Survey of Impact of COVID-19 on African Trade Finance

AFREXIMBANK

Transforming Africa's Trade

African Export-Import Bank
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UNECA

Making Finance Work for Africa

Survey of Impact of COVID-19 on African Trade Finance

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Foreword

At a time when significant progress is being made in understanding the dynamics of the coronavirus and in mitigating the pandemic's downside risks, we can easily become complacent and overlook the worsening of challenges to global trade and economic growth. One of the most important issues that deserve attention is trade finance, a market that has proven especially vulnerable to economic and financial shocks.

The supply of trade finance, which supports more than 80% of global trade flows annually, has been one of the key constraints to the growth of African trade. Although it has proven to be a low-risk asset class, trade finance's short-term and transactional nature has emerged as an important risk multiplier, with business cycle 'credit crunches' adversely affecting import and exports.

These risks were magnified by the COVID-19-induced downturn, which heightened global volatility and exacerbated risk perception in the face of increasing balance of payments pressures and widening trade deficits. Sharp falls in the economic activity triggered by lockdowns and border closures were accompanied by dramatic increases in health expenditures. Tighter global financing conditions triggered massive capital outflows from Africa and resulted in a sharp widening of interest rate spreads, while temporarily shutting out sub-investment grade borrowers from international capital markets.

The pandemic may be brought under control, but it is already clear that the consequences of this crisis for African trade finance will be significant and lasting. In the short term, the limited supply of trade finance could inhibit the potential for trade to act as a vector of economic recovery in a region where trade financing gaps were already sizeable. These gaps have been magnified by the withdrawal of major international banks from the African trade finance landscape, owing to increased compliance and regulatory costs. Similarly noteworthy are the risks associated with commodity price cycles, as the exit of major banks from the commodities trade finance market in the third quarter of 2020 illustrated.

This report – the product of a collaboration between the African Export-Import Bank (Afreximbank), the Making Finance Work for Africa Partnership (MFW4A), hosted by the African Development Bank and the United Nations Economic Commission for Africa (UNECA) – offers a ground-breaking, first-ever assessment of the potential impact of the COVID-19 pandemic on trade finance activities of commercial banks across Africa. Drawing on primary data collected from banks and financial institutions accounting for about 58% of total Africa banking assets across all subregions of the continent, the report covers not only the degree to which the pandemic undermined the supply of trade finance, but also the extent to which geography and ownership structures of banks affected access to trade financing.

The period covered by the survey, January to April 2020, including the initial lockdown period– in March, capital outflows from developing economies exceeded US$80 billion; in April, month-on-month global trade in goods contracted by 12.1% – points to the crisis's potentially significant adverse impact on African trade finance.

These massive outflows strained banks, most of which recorded sharp drops in net foreign assets, and exacerbated liquidity constraints, with significant implications for trade financing. The survey results reveal that letters-of-credit business and correspondent banking operations slumped substantially across the continent. Over the same period, major international banks and financiers cancelled and/or reduced their lines of credit limits for African banks.

The report highlights key policy responses and measures undertaken by governments and development finance institutions (DFIs) to mitigate the risk of widening trade financing gaps in the wake of COVID-19. It underlines several bold and swift interventions undertaken by DFIs to support the financing of African trade for a speedy post-pandemic recovery, including the Afreximbank's Pandemic Trade Impact Mitigation Facility (PATIMFA) and the AfDB's COVID-19 Rapid Response Facility (CRF). The report also outlines a set of policy measures undertaken by African governments to ease regulatory burdens. These include increasing reliance on public risk guarantee schemes to underwrite new trade exposures and a shift towards greater reliance on digital documents in the processing of trade transactions.

We hope the insights from this continent-wide survey will inform ongoing efforts to boost African trade, and in the process sow the seeds for a healthier, stronger, and synchronised economic recovery across the continent. At the time the report was going to press, there were growing hopes that remarkable progress on COVID-19 vaccines will lift the cloud of uncertainty and unlock the African and global economy in 2021. However, enhanced global co-operation with a view to ensuring safe, equitable and effective access to vaccinations for all will be key to the synchronised global recovery needed to address the widening trade finance gap triggered by the COVID-19 crisis. At the same time, sustaining the growth of trade finance over time will remain critical not only for a strong and robust economic growth in the post-pandemic world, but also for the successful implementation of the African Continental Free Trade Agreement (AfCFTA).

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The core team was composed of UNECA staff (Milly Chepkorir Chebochok, Simon Mevel-Bideaux, and Habiba Ben Barka), Making Finance Work for Africa Staff (Hugues Kamewe Tsafack and Abdelkader Benbrahim) and Afreximbank staff (Raymond Boumbouya, Anthony Kyereboah-Coleman, Yusuf Daya, Abah Ofon) and Alexander Malaket (Consultant). Data management and analysis was carried out by Diana Nyamoita and Nazih Latif, both Afreximbank staff.

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List of Abbreviations

AfCFTA	The African Continental Free Trade Agreement
AfDB	The African Development Bank
Afreximbank	The African Export-Import Bank
Africa CDC	The Africa Centre for Disease Control and Prevention
AFTRAF	Afreximbank Trade Finance Facilitation Facility
AGF	The African Guarantee Fund for Small & Medium-sized Enterprises
AML	Anti-Money Laundering
AMSP	The Africa Medical Supplies Platform
APMS	Advanced Project Management Solutions
AU	African Union
B20	Business 20
BADEA	The Arab Bank for Economic Development in Africa
Basel	Basel Accords
BCBS	Basel Committee on Banking Supervision
BGI	Bonds, Guarantees and Indemnities
CBN	Central Bank of Nigeria
CCRT	Catastrophe Containment and Relief Trust
CFR	Rapid Response Facility
CRF	Rapid Reaction Facility
DBSA	The Development Bank of Southern Africa
DFIs	Development Finance Institutions
ECAs	Export Credit Agencies
ECIC	Export Credit Insurance Corporation
EU	European Union
FTF	Fast-Track Facility
G20	Group of 20
ICC	International Chamber of Commerce
IDA	International Development Association

IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IRU	Irrevocable Reimbursement Undertaking
ITFC	The International Islamic Trade Finance Corporation
KYC	Know Your Customer
KYCC	Know Your Customer's Customer
LCs	Letters of Credit
LGD	Loss Given Default
MFW4A	Making Finance Work for Africa
MIGA	The Multilateral Investment Guarantee Agency
NEXI	The Nippon Export Investment Insurance
NEXIM	Nigerian Export-Import Bank
OECD	The Organisation for Economic Co-operation and Development
PAPSS	Pan-African Payment and Settlement System
PATIMFA	Pandemic Trade Impact Mitigation Facility
PPE	Personal Protective Equipment
RFC	Rapid Financing Facility
RFI	Rapid Financing Instrument
SADC	Southern African Development Community
SMEs	Small and Medium Enterprises
SMMEs	Small, Micro and Medium Enterprises
TDB	Trade and Development Bank
UNECA	The United Nations Economic Commission for Africa
WAEMU	West African Economic and Monetary Union

Executive Summary

"Portfolio outflows from emerging market economies amounted to more than US$100 billion in the first quarter of 2020"

The unprecedented impact of the COVID-19 pandemic on health, economic, and financial systems around the world, combined with containment measures (social distancing, lockdowns, and border closures) to reduce the spread of the virus and mitigate its impact, plunged the world into a major synchronised global downturn. Global output, which was pre-pandemic forecast to expand by 3.3 percent in 2020 contracted by about 3.5 percent, and Africa suffered its first economic recession in 25 years. Similarly, global trade, which was forecast to expand by 2.7 percent in 2020, contracted by 9.2 percent.

The reduction in global growth and trade was particularly significant in the second quarter of 2020, when the implementation of containment measures brought the world economy to a sudden stop and triggered massive capital flow reversals from emerging and developing market economies. Portfolio outflows from emerging market economies amounted to more than US$100 billion in the first quarter of 2020. Capital outflows from Africa exceeded US$5 billion in the same period, with about US$0.4 billion exiting the Egyptian market and US$3.1 billion leaving the South African market. These massive outflows strained African banks, many of which recorded sharp drops in their net foreign assets. This further exacerbated banks' existing liquidity constraints and undermined their capacity to finance the growth of African trade.

To better understand how COVID-19 affected trade finance in the continent, especially during the first quarter of 2020, the African Export-Import Bank (Afreximbank), together with the United Nations Economic Commission for Africa and the Making Finance Work for Africa Partnership of the African Development Bank (AfDB), surveyed commercial banks across the continent about the impact of the pandemic on their trade finance activities. The main objective of the study was to understand how the global health crisis affected the dynamics of trade finance. The survey also sought to make recommendations and outline policy actions that could ensure banks have adequate access to trade finance, to sustain trade flows and accelerate the process of economic recovery post-COVID-19.

The survey covers the first four months of 2020, including April, the height of the pandemic downturn, when global trade contracted by over 5 percent. The Afreximbank African Commodity Index—the trade-weighted composite index used by the Bank to track the price performance of key commodities of interest to Africa—fell by 44 percent in the first quarter of 2020 because of the pandemic's disruptive impact on global demand and commodity prices. The survey targeted more than 370 commercial banks involved in trade finance across the continent and achieved a response rate of more than 50 percent, with a balanced geographical coverage. In terms of asset coverage, the participating banks accounted for about 58 percent of the US$1.5 trillion in total assets held by commercial banks in Africa. While the survey results illustrate the adverse impact of the pandemic downturn on trade finance across the region, most notably reflected in increased rejection of letters of credit (L/Cs), the results also highlight significant variations across continent. The main findings are summarised below.

Material disruption to trade

The study findings broadly support the narrative that COVID-19 affected the trade finance activities of banks across the continent and led to material disruptions to trade. Specifically, L/C business and correspondent banking operations witnessed a significant slump and could exacerbate the continent's trade financing gap, while reversing gains in the expansion of African trade during the preceding few years.

Increased demand for trade finance

A significant range of respondents—across subregions, by size of bank, and by structure of bank—indicated an increase in demand for trade finance. Almost 37 percent of respondents reported an increase in demand from their export clients. By region, Southern Africa and Western Africa reported the largest increases in demand for trade finance, and by size of bank, smaller banks reported the greatest increase in demand. It is worth noting that demand for more financing may not necessarily reflect more new businesses, but instead may reflect the challenges faced by small and medium enterprises in concluding existing trade transactions, due to difficulties with cashflow or working capital.

Varying demand for letters of credit

While 27 percent of banks surveyed saw an increase in demand for L/Cs, 39 percent of banks indicated a decrease in demand for L/Cs, and 34 percent indicated no change. From a regional perspective, banks in North Africa reported the highest number of documentary credit applications on the continent, followed by banks in Anglophone West Africa.

Increased rejection of letters of credit requests and reduced correspondent banking relationships

The survey showed a substantial increase in L/C request rejections in the first four months of 2020 compared with the first four months of 2019, with 30 percent of respondents indicating an increase in rejection rates. Regarding correspondent banking relationships, major international banks and financiers cancelled and/or reduced their lines of credit limits for African banks, with Europe accounting for about 50 percent of this development.

Increased risk aversion by domestic and privately owned banks

Domestic and privately owned banks appear to be just as risk-averse as foreign banks. However, while the withdrawal of international banks in the face of heightening uncertainty could be part of a long-term trend, the relative increase in risk aversion of domestic banks could be largely due to temporary liquidity constraints and difficulties in accessing foreign exchange.

Higher risk appetite by government-owned institutions

Government-owned financial institutions appeared to have more appetite for risk and were making significant contributions to address liquidity flows during the crisis. This contributed to creating the necessary conditions for a swift recovery after the pandemic. The sharp contrast in risk perception between domestic privately-owned and domestic majority government-owned banks suggests that other factors could be driving credit allocation and trade finance. Also, since most L/C cancellations and correspondent banking services withdrawals appear to be informed by perceived high risk, a lot more must be done to address this perennial canker of risk misestimation, which leads to high-risk premiums.

Varying regulatory realities across Africa

At one end, some central banks and regulatory authorities took exceptional measures to facilitate the clearance of goods without paper documentation, some going so far as to make L/Cs an attractive settlement and financing option from a cost perspective. On the other end, some central banks and regulatory authorities remained wedded to paper-based requirements and (by choice or necessity) appeared to be restricting the use of L/Cs to facilitate the flow of pharmaceuticals and foodstuffs. Regulators made other compliance, regulatory, and policy changes to alleviate operational burdens on firms and financial institutions in the wake of COVID-19.

Executive Summary continued

Bold interventions by multilaterals and export credit agencies

Multilaterals including development finance institutions (DFIs) and export credit agencies took swift and bold measures to address urgent trade finance needs in the face of tightening financing conditions and deteriorating credit quality. Regional DFIs across Africa swiftly unveiled new facilities to alleviate liquidity constraints and sustain the growth of trade—including the Afreximbank through its Pandemic Trade Impact Mitigation Facility and the AfDB through its COVID-19 Rapid Reaction Facility. The liquidity provided by the DFIs to banks to enable them to remain solvent and maintain their lending activities to small and medium enterprises and households was critical in the push to cushion the pandemic downturn.

Significant interventions by central banks

As regulatory institutions, most central banks in Africa responded to the pandemic with significant and swift measures, including loose monetary polies and favourable prudential requirements, such as reductions in reserve ratios, with the goal of promoting access to finance while also ensuring financial sector stability. Additionally, most central banks granted some flexibility to commercial banks regarding adherence to regulatory and compliance requirements, extending deadlines for filing returns, reducing supervisory burdens, and instituting regular virtual meetings to minimise face-to-face interactions during the crisis. Through these exceptional measures to ease regulatory burdens and boost the availability of liquidity within the financial system, central banks sustained the flow of goods and trade for a speedy economic recovery in the post-containment phase of the pandemic.

The following recommendations and policy prescriptions emanate from the findings of the survey:

Increased correspondent banking relationships domestically, and more support from regional development finance institutions

Local and regional banks across Africa need to enter correspondent banking relationships to take advantage of growth opportunities created by the exodus of large international banks from the continent's trade finance landscape. Africa's trade finance needs are significant and expected to increase even further during the implementation of the African Continental Free Trade Area. DFIs, already major actors, will need to play an even more important role, increasing their support to commercial banks engaged in trade finance activities.

Coordination and alignment of COVID-19 response measures

Survey findings suggest that central banks are able to respond to pandemic-related regulatory measures in an agile fashion, and that such measures do not constitute a significant impediment to the flow of trade financing. However, it is notable that a significant inconsistency exists at the regulatory and transactional levels. For instance, while some regulatory authorities have taken measures to facilitate the clearance of goods without paper documentation, others have been less able to apply the same flexibility in the face of a major disruption in international courier services. It would appear there is an opportunity to advocate for, and perhaps facilitate, greater alignment of pandemic response options across subregions, and in so doing, perhaps directly motivate greater intra-African trade and a more robust set of conditions for the post-pandemic recovery.

Greater engagement between central banks and industry

COVID-19 and related challenges provide an impetus for central bank and capital market regulators to engage with industry, to explore the viability of creating new trade financing capacity via the participation of asset managers and private equity in directing capital to the financing of international trade—including South-South trade and African trade.

Improved dialogue between governments and development finance institutions

This will create a framework and/or mechanism that will reinforce dialogue between governments and DFIs so that DFIs continue to play a vital role of a front line in the fight against the pandemic. This role includes taking more risks, easing credit access criteria, and using government guarantee schemes to scale up liquidity to struggling banks, in efforts to protect small and medium enterprises and save jobs—and more generally, to better prepare the region to manage future crises.

A push for increased digitalisation and an embrace of evolving financial technologies. While measures taken by central banks have been supportive of trade and economic recovery, they have been viewed largely as stopgap measures, with sampled banks indicating that regulations within their countries have not been fully aligned with emerging technological innovation and major challenges facing their industry. The push for increased digitalisation in the trade finance arena could alleviate some of the sector's regulatory concerns, help to increase efficiency, and decrease costs. Banks and businesses across the continent also need to fully embrace evolving financial technologies, which can extend trade finance facilities to informal traders and other small businesses.

