability enables them to transfer their money to any other individual without needing multiple transaction accounts, highlighting the importance of transaction accounts and their usability.

Situation in Somalia

Somalia is yet to implement an interoperable national retail payments switch infrastructure as part of its NPS. An interoperable retail payments switch provides domestic interoperability by harmonizing a message standard and adopting an open API for participants to join directly.

Recommendations

The following recommendations could be considered to improve the interoperability environment.

1. **The CBS could provide timelines for achieving interoperability with stakeholders after implementing the national retail payments switch. This may include POS and mobile money interoperability to ensure the NPS ecosystem is fully ready to deploy digital remittance products.** Establishing a fully interoperable environment for POS and mobile money is critical for a well-functioning retail payment ecosystem, which is the basis for an efficient environment for digitally enabled remittance inflows. ATM interoperability has yet to be finalized, and POS and mobile money interoperability are at different stages. The CBS could establish a clear timeline of when full interoperability will be achieved (for ATM, POS, and mobile money), including the roles and responsibilities of various stakeholders, and communicate this to industry stakeholders who have the responsibility to resolve their infrastructure and connectivity issues based on timeline and expectations established by the CBS. The CBS could also consider establishing a working group of banks and MNOs to streamline this process to monitor key full-interoperability milestones. Lastly, using the stakeholder coordination mechanism, the CBS could encourage banks and MNOs to develop appropriate financial literacy campaigns or measures to address their pain points and accept digital payments.

2. **Clear market guidance is needed on the CBS plans for the standardization and interoperability framework for QR codes.** There is a need to outline the intended framework for the standardization process[23] for QR codes to bring uniformity and provide equal opportunity for all players in the payment space.

3. **The CBS could develop guidelines for market players on a harmonized and coordinated cyber-reporting framework as the first step towards coordinating efforts and sharing of experiences required to put adequate protections in place.** A standard security framework (ISO/IEC 27001) could be adopted. Cybersecurity issues around payments could be properly addressed, specifically indicating the following: (i) who should monitor unstructured supplementary service data (USSD) channels; (ii) who should be notified

[23] Based on EMVCo and international standards.

of USSD breaches and how to respond; (iii) who is ultimately responsible for any loss of customer funds because of such breaches; and (iv) who should handle any customer complaints where USSD-based breaches result in loss of funds. Infrastructure security should be properly addressed, particularly the roles and responsibilities of those who transmit and hold data.

4. **The CBS should receive capacity-building support for developing a regulatory sandbox and for market players to scale retail payment services.** A regulatory sandbox enables innovators to test products in a controlled environment. Capacity could be scaled up at the CBS and within the fintech community by developing and testing applications in the sandbox.

Interconnectivity with local, regional, and international hubs, gateways and multilateral payment platforms

Context

Cross-border payments through the correspondent banking model often involve long transaction chains that lead to fragmented and truncated data standards, high capital costs, and weak competition, negatively affecting payment speed, cost, and transparency. Interlinking retail payment systems (including fast payment systems) and wholesale payment systems (such as RTGS) enable PSPs to interact directly through the linked infrastructures, reducing their reliance on traditional correspondent banking. Interlinking arrangements can range from simple agreements on cross-participation to fully integrated technical systems.[24]

Situation in Somalia

In Somalia, PSPs are not permitted direct access to the NPS as there is no regulatory framework covering PSPs. They are, however, encouraged to partner with banks that have direct access to the NPS and are regulated by the CBS. As of 31 March 2022, STARS, the large-value payment system comprising RTGS and ACH, does not participate in regional or international payment platforms. Consequently, RSPs must form bilateral agreements through banks with their cross-border counterparts for remittance purposes. Somalia is listed as a high-risk jurisdiction, and banks struggle to process remittances since they experience challenges with correspondent banking. This could lead to the service users shying away from formal channels and adopting informal remittance channels.

Recommendations

The following recommendations could be considered to improve interconnectivity with local and regional multilateral platforms.