Online platforms, payment processors, and telecommunications companies could build upon existing business relationships and make use of their customer knowledge. The use of financial technologies in trade finance is still nascent, but it holds great potential to enhance the capacity and efficacy of trade finance providers to serve wider customer bases, while also reducing both the risk of liquidity constraints and the current excessive reliance on hard currencies for cross-border trade. The Afreximbank-led Pan-African Payment and Settlement System (PAPSS) is both innovative and timely in this regard. For the technologies to realize their full potential, coherent and coordinated action, especially from the regulatory and policy angle, is required through broader stakeholder consultation.

More reforms and reliable data

Creating an environment conducive to the expansion of trade and trade finance in Africa will require broad cross-sectoral reforms across the continent. Reforms to the banking and financial services sectors, as well as to the regulatory environment, could contribute to strengthening existing infrastructure, including technical infrastructure such as internet connectivity. Availability of data is also key to establish an environment that favours positive linkages between trade finance and trade in Africa. As the survey results show, insufficient collateral and client creditworthiness were the primary reasons for bank rejections of trade finance applications in Africa during first four months of 2020. The Afreximbank's MANSA Repository Platform, which provides a single source of primary data required for the conduct of customer due diligence on African entities, is an important step, but one that requires broad-based support at the continental level to have a greater impact on the financing of African trade.

Chapter 1
Introduction and Context

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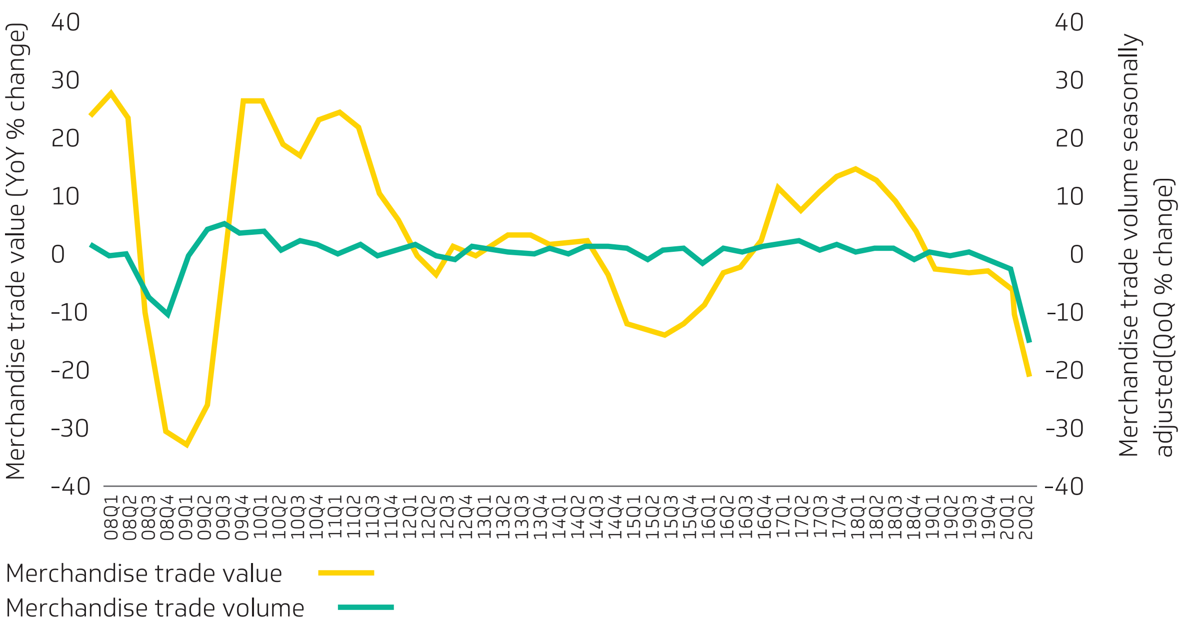
Introduction and Context

The international trade landscape is being reshaped, at least temporarily, by a combination of factors: weakening multilateralism and erosion of support for rules-based trading systems; a protracted "trade war" between the United States and China; heightening trade tensions between the United States and other major economies, including the European Union and Canada; and an increasing push toward supply chain resilience. Pre-COVID-19, these realities were at the root of some fundamental rethinking around globalisation, trade, supply chain structure and flexibility, and concentration risk related to sourcing patterns and trade corridors. Supply chain reconfiguration was also taking root, and since the pandemic, has accelerated.

COVID-19 containment measures (lockdowns, border closures, and social distancing) led to global demand and supply shocks. The World Trade Organization reported sharp reductions in trade flows across every region of the globe in 2020, even in the early days of the crisis, when it was still reasonable to envision some form of meaningful recovery in 2021. In the second quarter, global merchandise trade volume dropped by 14.3 percent and its value dropped by 21 percent (WTO, 2020).

Figure 1: Trend in seasonal adjusted merchandise trade



Source: World Trade Organization (2020a).

COVID-19 further highlighted the strong correlations between trade and economic growth and the role of global demand as a driver of growth. The dramatic fall in global trade was followed by a sharp contraction in economic output. In a major shift from earlier forecasts of synchronised global expansion, forecasts after the pandemic outbreak pointed to a synchronised global contraction comparable only to the Great Depression of the 1930s. According to International Monetary Fund (2020) revised growth forecasts, the global economy contracted by about 3.5 percent in 2020, significantly worse than during the 2007-2008 global financial crisis, and down from pre-pandemic synchronised growth of 3.4 percent.

Even before the outbreak of COVID-19, Africa was already hit by a sharp growth deceleration in China, most notably because of a drop in Chinese demand for African commodities. Oil-exporting countries in the continent were particularly affected, especially with the additional effects of a Russia-Saudi Arabia oil price war, which caused prices to collapse by as much as 30 percent in one day (Financial Times, 2020).

The pandemic downturn also affected Africa through channels other than trade, including tightening financial conditions, increasing risk premiums, and reverse capital flows, all of which exacerbated liquidity challenges and balance of payment pressures. The African Export-Import Bank's (Afreximbank) African Commodity Index, which measures the price movements of commodities of interest to Africa, lost 44 percent of its value in the first quarter of 2020 (Afreximbank, 2020).

In a region where growth remains highly correlated with commodity price cycles, the combination of sharp drops in global demand and commodity prices dramatically affected prospects for trade and growth. Africa suffered its first recession in more than 25 years, and African trade contracted by 11.9 percent in 2020. Between January and August 2020, Africa's merchandise trade contracted by 12 percent compared with the same period the previous year. Although the contraction was synchronised across the whole region, the greatest impact was on economies dependent on tourism and commodities, and especially leading oil-producing countries where oil exports account for more than 90 percent of foreign exchange earnings and more than 60 percent of fiscal revenues.

However, unlike in other regions of the world, African trade remains hindered by difficulties in accessing timely trade financing, in the post-2008 Global Financial Crisis, where stringent regulatory environment and sanction regimes led to the withdrawal of major international banks from the correspondent banking business in Africa (Erbenova et al, 2016; Alleyne et al 2017; Fofack 2017). These challenges remain in a world where trade flows continue to rely heavily on some form of trade financing (bank-intermediated trade finance, intra-finance trade credit, and a variety of other techniques, including documentary letters of credit and supply chain finance.

Introduction and Context continued

There is concern in some quarters that the COVID-19 pandemic will likewise pose challenges to assured access to timely and affordably priced trade financing. No immediate systemic issues were flagged at the start of the pandemic, when it was reported that banks and other industry participants continued to conduct transactions in good faith and in line with accepted rules, practice, and guidelines, with no evidence of shortage of capacity or liquidity constraints. However, concerns emerged gradually, for example regarding adequate access to US dollars, in which most trade flows (and therefore trade financing) are denominated. Of greater concern was the growing likelihood of default and bankruptcy across the commercial spectrum, with a resulting deterioration in credit quality and risk.

An analysis by the Asian Development Bank over several years confirms that there is significant unmet demand for trade financing around the world. The studies report a persistent trade financing gap estimated at around US$1.5 trillion per year, with more than half of it incurred by Africa and Asia (Kijin et al, 2019, 2019). Banks alone do not have the capacity to address this unmet demand, for a variety of reasons, including credit/risk limitations and balance sheet constraints.

Summary of recent study by the African Development Bank and African Export-Import Bank

A joint survey undertaken by the African Development Bank (AfDB) and the Afreximbank covering the ten-year period 2011-2019 titled “Trade finance in Africa: Trends over the past decade and opportunities ahead.” was published in September 2020. Constituting the third in AfDB’s Trade Finance in Africa research series, the report contained the following major findings and conclusions from the decade-long survey:

- Africa’s trade financing gap decreased steadily from US$120 billion in 2011 to US$70 billion at the end of 2016, with the downward trend reversing in 2019, when the continent’s trade financing gap increased to an estimated US$81.80 billion; while average unmet trade financing demand in Africa was estimated at US$82.5 billion (which represents 5.5 percent of the global trade financing gap during the 10-year period).
- The average size of bank-intermediated trade financing in Africa was estimated at US$417 billion, even though total African trade averaged US$1.077 trillion during the same period. This suggests that banks intermediated only 40 percent of Africa’s trade compared with 80 percent of world trade—which indicates that African trade is significantly underserved.
- Intra-African trade averaged about 17 percent of total African trade, while an average of 18 percent of bank-intermediated trade financing was dedicated to financing intra-African trade, suggesting that intra-African trade received its fair share of bank-intermediated trade financing.
- Participation in trade financing activities by banks has steadily decreased. This observation was buttressed by the finding that in 2019, 71 percent of banks that participated in the survey engaged in trade financing activities, compared with 92 percent in 2011. Competition, new banking regulations on know-your-customer/anti-money laundering (KYC/AML), and strict capital requirements introduced after the global financial crises have increased due diligence costs and decreased margins, making small transactions, particularly for small and medium enterprises, unprofitable for banks.
- While default rates on trade financing assets dedicated to small and medium enterprises have decreased sharply, approval rates on applications from these smaller businesses deteriorated consistently in all years but 2017, and the share of these trade financing applications rejected by banks increased from 20 percent in 2013 to 40 percent in 2019. The fear is that the COVID-19 pandemic could further worsen the rejection rate for trade financing applications by these smaller businesses and derail the earlier progress made.
- Default rates on trade-related transactions in Africa consistently have been lower than those on overall bank lending activities. For instance, the survey highlighted that in 2017–19, the default rate was 7.5 percent on trade financing facilities, compared with 11 percent for overall non-performing loans in the same period.
- Development finance institutions were seen to be playing a more active role in support of trade financing intermediation in Africa, and in 2015–19, an average of 60 percent of banks that engaged in trade financing activities received some form of support from these institutions. However, the distribution was far from even, as this support appeared to be more concentrated in banks based in West Africa and Southern Africa and in foreign-owned private banks throughout the continent.
- While banks continue to list weak client creditworthiness (30 percent) and insufficient collateral (25 percent) as the key reasons for rejecting trade financing applications, new challenges have emerged. For instance, the survey pointed out that about 16 percent of banks engaged in trade financing list KYC/AML noncompliance as the major reason for rejecting trade financing applications in the period 2015-19, compared with less than 1 percent in 2013–14. This indicates that stringent KYC/AML regulations are having unintended consequences for African banks engaged in trade financing.

Introduction and Context continued

Despite the global and sometimes complex nature of the structures and solutions involved in trade finance, it is a very high-quality form of credit. A brief review of the International Chamber of Commerce (ICC) Trade Register data reinforces the assertion that trade finance (both traditional trade finance and supply chain finance) is very low risk from a credit perspective. Despite this fact, massive capital outflows and increasing balance of payment pressures caused by COVID-19 have resulted in an increase in Africa's trade financing gap, while at the same time, pandemic containment measures have reduced the region's reliance on traditional forms of credit documentation (ICC, 2019; AfDB and Afreximbank, 2020).

Table 1: Default and recovery data, traditional trade finance

Total exposures and default rate by exposure, by product, 2008-2018			
	Total exposure (USD M)	**Defaulting exposure (USD M)**	**Exposure-weighted default rate**
Import L/C	3,202,070	2,544	0.08%
Export L/C	1,901,356	496	0.03%
Loans for import/ export	6,645,580	11,546	0.17%
Performance guarantees	2,559,444	6,275	0.25%

Overview of exposure-weighted default rate, LGD and Expected Loss by product, 2008-2018				
	Exposure-weighted default rate	**Exposure at default**	**LGD**	**Expected Loss**
Import L/C	0.08%	100.0%	29.9%	0.02%
Export L/C	0.03%	100.0%	36.3%	0.01%
Loans for import/ export	0.17%	100.0%	37.7%	0.07%
Performance guarantees (Applying CCF to EAD)	0.25%	4.1%	52.3%	0.01%
Performance guarantees (Applying CCF to LGD)	0.25%	100.0%	2.2%	0.01%

Source: ICC (2019)

In addition to increasing trade financing capacity or changing finance parameters, development banks and trade finance institutions have responded promptly to the impact of COVID-19-related lockdowns by carrying out transactions on a digital or quasi-digital basis. This speedy adjustment has allowed trillions of US dollars' worth of trade transactions to be completed and has enabled critically important supply chains to remain viable and operational.

However, there are signs of systemic issues emerging at the global level, including evidence of tightening controls over trade finance activity, and challenges in some markets and for some financial institutions in accessing adequate levels of foreign currency, including US dollar liquidity, to effectively enable trade flows. Overall deterioration in credit quality will inevitably arise, and it is unclear how much of this can be mitigated through policy interventions.

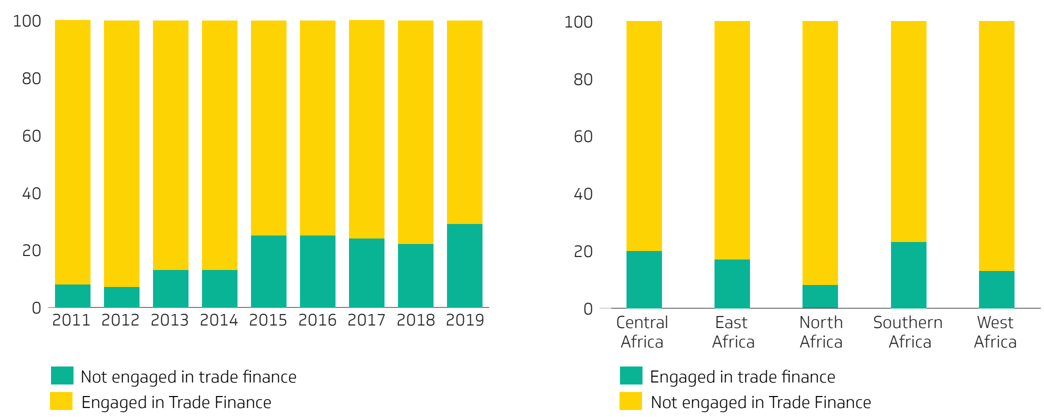
Regarding trade finance in Africa, while the continent is far from homogenous in terms of banking and drivers of growth, trade, and trade finance, it exhibits notable characteristics and features that align with trends in global markets. This includes the steady reduction of banks' involvement in trade finance activity overall, when taking traditional/classical trade finance together with supply chain finance. Concentration and consolidation have been in evidence for at least the last two decades, driven by a combination of factors that include the following:

- Cost-income ratios, in particular the cost of technology and staffing;
- Decreasing balance sheet capacity and risk appetite to pursue cross-border and trade-related banking activities;
- Increasingly complex regulatory and compliance requirements and expectations;
- Limitations on technical expertise and competency in trade finance;
- Margin compression among larger clients and challenges in profitably financing small and medium enterprise clients.

Bank participation in trade financing activities has steadily decreased. In 2019, 71 percent of banks in the survey engaged in trade financing activities, compared with 92 percent in 2011 (AfDB and Afreximbank 2020). Competition, new banking regulations on KYC/AML, and strict capital requirements introduced after the global financial crisis have increased due diligence costs and decreased margins, making small transactions, particularly for small and medium enterprises, unprofitable for banks.

Even in the (unlikely) event that the overall financing capacity had remained comparable, the narrowing of financing footprints across Africa naturally would have reduced access to trade financing.

Figure 2: Share of bank engaged in trade financing (%)

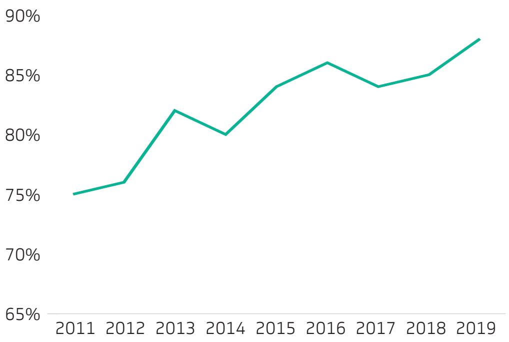


Source: African Development Bank and African Export-Import Bank (2020).

Introduction and Context continued

While estimates of bank-intermediated trade financing at the global level vary according to definitions, it is worth observing that in Africa, although bank engagement in trade financing has dropped over the last decade, the rates of approval of trade financing facilities have increased significantly, from below 75 percent in 2011 to about 88 percent in 2019. These higher approval rates could be the result of higher-quality, more "bankable" financing proposals, enhanced risk-sharing and mitigation mechanisms, and enhanced macro-level conditions.

Figure 3: Trade financing facility approval rate (%)



Source: African Development Bank and African Export-Import Bank (2020).

It is not surprising that the level of rejections of small and medium enterprise trade financing applications in Africa has increased materially in less than a decade. This is true even though the definition of a small and medium enterprise (whether determined by measures of annual turnover or staff complement) varies greatly across jurisdictions. Rejections of applications by these smaller businesses in Africa increased by 20 percent from 2013 to 2019, with Central Africa experiencing a striking increase in rejection rates over the same period. About 47 percent of requests for trade financing were rejected in the subregion (AfDB and Afreximbank, 2020).

Prior to the COVID-19 pandemic, the trade financing gap was stabilising in Africa and even decreasing in some jurisdictions. Amid a major exodus of global banks and decreasing corresponding banking relationships, global de-risking of bank relationships had a material impact in Africa, with the rate of de-risking increasing from 18 percent in 2013-2014 to 20 percent in 2015-2019.

Similarly, foreign exchange became a more significant constraint to the supply of trade financing. Among a list of constraints (Figure 4), foreign exchange rose from 17 percent in 2013-2014 to 19 percent in 2015-2019. Foreign exchange is heavily affected by access to US dollar liquidity, given the continuing dominance of the US currency in international trade transactions.

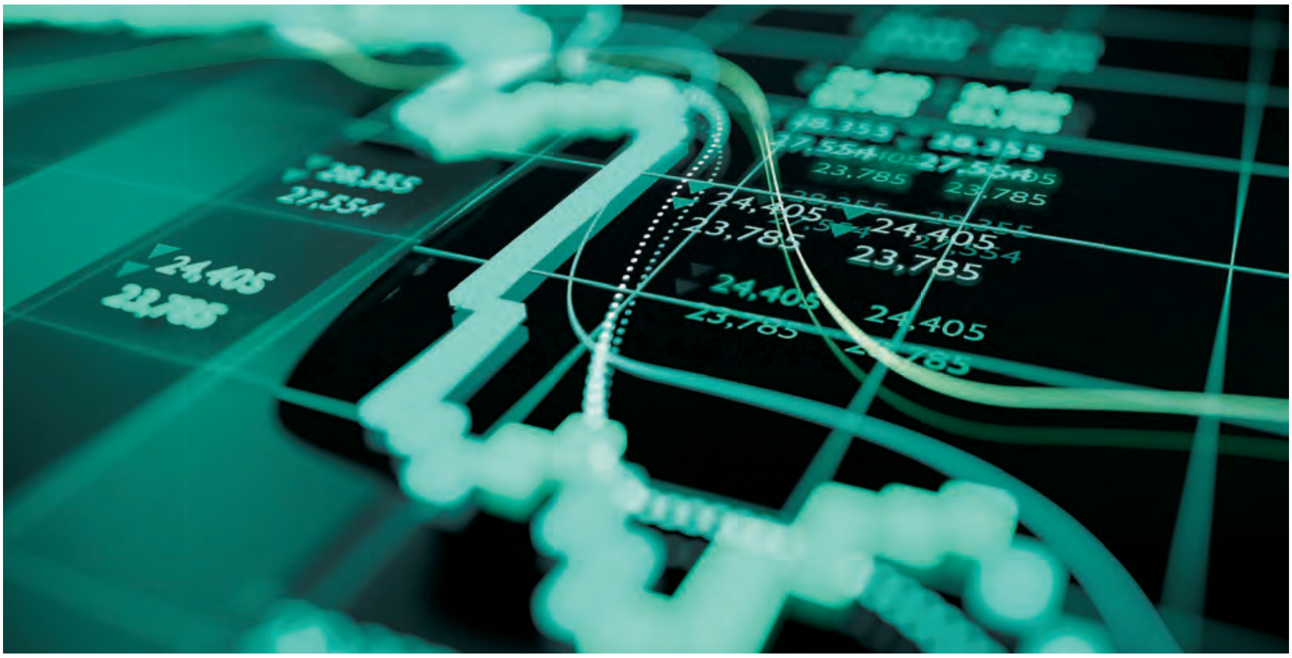
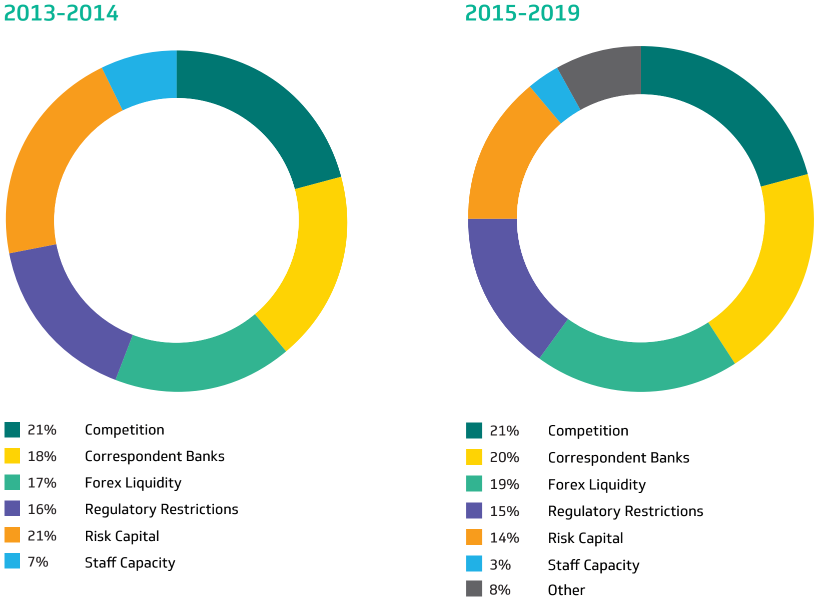


Figure 4: Ranking of constraints to trade financing supply (%)



Source: African Development Bank and African Export-Import Bank (2020).

Risk capital became a significantly less critical factor, dropping from 21 percent as a constraint in 2013-2014 to 14 percent in 2015-2019. In the meantime, regulatory restrictions—commonly but not exclusively encompassing financial crimes compliance—persisted in the range of 15 percent to 16 percent as a constraint, dropping one percentage point across the two time periods compared.

An important takeaway in considering constraints to the supply of trade financing in Africa is that most of the major obstacles identified can be mitigated or addressed through policy or regulatory action, even on a temporary basis, to help ensure adequate trade financing levels during the pandemic and in the critically important post-COVID-19 recovery phase.

Just as national governments, international bodies, and regulatory authorities have sought to respond quickly to the COVID-19 situation to ensure support to individuals, families, and businesses, those same authorities must keep trade flowing and trade-based development and economic recovery a viable option. This cannot be achieved without access to adequate levels of trade financing.

The rest of the report is organised as follows: Chapter 2 discusses the impact of COVID-19 on trade financing in Africa; Chapter 3 discusses COVID-19 and the trade financing regulatory environment; Chapter 4 reviews development finance institutions' and multilaterals' response to COVID-19 in Africa; Chapter 5 looks at enhancing policy and regulatory reforms for trade financing in a digital era; and Chapter 6 concludes and highlights key recommendations emanating from the study.

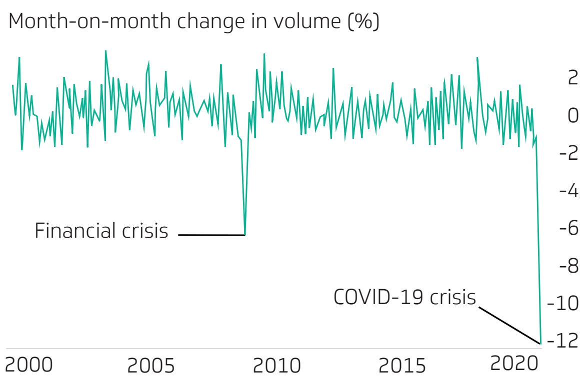
Chapter 2
Survey Analysis and the Impact of COVID-19 on Trade Finance in Africa

Survey Analysis

Historically, trade finance—particularly the traditional form of this aspects of finance—has performed well in times of crisis, being adequately available and sufficiently risk-mitigated to respond to needs across a wide range of difficult circumstances. The countercyclical nature of trade financing, from an economics and business cycle perspective, likewise has been useful in such scenarios.

With global trade flows dropping by more than 12 percent between March and April 2020—about twice the drop in global trade during the 2008 financial crisis—we were very much in a moment of a deep crisis, not only from the perspectives of global public health and economics, but also very directly from the perspective of global trade.

Figure 5: Episodic trends in global trade



Source: Financial Times, 2020

While some perspectives suggest that trade finance can be vulnerable in times of crisis, risk mitigation, product and solution flexibility—coupled with the significant priority given to settling trade obligations in international markets—combine to make this specialised form of finance fairly resilient across different types of crises.

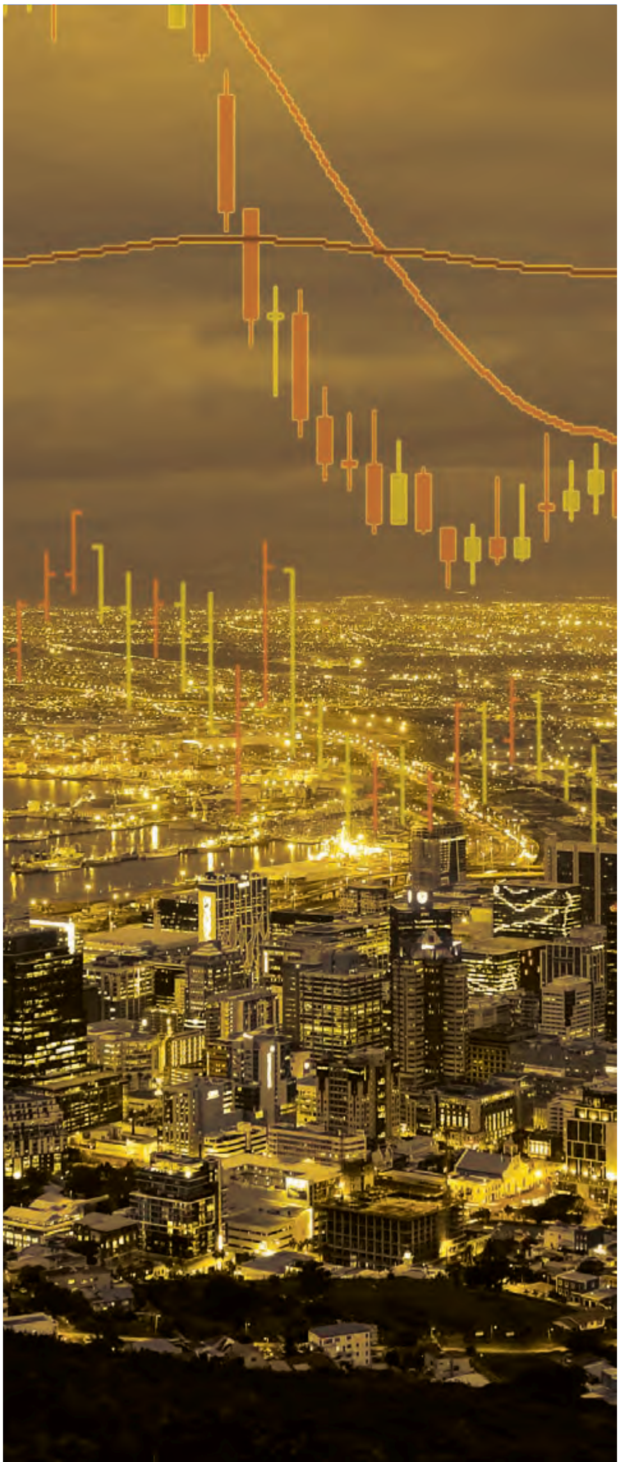
In the COVID-19 context, initial assessments were that trade finance had been resilient, supported by the immediate engagement (and increase in capacity) of multilateral development banks, export credit agencies, and other non-bank providers. Learning from past crises, there has also been a prompt focus on small and medium enterprises and their suppliers to global supply chains, and an immediate effort to shape effective advocacy and engage policymakers.

That said, the high, but still relatively new, visibility of trade finance at senior levels of commercial, political, and regulatory leadership is serving the industry well, motivating and allowing for agile responses and support. This is evidenced by the decisive action from the Bank for International Settlements aimed at relieving capital adequacy pressures in trade finance, as well as the B20/G20 and the ICC, reflected in the launch of the new C-Level advisory group on trade finance, noted earlier.

What has also come out strongly and is clearly reflected in survey responses and commentary, is the importance of the link between trade, trade financing, and the dominant role of the US dollar on international commerce.

Although it might be expected that a drop in currency values relative to the US dollar might spur greater demand and contribute to an uptick of trade activity, the International Monetary Fund raised concerns about this in a recent Discussion Note titled Dominant Currencies and External Adjustment, "Because exports are priced mostly in dollars, demand does not go up when the domestic currency weakens. Some 23 per cent of global exports are invoiced in US dollars, not counting commodity markets which are largely priced in the currency. The dominance of the US dollar in trade and finance is likely to amplify the impact of the COVID-19 crisis" (IMF, 2020).

The section analyses the survey responses related to demand for trade finance and the use of Documentary Letters of Credit (Documentary Credits, Letters of Credit, or L/Cs) across Africa. Traditional trade finance techniques, which include L/Cs and other mechanisms such as Documentary Collections, underpin about 10 percent of global trade merchandise flows today (around US$2 trillion annually). L/Cs are a vital component in facilitating extra- and intra-African trade.



Survey Analysis continued

Overview of the Trade Finance Survey

A total of 370 semi-structured questionnaires were sent to unique commercial banks across the continent, divided along the lines of the operational segmentation of the African Export-Import Bank (Afreximbank), namely, Anglophone West Africa, Francophone West Africa and Central Africa, Eastern Africa, Southern Africa, and North Africa. The response rate of 50 percent represented 185 unique commercial banks. The total asset size of the responding banks accounted for about 58 percent of total assets of commercial banks in the continent. Table 2 provides more information on the geographical distribution of survey responses and assets covered.

The survey was conducted to understand the dynamics of trade finance in Africa in the wake of the COVID-19 pandemic. The data collection covered a period of four months—January to April 2020. While the pandemic downturn has been felt throughout 2020, April has been singled out as the most dramatic month, when global trade and capital flows came to a sudden stop and pressures on balance of payments were exacerbated by massive capital outflows that were triggered by tightening global financing conditions.

Emerging markets experienced massive capital outflows during the first four months of the year, with more than US$100 billion in portfolio outflows (OECD, 2020). Capital outflows from Africa exceeded US$5 billion over that period. For instance, during the first four months of the year, about US$0.4 billion exited the Egyptian market and US$3.1 billion exited the South African market. These massive outflows put strains on banks, most of which recorded sharp drops in their net foreign assets, and further exacerbated liquidity constraints.