1. **The CBS could seek assistance from regional programmes to deal with issues of de-risking by international institutions.** Regional programmes, such as the Afreximbank Trade Facilitation Programme (AFTRAF), were established to tackle the recurrent tendency of international banks to shrink or withdraw trade lines from African banks after the de-risking process. Local banks could use the trade confirmation guarantee facility to expand their

[24] Building Block 13 describes the importance of interlinking different payment systems. Committee on Payments and Market Infrastructures, 2020. *Enhancing Cross-Border Payments: Building blocks of a global roadmap*. www.bis.org/cpmi/publ/d193.pdf.

correspondent banking relationships.[25] Similarly, the CBS could consider regional payment system platforms such as the Pan African Payment and Settlement System (PAPSS). PAPSS is a centralized payment and settlement infrastructure for intra-African trade and commerce payments. It is endorsed by the African Union (AU) and is being developed in collaboration with the African Export-Import Bank (Afreximbank). It will facilitate payments and formalize unrecorded trade due to the prevalence of informal cross-border trade in Africa.[26] Somalia has been a member of the African Union (AU) since 25 May 1963.[27] With the collective voice of the AU, countries in the Horn of Africa can find collective solutions to prevent intra-African trade from being affected by de-risking.

2. **The CBS could foster connectivity between the NPS and regional and international hubs and payment gateways.** Establishing connectivity with international hubs and gateways will support greater access to digital payment channels. Such service aggregation platforms and remittance hubs enable RSPs to scale quickly and not incur disproportional operational and regulatory costs. These platforms and remittance hubs also have the potential to reduce the distance to access points and the cost of transactions by supporting a high number of low-value/low-fee transactions through many access points (or accessed remotely via the Internet or mobile networks).

3. **The CBS could consider implementing a fintech regulatory sandbox approach to foster long-term inclusive innovation in digital payments, financial and banking services.** While the regulatory environment for digital payments is still evolving in Somalia, the CBS could consider implementing a fintech regulatory sandbox so that banks and emerging fintech players can experiment with innovative financial products or services in a live environment but within a well-defined space and duration. The sandbox should include appropriate safeguards to contain the consequences of failure and maintain the overall safety and soundness of the financial system. Upon successful experimentation and exiting the sandbox, the sandbox entity must fully comply with the relevant legal and regulatory requirements. The sandbox may address the onboarding friction, the time it would take to integrate it with other apps, and the period for the learning curve.

[25] AFTRAF: https://www.afreximbank.com/products-services/our-key-services/trade-project-financing/trade-finance-programs/structured-trade-finance/afreximbank-trade-facilitation-programme-aftraf/. (Accessed on 14 August 2022)
[26] PAPSS: https://papss.com/. (Accessed on 5 May 2022)
[27] African Union members: https://au.int/en/member_states/countryprofiles2. (Accessed on 8 August 2022)

Impact Capital for Development

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ABOUT IGAD

The Intergovernmental Authority on Development (IGAD) is one of the eight regional economic communities (RECs) and building blocks for the African Union. IGAD was established in 1996 to supersede the Intergovernmental Authority on Drought and Development (IGADD) which was founded in 1986. The new and revitalized IGAD was launched during the 5th Summit of IGAD Assembly of Heads of State and Government—Djibouti, Eritrea, Ethiopia, Kenya, Somalia, South Sudan, Sudan, and Uganda—held on 25-26 November 1996 in Djibouti. The Summit endorsed the decision to enhance regional cooperation in three priority areas of food security and environmental protection, economic cooperation, regional integration and social development peace and security. The founding leaders of IGAD were motivated by a vision where the people of the region would develop a regional identity, live in peace, and enjoy a safe environment alleviating poverty through appropriate and effective sustainable development programmes.

ABOUT UNCDF

The United Nations Capital Development Fund (UNCDF) is the United Nations' flagship catalytic financing entity for the world's 46 Least Developed Countries (LDCs). With its unique capital mandate and focus on the LDCs, UNCDF works to invest and catalyse capital to support these countries in achieving the sustainable growth and inclusiveness envisioned by the 2030 Agenda for Sustainable Development and the Doha Programme of Action for the least developed countries, 2022–2031.

UNCDF builds partnerships with other UN organizations, as well as private and public sector actors, to achieve greater impact in development; specifically, by unlocking additional resources and strengthening financing mechanisms and systems contributing to transformation pathways, focusing on such development themes as green economy, digitalization, urbanization, inclusive economies, gender equality and women's economic empowerment.

A hybrid development finance institution and development agency, UNCDF uses a combination of capital instruments (deployment, financial & business advisory and catalysation) and development instruments (technical assistance, capacity development, policy advice, advocacy, thought leadership, and market analysis and scoping) which are applied across five priority areas (inclusive digital economies, local transformative finance, women's economic empowerment, climate, energy & biodiversity finance, and sustainable food systems finance).

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