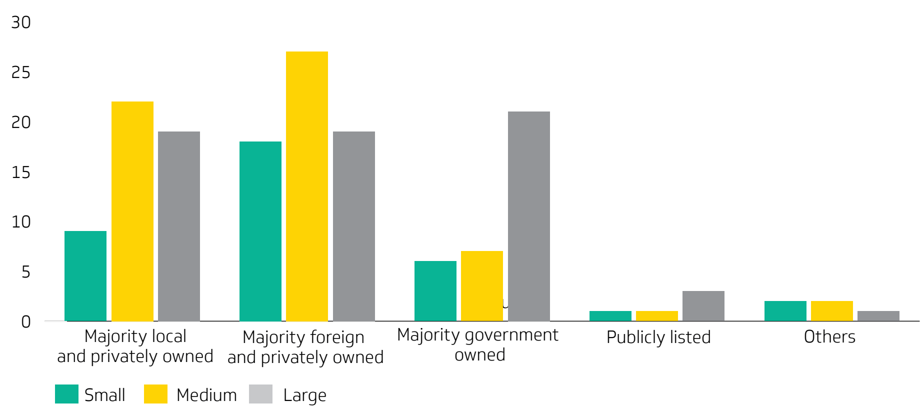
Table 2: Summary statistics

Survey sample size (number of banks) 370	
Period covered	Jan-Apr 2020
Response rate	185 (50%)
Asset coverage	57.33%
Regional distribution	
Central Africa and Francophone West Africa	26 (14.53%)
Eastern Africa	37 (20.11%)
North Africa	44 (24.58%)
Southern Africa	41 (21.23%)
Anglophone West Africa	37 (19.55%)

Source: Survey data.

The Survey also achieved a balance of perspectives by bank size (measured in terms of asset base) as well as categories of ownership (or majority ownership) type. For this survey, commercial banks with an asset base of up to US$100 million were classified as small, those with an asset base between US$100 million and US$1 billion were classified as medium, while banks with an asset base more than US$1 billion were classified as large. The summary of ownership structure and size distribution are represented in Figure 6. For instance, there were about 22 large, 7 medium-sized, and 6 small banks for the majority government-owned category.

Figure 6: Distribution of banks by size and ownership structure



Source: Survey data

All the Banks sampled indicated trade finance accounted for a significant proportion of their activities, with 64 percent indicating trade finance accounted for more than 10 percent of their assets. Overall findings of the survey, undertaken to understand the impact of the COVID-19 pandemic on trade finance (and therefore trade) across Africa, appear broadly consistent with observations at the global level which found the pandemic has led to material disruptions to trade.

Credit, Crisis and Capacity

Globally, unmet demand for trade finance has persisted at level of US$1.5 trillion annually under the best of conditions observed since the global financial crisis of 2008. There is increasing concern that private sector banks may be unable to sustain normal levels of support for trade, if waves of default begin to arise as a result of the COVID-19 lockdowns.

Multilaterals and export credit agencies have already taken steps to address urgent needs for trade finance capacity, and it is likely that calls for additional capacity will be heard as the crisis runs its course, and credit quality deteriorates.

Trade financiers have attempted, on three prior occasions, to initiate programs aimed at attracting non-bank, private sector investment capital to support trade flows. This may not be an easily implemented option, given economic conditions and the challenges faced by asset managers in assuring adequately funded pension plans. But it may be worth exploring how the characteristics of trade financing might prove attractive to the investor community in Africa, and whether policy-shaped incentives can be developed and deployed quickly enough to help create additional capacity for trade financing.

The COVID-19 crisis may provide an impetus for Central Bank and Capital Market regulators to engage with industry, to explore the viability of creating new trade financing capacity via the participation of asset managers and private equity in directing capital to the financing of international trade—including South-South trade and African trade.

Survey Analysis and Implications

A significant range of respondents—across subregions, by size and structure of bank—do indicate some increase in demand for trade finance. Almost 37 percent of respondent's report seeing an increase in demand from their export clients. Southern Africa and Western Africa have seen the largest increases in demand for trade finance, with smaller banks showing the greatest increase in demand.

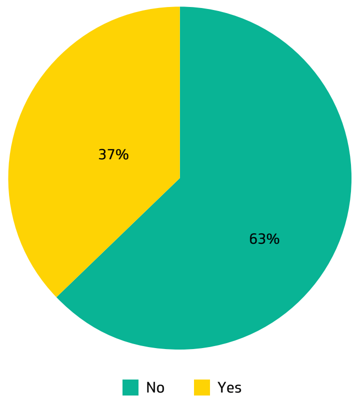
However, 63 percent of respondents indicate they have not observed an increase in demand for trade finance over the four-month period covered by the data, with only 25 percent of respondents in North Africa reporting an increase in demand.

Survey commentary does not raise striking concerns from respondents about their ability to meet whatever additional demand is developing. Perhaps the swift and bold responses taken by multilateral institutions, export credit agencies, and other players in the trade and trade finance ecosystem in response to the COVID-19 downturn contributed to this favourable finding.

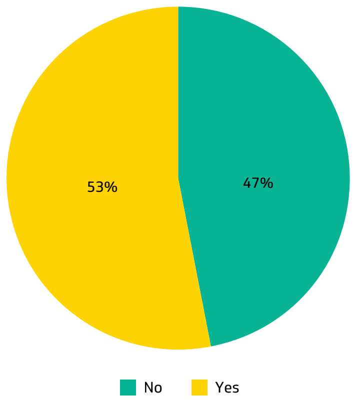
Survey Analysis continued

Figure 7: **Increase in requests for financing from exporting clients, January-April 2020 (%)**

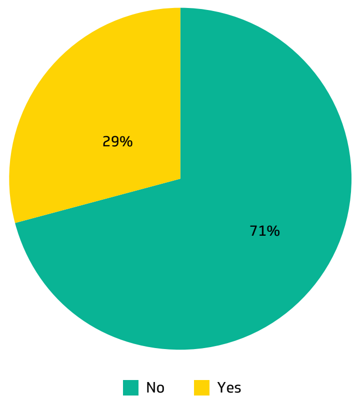
Overall



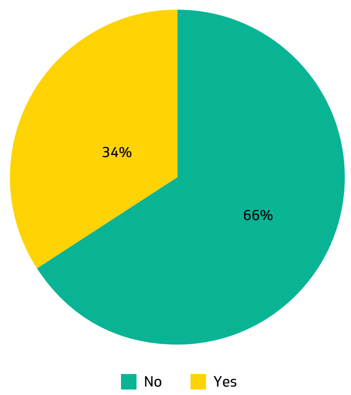
Southern Africa



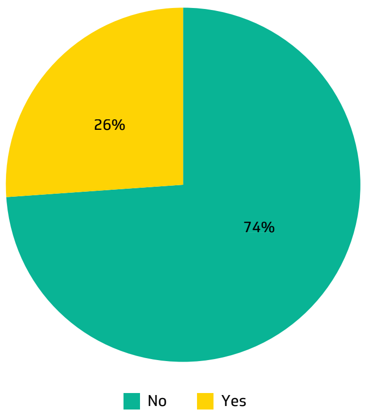
Central and West Africa Francophone



Eastern Africa



North Africa



West Africa

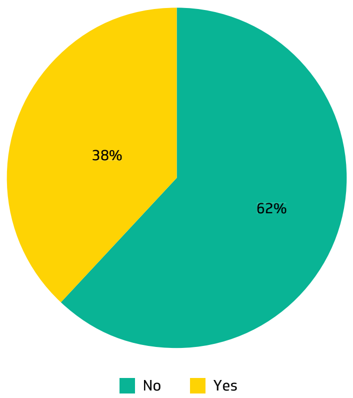
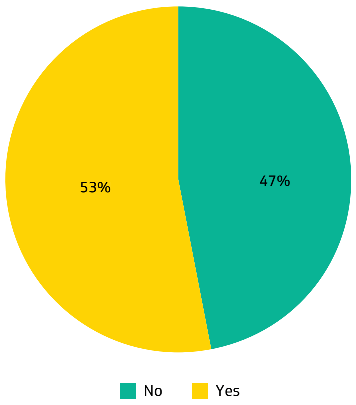
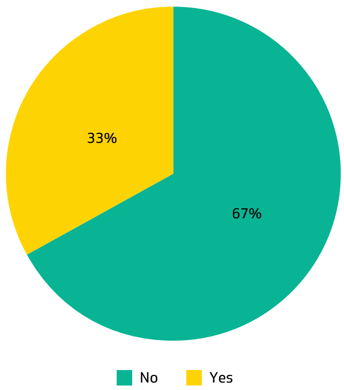


Figure 7: Increase in requests for financing from exporting clients, January-April 2020 (%)

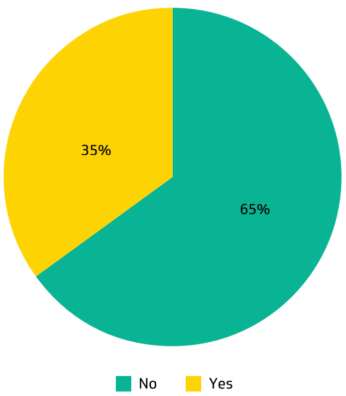
Small Sized Banks



Medium Sized Banks



Large Sized Banks



Source: Survey data

In Southern Africa, a majority of respondents, nearly 53 percent, report an increase in demand for financing among their exporting community. Whether this increase is proving difficult to address is unclear, but merits closer assessment, and perhaps supporting measures from authorities and non-banks to help respond to the export aspirations of businesses in the subregion (Figure 8). Forty-three percent of government-owned banks report an increase in demand for export-related financing.

Small banks all referenced an increase in requests for financing from their export clients, with 53 percent reporting an increase in demand for export-related financing. It is reasonable to expect that small bank respondents are serving midcap to small clients, and to conclude that small and medium enterprises are seeking more trade finance as a means of pursuing or maintaining trade activities.

It is worth observing that demand for more financing may not mean more new business, but rather, reflect the challenges faced by small and medium enterprises in concluding existing trade business independent of bank financing, due to cashflow or working capital difficulties (Figure 7).

In Southern Africa, the agricultural sector appears to be driving the demand for additional export finance. Forty-one (about 52%) of banks responding to the survey noted that clients seeking more export finance were engaged in the agriculture sector, with only nine banks seeing this among their textile sector clients.

Notably, 50 percent of survey respondents report a decrease in export-related proceeds, with a striking 71 percent of banks in Central and Francophone West Africa reporting a decline.

Table 3: Sectors requiring additional support in Southern Africa

Sectors of client activity seeking additional export-related financing (number of banks reporting)	
Agriculture	41
Manufacturing	16
Textiles	9
Mining	9

Source: Survey data.

Survey findings provide some initial indications of developing market dynamics in the context of the COVID-19 crisis. It may prove instructive to supplement these findings with a targeted set of follow-up interviews in the next 4–6 weeks, and perhaps conduct a second survey after the crisis has subsided.

Demand for L/Cs

Figure 10 shows changes in L/C demand and the average value of L/C issued over the period of the survey. Of the banks sampled, 39 percent indicated a decrease in demand for L/Cs over the period. Thirty-four percent indicated no change and 27 percent saw an increase in the demand for L/Cs. Banks in North Africa displayed the highest number of documentary credit applications on the continent, followed by banks in Anglophone West Africa. The results from North Africa and Anglophone West Africa are consistent with the fact that these regions host two of the largest economies on the continent.

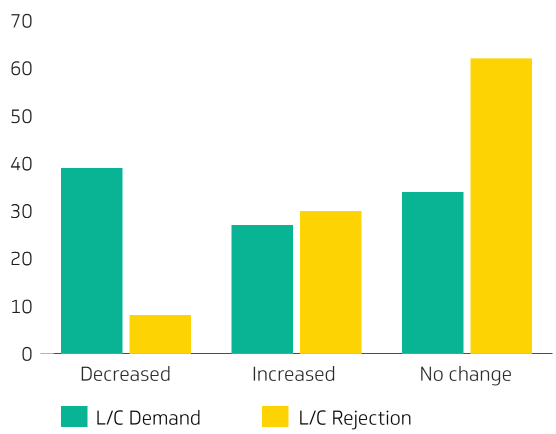
Most regions showed a decline in L/Cs issued in the first trimester of 2020 compared with 2019, except Eastern Africa, which recorded an 18 percent increase in L/C issuances over the period. Issuances from Francophone West Africa remained relatively flat. Notably, large banks on the continent received the most requests for L/Cs in 2020 as they did in 2019, although most banks indicate client preference for shorter tenors—between 0 to 20 days, tenors above 60 days accounted for 16 percent of L/Cs issued during the same period of 2020. The bulk of L/Cs on the continent are issued by foreign and privately-owned banks, but these appear to be relatively smaller value L/Cs amounts, with publicly listed and majority government owned banks issuing bigger value L/Cs.

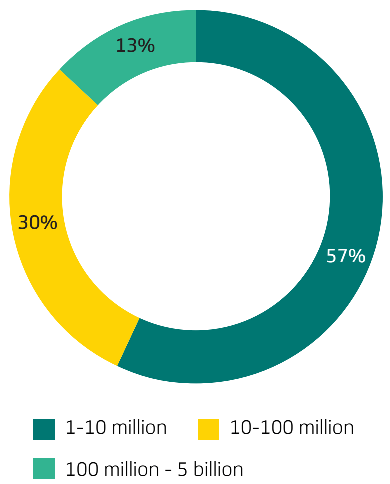
The majority of L/Cs requested in the period of the Survey were valued at US$1 million to US$10 million, values largely consistent with the previous year. This is also in line with the findings of an International Chamber of Commerce survey showing the average value of L/Cs received in Africa to be in the range of US$2 million.[1] The size of these amounts and ranges show the significant presence of small and medium-sized and mid-market enterprises in trade flowing in and out of Africa.

1 The results are based on SWIFT message data.

The survey also showed a substantial increase in L/C request rejections in the first four months of the year compared with the first four months of 2019, with 30 percent of respondents indicating an increase in rejection rates. Of these, banks in Anglophone West Africa reported the highest increase in rejection rates, followed by banks in Southern Africa and Eastern Africa. About 8.4 percent of respondents indicated a decrease in rejection rates whilst 61.7 percent experienced no change in rejection rates. Banks in North Africa displayed strong consistency in L/C issuance, with 92 percent reporting no change in rejections rates in the first trimester of 2020 compared with 2019.

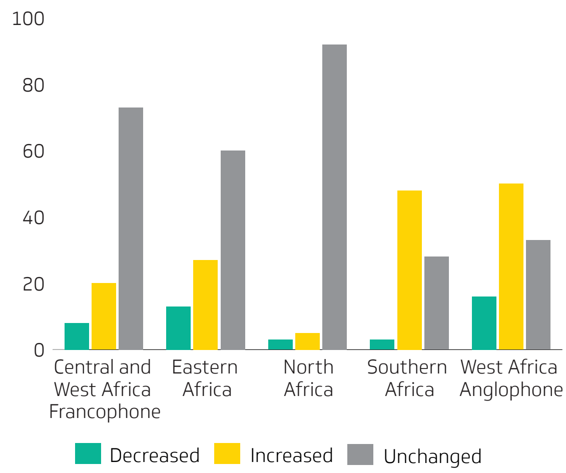
Figure 8: Change in L/C demand and rejection January to April 2020 (top panel). Average value of L/C issued January to April 2020 (bottom panel). In US$.

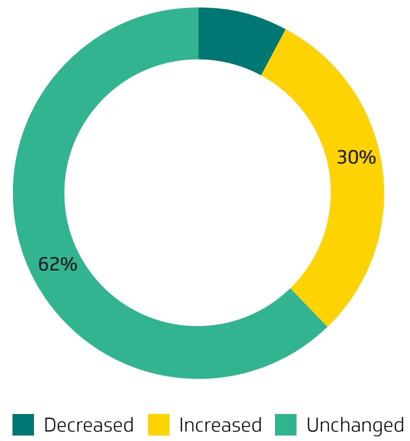




Source: Survey data

Figure 9: L/C rejection rate (%)



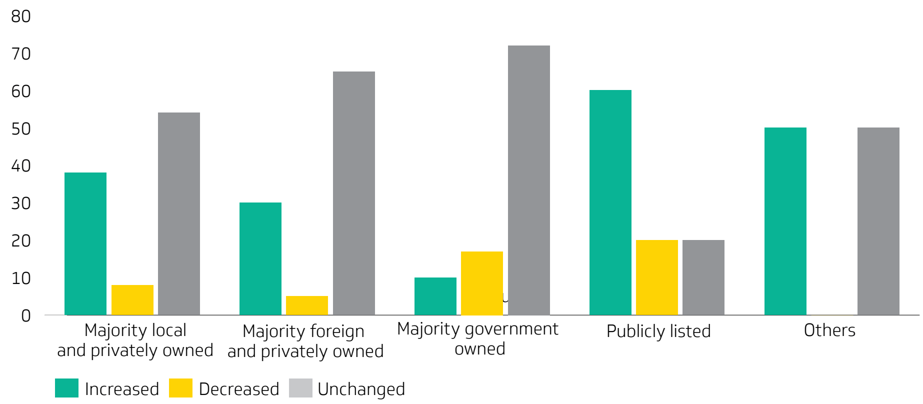


Source: Survey data

The distribution of rejection rates shows important variations across regions. Anglophone West Africa and Southern Africa exhibited the most significant level of increase in rejection rates at 50 percent and 48 percent, respectively. The rejection rates were lower in North Africa, where 92 percent of respondents reported the situation to be "unchanged".

In addition to significant differences between some sub-regions, there are, unsurprisingly, notable differences in reported experience, based on the legal structure and nature of the responding financial institution.

Figure 10: **L/C rejection rates: Reported change by type of bank ownership (%)**



Source: Survey data

The profile of L/C rejections during the period was most evident in small banks. Among them, 50 percent reported an increase in rejection rates. Among medium banks, rejection rates were 32.1 percent. They were slightly lower just 20 percent among large financial institutions. This appears to reflect the asymmetric impact of COVID-19 on small and medium sized businesses on the continent. It is notable that L/Cs with longer tenors recorded the largest increases in rejections, consistent with growing uncertainty triggered by the pandemic which has made decision-making more difficult and shortened the timeframe for financial planning.

Importantly, the increase in the rejection rate for L/Cs issued by majority government-owned banks was the lowest, with only 10.3 percent of banks in this category reporting an increase in rejection rates, compared with 29.51 percent of majority foreign and privately-owned banks and 38.5 percent of majority local and privately-owned banks. The much higher rejection rates for privately-owned banks, both local and foreign, may reflect the much higher aversion to risk by these financial institutions in a context of heightening COVID-19 uncertainty.

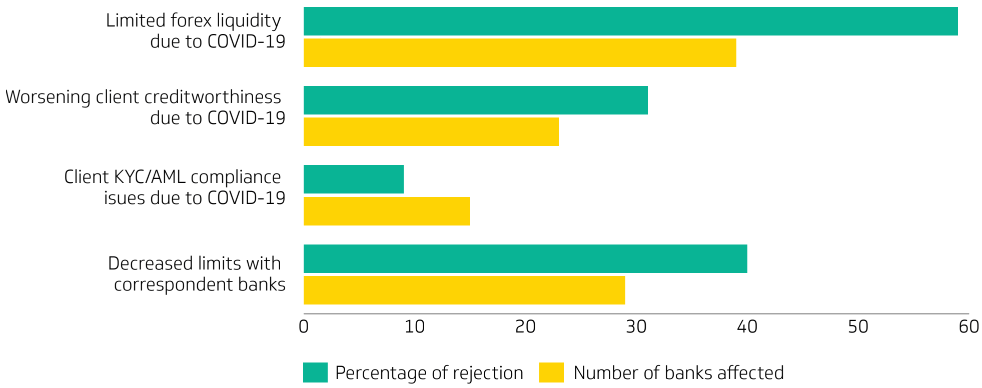
The aversion to risk also appears to dominate and inform operations carried out by publicly listed banks. These institutions appear to be rejecting L/C applications at a disproportionately higher rate when compared with banks with other legal and organisational structures. Publicly-listed institutions report a striking 60 percent increase in rejection rates during the period, which raises the question of whether market conditions have deteriorated significantly, or whether these institutions have swung materially to the conservative end of the credit adjudication spectrum. If the former, that would suggest that some significant default and credit quality concerns are affecting other categories of financial institutions. If the latter, it may be prudent from a commercial and a policy perspective to assess the underlying reasons for such a significant variation.

Local, privately-owned banks appear to be more risk-averse than foreign, privately-owned institutions. While the difference could be explained by liquidity constraints among the local banks and difficulties they encounter in accessing foreign exchange, the sharp contrast in risk perception between local privately-owned and local majority government-owned banks suggests other factors could be driving credit allocation and trade finance. This would place local players closer on a spectrum, except for majority government-owned banks across Africa, which report a mere 10 percent increase in rejection rates over the review period.

These developments may involve conscious efforts to address market gaps and unmet demand, or they may be a function of credit decisions taken based on policy priorities or public good (as opposed to commercial drivers). Either way, they suggest that government-owned institutions have more risk appetite in the current crisis and are probably making significant contributions to sustain liquidity flows during the crisis, and perhaps creating the conditions for swift recovery.

Survey findings also point to macro or systemic reasons for elevated rejection rates that exist independently of individual client relationships and related credit quality considerations (see Figure 11).

Figure 11: Reason for L/C rejection



Source: Survey data

About 59 percent of survey respondents identified access to foreign exchange as a reason for increasing injection of L/C applications, and 40 percent pointed to decreases in credit lines from foreign correspondent banks as an important factor in the sharp increase of L/C rejections during the COVID-19 pandemic. Less than 10 percent pointed to AML/KYC issues, and a material but not alarming (given global conditions) 31 percent highlighted worsening client creditworthiness (Figure 11).

Encouragingly, even with the onset of the COVID-19 crisis, it appears that L/Cs originating in Africa in support of imports to the continent continue to experience levels of global acceptance broadly in line with pre-COVID-19 realities.

About 90 percent of survey respondents reported that the rate of rejection of L/Cs issued by their financial institution either remained the same or decreased between 2019 and 2020. Only 10 percent reported that more of their L/Cs were rejected either by the ultimate beneficiary (the foreign exporter), or by the correspondent bank.

Table 4: Development in correspondent banking

Rates of beneficiary or correspondent rejection of L/Cs issued by African banks	
Increased	10%
Decreased	15%
Remained unchanged	75%

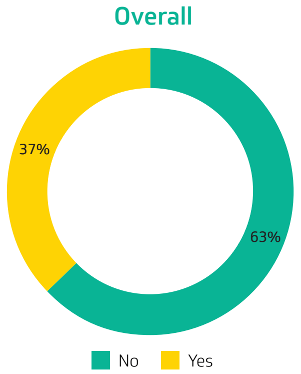
Source: Survey data.

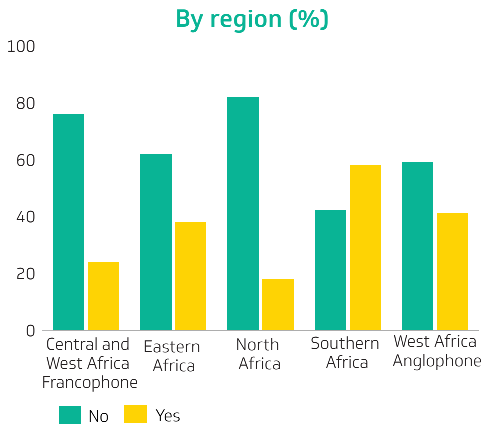
Understanding that intra-African trade volumes can best be characterised as modest even under normal circumstances, it is notable that 37 percent of survey respondents expect an increase in L/C volumes supporting intra-African trade around health, pharmaceutical, and food supply chains, with southern African banks most optimistic about the prospect.

This also reflects the dominance of Southern African countries, and principally South Africa, in intra-African trade. Indeed, South Africa has consistently accounted for over 24 percent of intra-African trade (Afreximbank. 2019 and 2020). Moreover, Southern Africa has the largest export potential to the rest of Africa —approximately US$53 billion—and some of the products with the greatest export potential include machinery, apparel, chemicals, motor vehicles and parts (Afreximbank, 2020).

What also emerges from the survey is that majority local and privately owned banks are most optimistic on prospects for greater intra-African trade as a result of COVID-19, with 39.3 percent of respondents projecting a positive outlook for intra-African trade compared with the average of 36 percent.

Figure 12: Expectation of increased L/Cs enabling intra-African trade in health, pharmaceutical, and food manufacture (and trade) resulting from COVID-19 (%)





Source: Survey data

It is worth noting that 58 percent of survey respondents in Southern Africa indicated they expect increased L/C volumes related to intra-African trade flows, nearly inverting the perceptions, which emerged from the continent-wide analysis. This implies an opportunity for useful dialogue between authorities and business leaders on the subject, to explore opportunities for alignment and action.

While survey data related to the COVID-19 crisis does not extend explicitly to an exploration of product pricing, the recently published African Development Bank and Afreximbank report highlights an interesting reality about L/C opening fees. While most banks, including those partly or fully foreign-owned, have maintained relatively stable fees from 2013, publicly owned banks have nearly quadrupled such fees in the same period.

Assuming the fee data relates to substantially similar trade finance instruments, features and services, this is a significant data, and may merit some form of analysis, at time of crisis where lenders and others are extending loan maturity dates and implementing additional flexibility and features aimed at helping businesses survive and economies recover from the COVID-19 crisis as soon as reasonably feasible.

Trade, Correspondent Banking and FI Capacity: Global State of De-risking

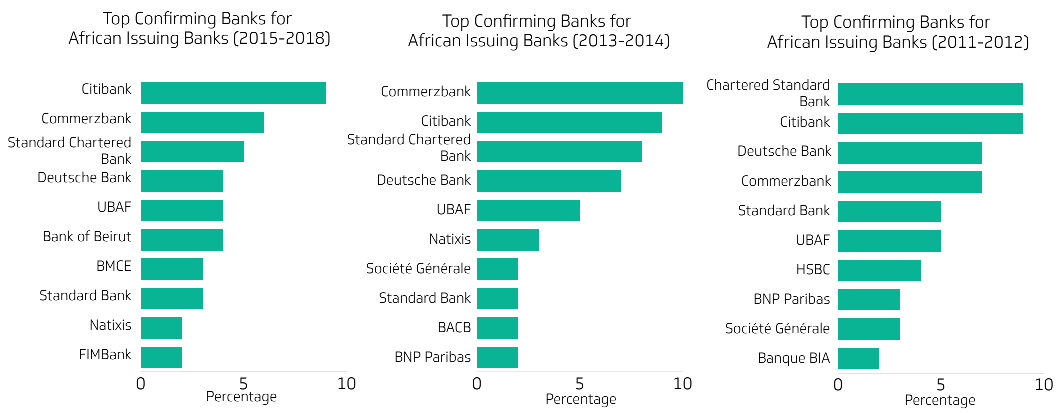
Correspondent Banking and Africa

On the credit quality of trade finance risk, and the degree to which it is deemed acceptable by international lenders, the need for, and provision of, Confirmations of L/Cs provides a proxy illustration for the state of the market. An important element that shapes the credit character of trade finance relates to the efficacy of risk mitigation measures taken at transaction level.

L/C Confirmations are just a mitigating mechanism, providing exporters outside Africa (whose perceptions of local risk may be amplified through lack of awareness, or whose assessments of risk may be accurate) with a way to transfer risk to their own home markets via Confirmation of an L/C. Such Confirmations are commonly provided by international banks for a fee and may involve the Confirming Bank seeking insurance cover (through Export Credit Agencies or private sector trade risk insurers) to mitigate its own exposure.

Since 2011, the same four international banks have ranked at the top of the list of those active in providing Confirmations of L/Cs issued by African banks (See Figure 13). These foreign financial institutions are Citibank, Commerzbank, Standard Chartered Bank and Deutsche Bank. Together they have consistently accounted for 30 percent of total L/C confirmation over the last decade. Western banks continue to dominate this market despite the geographical diversification of African trade and rising Africa-South trade.

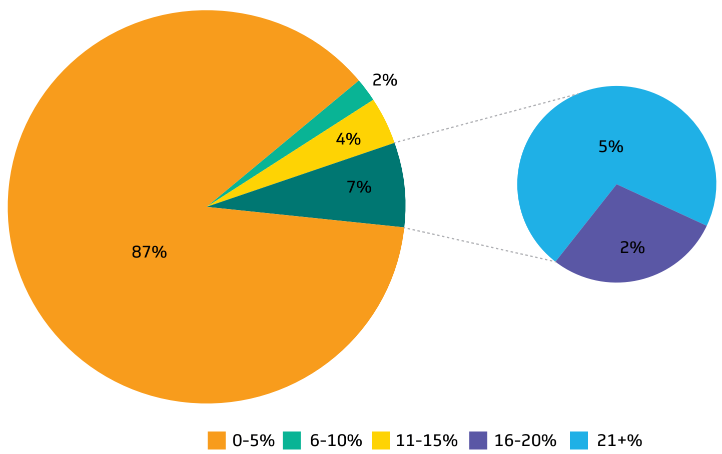
Figure 13: **Ranking of confirming banks**



Source: African Development Bank and African Export-Import Bank (2020)

Despite the shift in the geographic distribution of African trade, the geographic coverage/distribution of correspondent relationships has been relatively stable since 2015. This may be an area where incremental improvement can be achieved for under-served parts of the continent, building on the increasing role played by banks and financial institutions of leading trading partners such as China, Japan, and India. However, while the benefits of such an engagement may not materialise in time to help countries deal with trade finance-related challenges and the fallout from COVID-19, they could better prepare the region to deal with future crises.

Figure 14: **Share of correspondent relationships cancelled, January to April 2020 (%)**



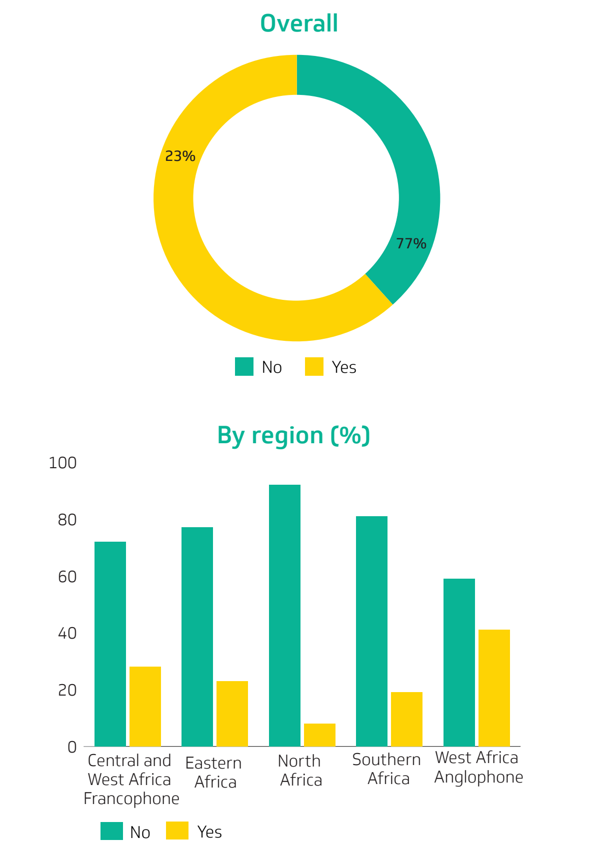
Source: Survey data

Forty-seven correspondent banking relationships were cancelled from January to April 2020, the survey found. Of those the majority (51 percent) were from Europe. Although the survey did not show a systematic decrease in the size of confirmation lines in the initial months of the pandemic, there were some notable variances. Only 2.9 percent of financial institutions in North Africa signalled a decrease in confirmation lines compared with 23.5 percent in Anglophone West Africa. Majority local and privately-owned banks appear to have been disproportionately impacted by the reduction in corresponding bank lines, with 22.6 percent indicating their lines had been reduced during the period, compared with 6.5 percent for majority foreign and privately owned banks and 3 percent for majority government-owned banks.

While there is evidence of some contraction of risk appetite reflected in reductions of L/C Confirmations, at the bank-to-bank relationship level, more than 87 percent of survey respondents reported limited cancellations of correspondent relationships, in the 0-5 percent range. These cancellations are—or are reported to be—most commonly due to deteriorating perceptions of the risk profiles of end-clients. Regulatory concerns or due diligence considerations do not appear to make a significant contribution.

From January to April 2020, only about 11 percent of respondents reported reductions in confirmation lines from their correspondent bank partners. Outright cancellations of lines were even less frequent, with about 7 percent of respondents indicating they have been impacted in this way.

Figure 15: Correspondents seeking additional security to provide L/C confirmations (%)



Source: Survey data

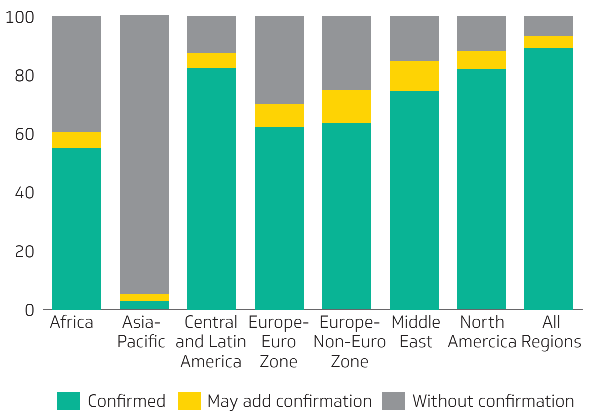
It is nevertheless notable that nearly a quarter of survey respondents report being asked to provide additional security in support of requests to Confirm L/Cs. Responses from Anglophone West Africa indicate the challenge is more severe, with over 40 percent of banks noting such requests (Figure 16). This can prove to be challenging for the local bank and/or for the end-client, depending on what form of additional security is being sought. Further, over a third of majority foreign and privately-owned banks reported requests for additional L/C security from confirming banks, compared with less than a quarter of government owned banks.

As global banks pull out of markets that they perceive as too risky, they leave many African-based banks at risk of not being able to conduct trade in foreign currency. For instance, based on SWIFT data analyses, the number of correspondent banking relationships involving US dollar transactions decreased by about 25 percent between 2011 and 2017, and by 19 percent for all transactions for the same period (Financial Stability Board, 2018).

Because commodity trade is predominantly priced in US dollars, African trade is particularly vulnerable to correspondent relationships. On average West Africa which is one of the most commodity-dependent regions in the continent accounted for close to 40 percent of all correspondent relationships in the continent, twice the share in Southern Africa (19 percent) followed by East Africa (27 percent). North Africa had only 1 percent of the total correspondent relationships in the region.

Data from SWIFT, whose network transmits the vast majority of Letters of Credit around the globe, brings sharply into focus the importance of correspondent relationships and confirmations of L/Cs. The latest edition of the International Chamber of Commerce Global Survey on Trade Finance, which incorporates SWIFT data in its analysis, shows that 45 percent of L/Cs originating in Africa either included the option to add a Confirmation (5.3 percent) or were indeed Confirmed (39.7 percent). This notable data point reflects the importance of effective risk mitigation from the perspective of exporters doing business with Africa-based buyers (see Figure 16).

Figure 16: Distribution of confirmed export L/C volumes (%)



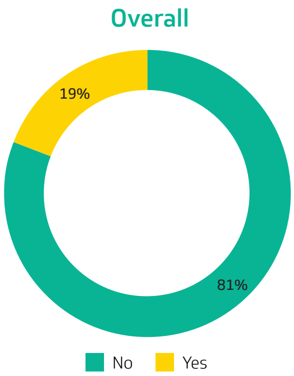
Source: ICC (2020)

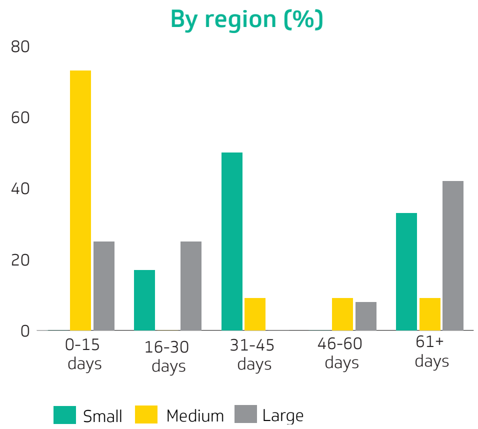
Less than 20 percent of survey respondents reported anticipating delays in settling obligations with Confirming Banks. Of those that did, over 40 percent estimated the delays would be no more than 15 days. About 25 percent thought they might delay 61 days or more. Most respondents experiencing delays in settling obligations are largely local and privately-owned banks, with the situation more acute in Anglophone West Africa. There, 41.2 percent of respondents indicated settlement delays, compared with 12.9 percent in Eastern Africa. This contrasts with respondents in North Africa, where no bank surveyed reported any delay in setting their L/C obligations.

In the end, about eight percent of the survey respondents then, indicated a potential delay of up to 15 days, whilst less than five percent indicated possible delays more than 60 days. Anglophone West Africa was somewhat of an outlier in that 43 percent of those expecting delays reported the delays might exceed 60 days.

Notably, the survey findings suggest that larger banks skew somewhat to longer delays, with about 42 percent of large financial institutions reporting expected delays of more than 61 days.

Figure 17: Expectation of delays in settling obligations with confirming banks (%)





Source: Survey data

Finally, the survey results indicate that during the first four months of the year, 36.6 percent of banks sampled reported an increase in requests for financing from exporting clients, mainly in the agricultural sector. This was particularly evident in Southern Africa, where over 52 percent of respondents experienced increased requests for client financing. Anglophone West Africa also saw an upsurge in client financing, with 38.2 percent of banks responding positively. This compares with a 34.5 percent positive response from Eastern Africa, 29.2 percent in Francophone West Africa and a 25.64 percent in North Africa.

Despite the uptick in export L/Cs, half of all banks surveyed indicated a decrease in the value of export proceeds they received in the first four months of the year compared with the same period last year. A higher proportion of banks from Francophone Central and West Africa reported a decrease in export proceeds, followed by Eastern African banks, and banks in Anglophone West Africa.

Trade finance: Complementary Products and Solutions

Trade finance, particularly the traditional form of trade financing, with which the Survey is concerned, is well-known to link well to a range of bank and finance products and solutions and is an effective channel for expanding and locking in client relationships. It is by definition closely connected to a suite of products and solutions that typically fall under the umbrella of "Transaction Banking", from the perspective of financial institutions.

Transaction Banking can include trade finance, payments, cash management, and other products, perhaps foreign exchange and related solutions. Foreign exchange is the complementary solution most relevant to—and addressed in—the survey. Supply Chain Finance is a notable complement to classical trade finance that may prove a useful COVID-19 and post-COVID-19 option in supporting intra-Africa supply chains, or in connecting Africa-based businesses to regional or global supply chains.

The sharp appreciation of the US dollar in the early stages of the COVID-19 crisis may have had knock-on effects to trade finance from stress in the banking system. But excess reliance on the US dollar for trade in Africa means access and exchange rate volatility, it also involves potentially high transaction costs. Fees associated with the use of the US dollar are extremely high and can increase transaction costs by up to 10 percent. Given the prevalence of the US dollar in trade financing, mitigating the impact of dollar-denominated credit fluctuations will be an important component of shielding global value chains from the pandemic's economic fallout. In this respect, the recent expansion of central bank dollar swap lines and other measures to mitigate dollar liquidity conditions are likely to further cushion trade finance.

Pre-COVID-19, access to trade finance was already a major constraint to trade and growth in Africa, a region where the annual trade finance gap was estimated to exceed US$80 billion, according to the latest continental survey carried out by the African Development Bank and Afreximbank. These challenges of financing African trade have been exacerbated by the COVID-19-induced global downturn, which tightened global financing conditions, triggered massive capital outflows, and put significant strain on banks and financial institutions.

There is little doubt that access to trade finance will be important to the recovery post-containment phase. This reality is reflected in calls on policymakers most notably by G20 Leaders and the International Chamber of Commerce and others (including the B20/G20 processes) to ensure that appropriate priority and enabling conditions are accorded to trade finance.

Chapter 3
COVID-19 and Trade Finance Regulatory Environment in Africa

Amid the ongoing fallout from the COVID-19 pandemic, traditional forms of conducting business have been uprooted as governments impose lockdowns, restrict movement and travel, and enforce strict social distancing measures, including work-from-home arrangements. Global trade has been severely affected, with production shutdowns and disruptions or closures of transport and logistics routes placing enormous pressure on companies, traders, logistics providers, and banks.

Lockdown measures related directly to COVID-19 have had significant and perhaps unanticipated impact on trade finance, and by extension, on global trade flows. Shipping documents submitted by exporters to trigger payments under Documentary Letters of Credit (L/Cs)—as well as Documentary Collections, a similar but less secure and complex instrument— became "trapped" in warehouses and therefore inaccessible. In most instances, regulations related to L/Cs require significant levels of in-person staffing to review hard-copy paper documentation as part of the approval process.

This reliance on hard-copy paper documentation to process payments and facilitate the clearance and release of goods is posing significant challenges, given that many bank-staff are either working reduced hours or remotely as a result of the pandemic. In addition, the exchange of physical documentation has been curtailed due to disruptions in international courier services. Banks in most cases are unable to apply needed flexibility in this area by switching to electronic documents, largely due to regulatory constraints. Local legal frameworks may not adequately protect them. Extant regulations do not in most cases recognise electronic data, while the banks may also be subjected to regulatory fines. Their customers may not be able to take inventory of their goods using electronic documents.

Industry practitioners, and bodies like the International Chamber of Commerce and others, reacted with unprecedented speed to devise stop-gap measures, and to implement changes in internal policy and risk management to enable transactions to be completed without access to paper documentation. The International Chamber of Commerce (ICC) Digitalisation Working Group, the Bankers Association for Finance and Trade, and the International Trade and Forfaiting Association came together to author "Digital Rapid Response Measures Taken by Banks Under COVID-19", as a formal and authoritative illustration of immediate steps taken by industry to enable the flow of trade amidst pandemic-related constraints.

Open-ended comments provided through the survey paint a widely variant picture of regulatory realities across Africa. At one end of the spectrum, central banks and regulatory authorities appear to have taken measures to facilitate the clearance of goods without paper documentation, some having gone so far as to make L/Cs an attractive settlement and financing option from a cost perspective.

Others seem to remain wedded to paper-based requirements and seem (by choice or necessity) to be restricting the use of L/Cs to facilitate the flow of pharmaceuticals and foodstuffs.

"The Central Bank regulates that all letters of credit operations are for food and medicines..."

"Totally unable to get documents though goods were at destination ports..."

"Certain transactions require approval before they can be consummated, and has been experiencing delays..."

Figure 18: Digital rapid response measures taken by banks under COVID-19

Expanded Existing Digital Channels	Electronic Documents	Electronic Signatures	New Business Process and Controls
Great use of email	Advice from customs authorities: US, EU, India and others accepting electronic phytosanitary certificates	Waiving the need for wet-ink customer signatures	Amending agreements to allow for all parties to agree to use electronic documents
Third party platforms	Advice from domestic regulator, eg, Bank of Algeria advising all authorities and banks to use electronic documents. Indian banking association advising the same	Email in place of a signature usually by attaching an unsigned document to the email and through appropriate wording, making the typed name in the email apply to the document	Include wording on PDF presentations and delivery of LC instruments through PDF with e-signatures due to remote working of staff.

Source: ICC (2020).

Other compliance, regulatory, and policy considerations have also been taken by regulators to alleviate operational burdens on firms and financial institutions in the wake of the COVID-19 outbreak. For instance, the Bank of England decided to cancel the 2020 stress test for the eight major United Kingdom banks and building societies to help lenders focus on meeting the needs of households and businesses via the continuing provision of credit. The Bank provided guidance and allowances on the implementation of International Financial Reporting Standards 9 (IFRS9) to support financial stability during the crisis.

In Africa, several central banks have undertaken similar measures in response to the crisis. In the West African Economic and Monetary Union (WAEMU) authorities extended by one year the five-year period initiated in 2018 for the transition to Basel II/III bank prudential requirements. The Bank of Algeria eased solvency, liquidity, and non-performing loan ratios for banks, allowing banks to extend payments of some loans without a need to provision against them. The Bank of Central Africa States created an allowance for banks to use their capital conservation buffers, while several central banks reduced reserve requirements to support credit provisions. These measures are all intended to provide flexibility to help businesses and financial institutions stay sound and deliver key functions to the economy, including the financing of trade, critical for economic recovery and growth post-COVID-19.

Examples of important interventions include:

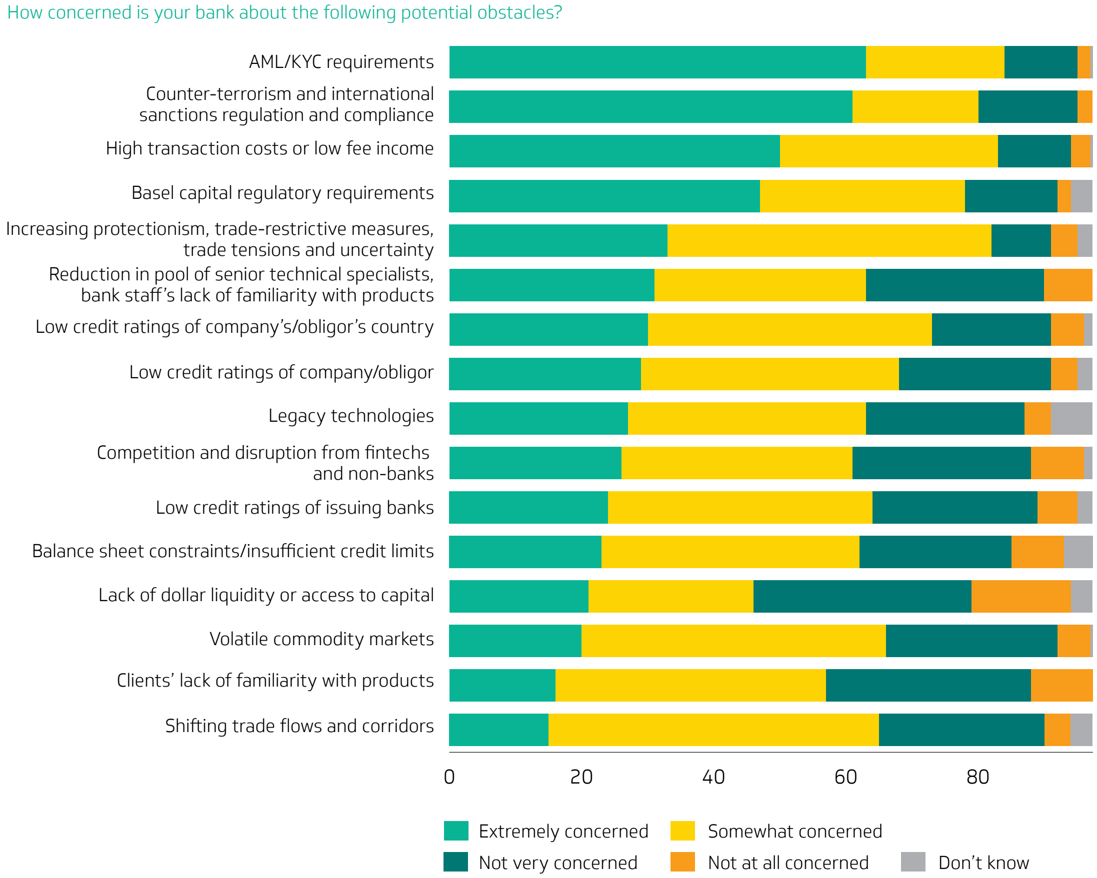
- deferral of the full implementation of Basel III to ease any potential capital constraints faced by banks in responding to the crises, together with helpful technical clarifications provided by the Basel Committee to ensure that banks reflect the risk-reducing effect of government guarantee programmes when calculating regulatory capital requirements;
- voiding or pre-existing legal requirements for key trade documents to be presented in hard-copy paper format by governments including Algeria and India;
- temporary expansion of the mandate of export credit agencies in the European Union to provide broader geographical coverage of short-term trade transactions;
- a total of US$4 billion additional capacity for the IFC's Global trade Finance Program and Global Trade Liquidity Program;
- inclusion of trade lines in development banks' emergency COVID-19 response funds by, for example, the Inter-American Development Bank, ADB and Islamic Development Bank - including priority allocations for trade in essential medial products; and
- expansion of on-line training to banks to underpin support for companies in trade and supply chains, such as by the ADB and the European Bank for Reconstruction and Development.

Source: ICC (2020)

Recognising the unique and non-homogenous characteristics of the African market for trade and trade financing, African regulators should continually assess and potentially adapt (or adopt) measures taken at global level, to help shape Africa's approach to trade finance in the COVID-19 crisis.

Even before the COVID-19 challenges, compliance and regulatory requirements have been consistently identified as impeding the provision of trade finance in support of legitimate trade transactions over the last few years. Anti-money laundering and terrorism financing are areas of financial crimes compliance often flagged as areas of concern. Relatedly, due diligence requirements, including Know your Customer (KYC) and Know your Customer's Customer (KYCC) can be problematic and have been shown to contribute to the trade finance gap globally and in Africa. In a global survey of banks carried out by the ICC in the wake of COVID-19, 63 percent of respondents singled out anti-money laundering (AML) and KYC requirements as the most important constraints to trade finance, ahead of high transaction costs and Basel capital regulatory requirements (Figure 20).

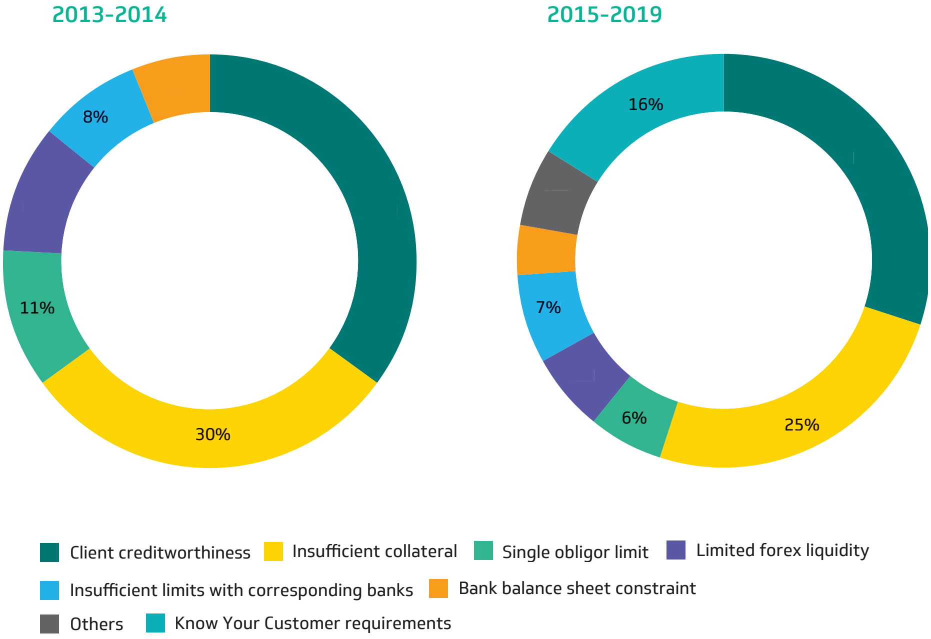
Figure 19: Potential obstacles (%)



Source: Survey data

These realities are also reflected in trade finance in Africa, where the added pressure of dependence on global correspondent networks arguably amplifies sensitivities around such issues. The massive exodus of international banks from the African correspondent banking space first triggered by compliance with increasingly stringent KYC/AML and regulatory environments became even more hardly felt during COVID-19. For instance, 29 banks surveyed cited decreased limits with correspondent banks due to COVID-19 as a reason for L/C rejections, and 47 correspondent banking relations were cancelled (see Figure 20).

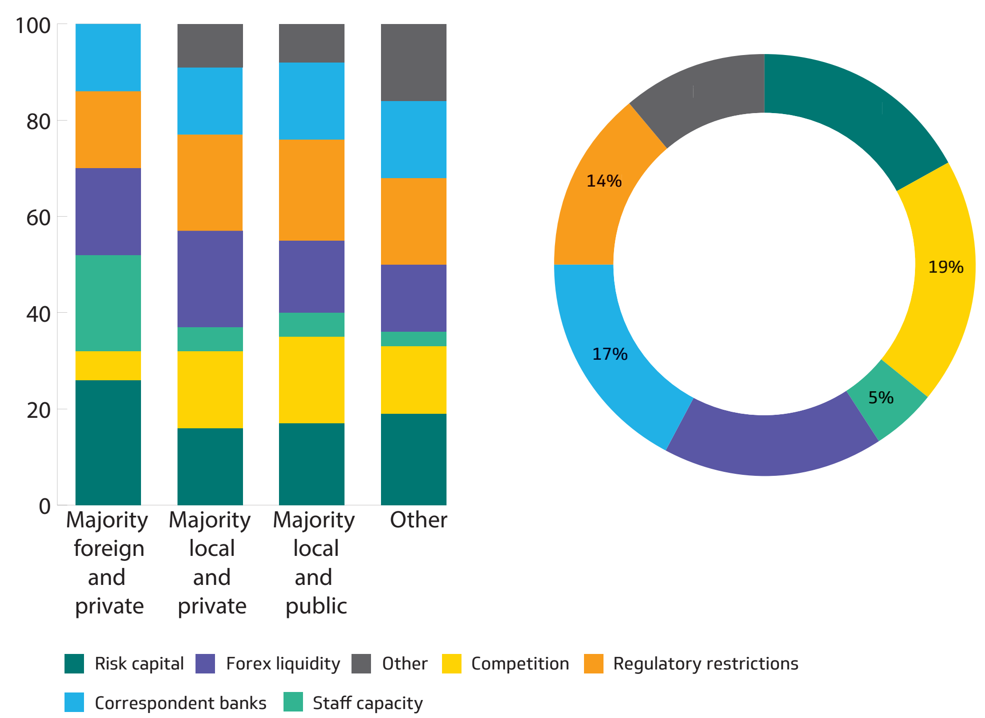
Figure 20: Reasons for rejecting trade finance applications



Source: African Development Bank and African Export-Import Bank (2020).

A variety of issues in Anti Money Laundering and Combatting Terrorism Financing-related regulations and compliance appear to be recurring in terms of their unintended adverse impact on the provision of timely and affordable trade finance at the global level. About 16 percent of banks engaged in trade finance now list KYC/AML compliance as their major reason for rejecting trade finance applications from 2015 to 2019, compared with less than 1 percent from 2013 to 2014. This shows stringent KYC/AML regulations are having unintended consequences on African banks engaged in trade finance (AfDB and Afreximbank, 2020). COVID-19 appears to have exacerbated KYC/AML compliance issues in the trade finance space, with 15 respondents citing Client KYC/AML compliance issues due to COVID-19 as a factor in L/C rejections.

Figure 21: Ranking of constraints to trade finance supply: Intra-African trade (%)



Source: African Development Bank and African Export-Import Bank (2020).

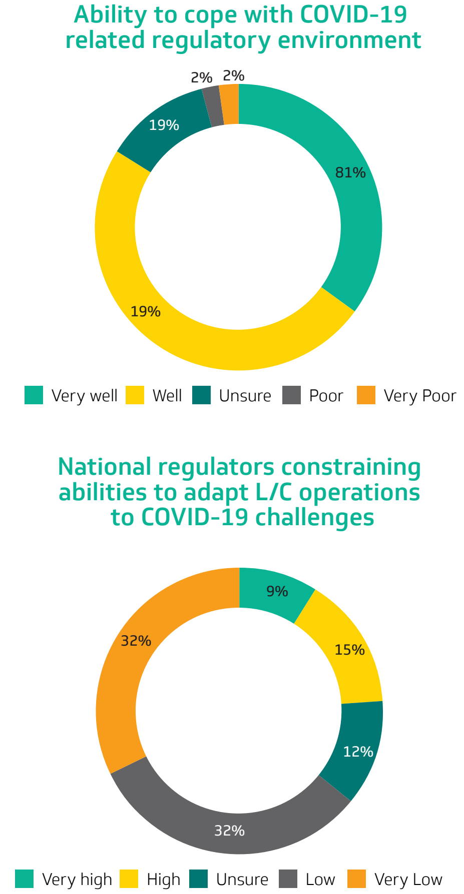
Survey Analysis and Implications

The segment of the survey which focuses on COVID-19's impact on the regulatory environment related to trade finance does not address issues related to digitisation of trade and trade finance, nor does it materially focus on capital adequacy and reserve requirements (and related capital costs of providing trade finance). The survey makes broad reference to banks and their ability to deal effectively with the COVID-19-related regulatory environment, and in this respect, respondents are clear:

- Nearly 84 percent of respondents report their L/C operations are coping "well" or "very well" despite regulatory challenges linked to the COVID-19 crisis;
- In North Africa, COVID-19 related regulatory challenges do not appear to have any impact on L/C operations, with more than 92 percent of respondents indicating they are coping "well" or "very well";
- More than 20 percent of respondents in Central Africa and Francophone West Africa noted however they are "unsure" of how their operations are coping;
- More than 26 percent of smaller banks likewise were "unsure"; and
- Only about 4 percent of respondents report their L/C operations are coping "poorly" or "very poorly" as a result of regulatory challenges linked to the COVID-19 crisis.

On the specific query related to regulatory constraints and banks' ability to adapt L/C operations to the challenges of COVID-19, industry respondents are sending a clear message, with more than 64 percent of respondents indicating the constraints are either low or very low.

Figure 22: Dealing with the effects of COVID-19



Source: Survey data

Nevertheless, nearly one quarter of survey respondents reported high to very high regulatory constraints to their ability to adapt processes to the context of the COVID-19 crisis. It is worth noting that the scenarios are fairly consistent across sub-regions. However, foreign-owned private banks report less concern with this issue, with only 18 percent reporting high or very high constraints. It may be worth exploring whether the difference implies overcompliance by local banks, or an underestimation of expectations by foreign institutions. In the former instance, regulatory guidance and/or some form of communication of endorsed best practice may prove helpful.

It would appear there is an opportunity to advocate for, and perhaps facilitate, conditions for greater alignment of COVID-19 response options across sub-regions, and in so doing, perhaps directly motivate greater intra-African trade and a more robust set of conditions for post-COVID-19 recovery.

Global best practice, referenced earlier and documented by leading international banks via the ICC, illustrate that, with the right environment and the support of regulatory authorities, it is very much an option, to safely process trade finance transactions without direct access to original documentation.

The Central Bank of Nigeria cut the monetary policy rate while expanding liquidity available for nonbank financial institutions and introduced regulatory forbearance to restructure loans in impacted sectors.

Central Bank of Kenya has encouraged banks to restructure facilities, which in turn helps customers to meet their facility obligation with the available cash flows…"

The Central Bank of Egypt reduced the policy rate by 300bps in response to the pandemic and has since then reduced the policy rate by a further 100 bps.

The South African Government and the South African Reserve Bank took several measures to provide additional liquidity to the financial system, including (i) temporary relief on bank capital requirements, (ii) reduction of policy rate by 275 bps, and (iii) reduction of liquidity coverage ratio to provide additional liquidity and counter financial system risks.

The measures taken by African regulators and policymakers (in the form of loans, grants, debt restructuring, guarantees and monetary easing) to sustain the flows of African trade were generally well received and welcomed by the financial industry, according to the survey. These proactive interventions taken to ensure that the trade finance market is primed to support a rapid recovery from COVID-19 were also consistent with key recommendations which emerged from extensive consultations with financial institutions and business leaders throughout the ICC's Global Network. Among these set of recommendations, the most relevant ones include:

- Enacting emergency legal reforms to allow documents to be used in the processing of transactions—following the lead taken by a number of governments in recent months in phasing out requirements for some trade documents to be presented in hard copy;
- Utilising flexibilities in the application of Basel III to trade financing to free up bank capital to support SME transactions at scale;
- Considering large-scale government/central bank purchases of trade assets—for instance, through securitised vehicles—to free up bank balance sheets to finance new transactions;
- Scaling the capacity of development bank schemes to provide risk mitigation and liquidity at levels commensurate with the anticipated needs of the real economy; and
- Mandating development banks to take on greater levels of risk to provide counter-cyclical support for SME transactions for the duration of the crisis.

Chapter 4
Development Finance Institutions and Multilaterals: Response to COVID-19 in Africa

The Role of Development Finance Institutions and Multilaterals in Trade Finance

The outbreak of COVID-19 has exacerbated the perennial challenge of availability of trade finance in Africa. As international sources of commercial capital dried up and global investors pulled back in the face of heightened risk and widening spread during the pandemic, it became increasingly necessary for regional development finance institutions (DFIs) to continue investing in the continent, by supporting the financing of trade and the process of economic recovery. Beyond immediate liquidity support—including in hard currencies where shortages arise—some players in Africa's banking sector, particularly nonbank financial and microfinance institutions, are likely to face long-term challenges and difficulties, especially if the pandemic downturn persists. The exposure of financial institutions to sectors and industries such as tourism and hospitality could increase even further.

DFIs are uniquely placed to strengthen these vital institutions by supporting their financing needs. Indeed, the role of DFIs is critical in the context of the global and African response to COVID-19, given the high levels of volatility and uncertainty in global capital and financial markets coupled with the large outflow of capital from emerging and developing economies. In Africa, the liquidity and other challenges faced by banks and other financial institutions in the wake of COVID-19 are compounded by the fact that prior to the pandemic, several correspondent international banks had already started withdrawing and scaling down their operations, including correspondent banking services from the African financing space.

Even though the average annual trade finance gap has declined significantly from its peak of US$120 billion in 2011 to US$81 billion in 2019, thanks in large part to the global response from key players in the trade finance industry, including DFIs, financing African trade, especially intra-African trade, remains a challenge. DFIs are increasingly playing a more active role in Africa's trade, with facilities for short-term lending of working capital and credit guarantees aimed at small and medium-sized enterprises (SMEs). The survey highlighted that an average of 60 percent of banks that engaged in trade finance activities received some form of DFI support between 2015 and 2019 (AfDB and Afreximbank, 2020).

Global Intervention in Support of Africa

As part of the global response to help African countries deal with the socioeconomic fallout from the COVID-19 pandemic downturn, global and African DFIs and Multilateral Development Banks launched several rapid response facilities and programmes. The IMF and the World Bank issued a joint statement to the G20 countries requesting all official bilateral creditors to suspend debt payment from IDA countries that request forbearance, bearing in mind that 39 African countries are IDA-eligible. The objective of this request is to help countries address their immediate liquidity needs to tackle the challenges posed by the pandemic.

The IMF stepped up to provide financial assistance to several African countries to support their efforts to respond and contain the socio-economic impact of the pandemic. Through its Catastrophe Containment and Relief Trust (CCRT), the IMF offered debt relief to poor countries, including those in Africa, which cumulatively amounted to US$111.48 million for 6 months and US$422.06 million for 24 months. It also dramatically increased its assistance, providing large and timely financing under concessional terms through its Rapid

Financing Instrument (RFI) and Rapid Credit Facility (RCF). Altogether, the IMF is currently making about US$250 billion, representing a quarter of its lending capacity, available to member countries (IMF, 2020). The IMF's lending to Africa exceeded US$25.2 billion in 2020, considerably more than the historical annual average of less than US$5 billion. As of November 2020, several African countries have received assistance to deal with the COVID-19 pandemic and reduce pressure on their balance of payments.

The World Bank Group has also taken broad and swift actions to help developing countries improve public health support and help the private sector continue to operate and sustain jobs as the impact of the pandemic gradually deepens in these countries. The institution committed to deploy up to US$160 billion in financial support through broad economic programs and facilities over the next 25 months to help countries protect the poor and vulnerable, support businesses, and strengthen efforts towards economic recovery. Through its dedicated COVID-19 Fast-Track Facility (FTF), the World Bank has already rolled out the first tranche of financing to support projects in an amount of US$1.9 billion for 25 developing countries. As of November 2020, several African countries had received financial assistance from the World Bank under the FTF. This assistance is being deployed to finance the procurement of medical supplies and equipment to build diagnostic capacity and training.

European DFIs already have some EUR 15 billion invested in Africa, with many more invested by the International Finance Corporation and North American DFIs. The French Development Agency (AFD) also provided additional financial support up to EUR 500 million by fast-tracking and easing disbursement to existing partners. Furthermore, as the African microfinance sector is crucial for the dominant low-income population and particularly exposed to a number of risks, the AFD Group (including Proparco) and the European Union are working on a new guarantee scheme aimed at de-risking new operations in the African financial sector. Over the long term, the AFD will provide financial institutions and regulatory bodies with resources to enhance their counter-cyclical role during the recovery phase.

Intervention of African Development Finance Institutions and Multilaterals in the Trade Finance Space

Regional DFIs across the continent have also supported affected countries to deal with the COVID-19-triggered liquidity constraint through various initiatives and interventions. In this regard, the African Development Bank (AfDB) set up a US$10 billion program, called COVID-19 Rapid Reaction Facility (CRF). With regards to the COVID-19 CRF, US$8.7 billion of its funds are dedicated to sovereign and regional operations in support of member countries, while US$1.3 billion will support non-sovereign operations in all African countries. The COVID-19 CRF focuses on the most urgent operations and more broadly, aims to support African governments in attracting and encouraging support from multilateral, bilateral and commercial lenders with the view to closing the liquidity gap created by the pandemic. Specifically, on trade finance, AfDB has also earmarked US$270 million for trade finance support, in addition to existing guarantee capacity of more than US$700 million.

As the trade finance leader in Africa, Afreximbank has been bold and swift, undertaking initiatives to help its member countries deal with the fallout from the COVID-19 pandemic downturn. In this regard, in the wake of the pandemic, Afreximbank introduced the US$3 billion Trade Pandemic Impact Mitigation Facility (PATIMFA), with the view to alleviating the impact of COVID-19 on member countries as well as to meet trade-related payments falling due. Under PATIMFA, the Bank provided financing to governments, central banks, commercial banks, national and sub-regional development banks, and corporates. PATIMFA is available to member countries' institutions through various financing instruments including direct cash advances, term loans, lines of credit, guarantees, and cross currency/interest rate swaps. PATIMFA has also enabled the Bank to leverage additional financing and resources within the continent and globally.

Afreximbank, in collaboration with the Arab Bank for Economic Development in Africa, the International Islamic Trade Finance Corporation, and the OPEC Fund for International Development, has launched another initiative called the Collaborative COVID-19 Pandemic Response Facility. Its purpose is to assist African countries mitigate the impact of financial and economic shocks caused by COVID-19 and ramified through commodity price shocks, a significant drop in tourism earnings, disruptions in supply chains and export manufacturing facilities, and sudden declines in financial flows, including both trade and project finance. Its specific objectives include providing support to central banks, commercial banks, and corporates to enable them to finance the import of COVID-19-related materials and services; supporting the import of raw materials and equipment that will facilitate the production of COVID-19-related materials and services in Africa; providing financing to Arab-Africa as well as intra-African trade in COVID-19-related materials and services; and supporting the import of critical items, such as fertilizers, necessary for meeting the food production deficit caused by the COVID-19 pandemic. The US$1.5 billion initiative is accessible through direct cash advances, term loans, lines of credit, guarantees, cross-currency/interest rate swaps, and confirmation and refinancing of documentary credits.

At the same time, the Nippon Export Investment Insurance (NEXI) of Japan provided overseas United Loan Insurance of US$520 million to support Afreximbank's PATIMFA. The partnership was both timely and groundbreaking. It is the first transaction of its kind ever offered by NEXI to an African entity and could form the basis for rolling out assistance and support to other financial institutions operating in the trade finance space across the continent.

The Africa Medical Supplies Platform (AMSP), launched by the African Union in June 2020, is an initiative created in partnership with Afreximbank and the United Nations Economic Commission for Africa (UNECA) with the support of leading African and international institutions, foundations, and corporations, as well as the governments of Canada, China, and France. The initiative is an online non-profit platform created as an immediate, integrated, and practical response to the COVID-19 pandemic. It enables immediate access to an African and global base of pre-selected and vetted manufacturers and enables African Union Member States to purchase certified medical supplies such as diagnostic kits, personal protective equipment (PPE), and clinical management devices. AMSP also enables pooled procurement of medical supplies, ensuring that smaller countries benefit from reduced prices arising from aggregated volumes.

Afreximbank is supporting the platform as a Payment Services Provider (via a Customer Settlement Account or Virtual Settlement Account with Afreximbank); Trade Services Provider; Liquidity Services Provider (via a US$100 million Overdraft Facility for countries in need), as well as Operational Support funding. Review of operational processes were completed in December 2020, with purchases through the platform amounting to about US$30 million. In just a few months, the AMSP pipeline or orders exceeded US$312 million.

Furthermore, Afreximbank and UNECA, in collaboration with the Africa Centre for Disease Control and Prevention (Africa CDC), introduced the Afreximbank–UNECA Initiative, a US$200 million facility focusing on the financing of local manufacturing of COVID-19-related supplies (PPE, pharmaceuticals, test kits, and ventilators), food, and fertilizer imports. The initiative is accessible through Direct Financing (financing requests from corporates that meet Afreximbank's standard direct financing threshold of US$5 million and above) and Indirect Financing (financing requests from corporates that are less than US$5 million and not meeting the required annual turnover of US$10 million and a balance sheet size of US$2 million) through Afreximbank's On-Lending and Guarantee Programmes. As of December 2020, an amount of US$74 million out the Initiative's pipeline of about US$146 million has been disbursed.[2]

[2]Afreximbank has also approved a US$3 million COVID-19 grant to support African countries in addressing their immediate and short-term needs to stem the rise of infections and minimize the spread and socioeconomic impact of the pandemic.

Other DFIs in the region have also taken bold actions in effort to mitigate the growing spread of the pandemic and associated economic consequences in their operational jurisdictions. As a result, the Eastern and Southern African Trade and Development Bank (TDB) has continued to embark on special initiatives to help ensure continued access to finance for trade and development, with priority for medical supplies and other essential commodities. The Bank has also provided targeted support to its Member States with a focus on specific emergency medical supplies. The overarching thrust of their response is to ensure that capital continues to flow into the region, and that international trade transactions continue to take place.[3]

In Southern Africa, the Development Bank of Southern Africa's response to the COVID-19 pandemic has covered humanitarian, short-term, and long-term needs with support for disaster management and health equipment, economic recovery, and urgent infrastructure-related projects. The Bank launched its R150m COVID-19 response programmes in South Africa and the Southern African Development Community (SADC) region aimed at providing support to various activities that will bolster national and local government capacity to manage the ongoing response, with a view to promoting accelerated recovery within the SADC region in the post-containment phase. The Bank has indicated that it would increase its disbursement by over 75 percent during 2020 for services and infrastructure development.[4]

Export Credit Agencies (ECAs) have also emerged as key players in ongoing efforts to ease cashflow pressures to sustain the flows of trade finance in the wake of COVID-19. These entities are providing assistance to corporates and SMEs in the form of liquidity support, flexible payment, waivers on premiums and fees, as well as direct lending and guarantees. Some of these entities are expanding their scope, capacity, and limit of cover, others are allowing policyholders to extend credit terms to the buyers without needing additional consent from ECA. Yet, others are offering portfolio guarantees to banks as collateral, while others, still, are permitting covers for existing loans to facilitate risk transfer of banks. Table 4 summarises the measures taken by OECD countries and their ECAs in response to the COVID-19 pandemic (source, 2020):

Across Africa, a few ECAs, some of which have been working closely with Afreximbank, expanded their assistance to SMMEs to support the process of economic recovery in the context of increasing liquidity constraint and balance of payment pressure triggered by COVID-19. For instance, the South African Export Credit Insurance Corporation (ECIC) intensified its assistance across the board, supporting all South African exporters looking to export capital goods and services from South Africa to the rest of the world. The Ghana Export-Import Bank took several supportive measures, including moratorium on payments from clients and restructuring of loans. It also provided working capital to import COVID-19-related equipment.

Nigerian Export-Import Bank (NEXIM) is complementing the COVID-19 pandemic response measures implemented by the Government of Nigeria, with additional support towards Nigerian SMME clients short-term trade business, in the form of guarantees and working capital support offered through the local financial institutions. NEXIM has also received support from Afreximbank under the Afreximbank PATIMFA facility.

[3]In addition to direct financing, the TDB has also provided support under its corporate social responsibility. It donated US$500,000 to support COVID-19 response across Africa by the Africa CDC.
[4]In a related development, it also dispatched PPE to Mozambique as part of a coordinated SADC regional response to the COVID-19 pandemic.

Table 4: Selected Measures taken by OECD countries and their ECAs in response to COVID-19

Broad category	Sub-category	Detailed measure
Modification of the terms and conditions of official support	Repayment flexibilities	• Deferring loan repayments/Moratorium of loan payments • Extending loan terms • Extending restructurings
	Interest rate and fees flexibilities	• Waiving all fees associated with extensions, including legal and documentation fees • Waiving late interest and late fees • Reduction of fees for exporters in case of new demand for insurance cover
	Changes in premium	• Discounts on premiums (SMEs)
	Cover changes	• Expansion of the ST facilities to marketable risks (EU) • Willingness to take on greater risk than in the past when assessing new buyer cover requests • Increase of the maximum percentage of cover
	Claim flexibilities	• Shortening of claims waiting period • Speeding up of claims payment (SMEs)
	Deferment of deadlines	• Extension of the term of export pre-financing guarantee agreements
	National content changes	• Flexibilities to national content rules
	Flexibilities for cancellations	
Working capital	Increasing facilities	
	Cover changes	• Increased maximum cover
	Repayment flexibilities	• Extension of the repayment period of loans, extension of duration to fulfil export commitments for loans
Increased capacity		• Increasing ECAs' statutory limits, Special government-back programmes, etc
New facilities	Insurance/Guarantee facilities	
	Direct lending programs	
Other	Application flexibilities	• Faster processing of applications • Discounted services (credit research service)
	Documentation flexibilities	• Moratorium on deadlines for submitting documentation and financial reports
	Reinsurance schemes with private insurers	

This table has been prepared based on the survey submitted to OECD countries and their ECAs and reflects the answers received up to 20 May 2020.

Source: OECD, 2020

The African Guarantee Fund for Small and Medium-sized Enterprises (AGF) unveiled its COVID-19 response aimed at reducing the uncertainties facing financial institutions in Africa as a result of the global coronavirus pandemic. AGF's COVID-19 response is premised on the need for commercial solutions over and above the regulatory efforts already provided by the various central banks and governments on the continent. AGF's COVID-19 Guarantee Facility is supporting African financial institutions through several channels, including, including (i) providing more comfort to financial institutions to restructure facilities that become non-performing because of COVID-19 and, (ii) providing commercial stimulus to the financial sector with the aim of mitigating the deterioration of SMEs' perceived risk.

In August 2020, the Multilateral Investment Guarantee Agency (MIGA), a member of the World Bank Group, issued guarantees of up to US$235 million to a wholly-owned subsidiary of South Africa's FirstRand Group, for a period of up to 15 years, covering the subsidiaries' mandatory reserves held as per regulatory requirements in Botswana, Eswatini, Ghana, Lesotho, Mozambique, Nigeria, and Zambia. The guarantees will help unlock funding and liquidity, and support the economies of the host countries, which are being severely impacted by the COVID-19 pandemic, particularly in the commodities markets. Nearly 60 percent of the support provided by the MIGA guarantees will be directed to low-income IDA countries, and twelve percent will go to Mozambique, a country recently affected by conflict and cyclones.

As providers of patient, flexible capital to the private sector, DFIs have a critical role to play in the management of the COVID-19 pandemic downturn. The DFI community is committed to protecting businesses and jobs across Africa by channeling timely additional liquidity and technical assistance to new clients, both sovereign and corporates, especially those that are struggling. Similar measures were undertaken to help countries in the aftermath of the financial crisis of 2008/09, when DFIs implemented counter-cyclical responses, and they have generally informed DFIs' lending toolbox and assistance to their member countries as they did with the fallout from the COVID-19 pandemic.

In this pandemic environment, several domestic and regional challenges require coordinated efforts from DFIs/ECAs to better manage rising fiscal pressures and economic shocks and to enhance public health systems. The banking sector is the most important area where these institutions can intervene, by providing liquidity support to help financial institutions maintain or increase lending to their clients. This will be vital for SMEs, the key drivers of growth, which over the years have had difficulties accessing financing and could be challenged even more during the COVID-19 pandemic downturn. Likewise, many African financial institutions will need additional liquidity as loan moratoriums are implemented and their ability to raise capital from wholesale markets becomes more limited. By reinforcing partnerships with local banks and financial intermediaries to strengthen financial systems, DFIs/ECAs can quickly reach the real economy and achieve transformative impact at scale.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Chapter 5
Enhancing Policy and Regulatory Reforms for Trade Finance in a Digital Era

The primary goal of the African Continental Free Trade Agreement (AfCFTA), a flagship project of the African Union's Agenda 2063, is facilitating and boosting intra-African trade. The United Nations Economic Commission for Africa (ECA) estimates the AfCFTA has the potential to boost intra-African trade by more than 50 percent. Trade-related impacts of COVID-19 have highlighted the longstanding less-than optimal utilisation of regional markets by African countries that are highly dependent on external partners (Gondwe, 2020). In this regard, there is an urgent need to implement the AfCFTA Agreement for several reasons: to help African countries recover from the COVID-19 crisis, increase intra-African trade, and ultimately, support much-needed economic development and structural transformation of economies in the continent.

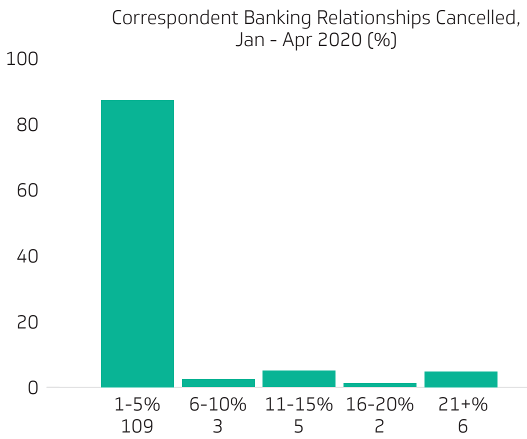
Despite the promised benefits of the AfCFTA reforms, they are not assured. Trade finance is a critical tool that can contribute to the success of these ongoing continent-wide integration efforts. In turn, for trade finance to produce the desired effects, a necessary precondition is the establishment and maintenance of stable and well-regulated financial systems at all levels (Llewellyn et al. 2016).

Recent Trends in Trade Finance in Africa

Trade finance remains a key constraint to the financing and growth of African trade. And while the past decade has seen relative improvement, the trade finance gap remains high throughout the region. The continent's unmet demand for trade finance over the past three years is estimated at about US$81 billion a year (AfDB and Afreximbank, 2020). Prospects for narrowing the trade finance gap are made still more difficult by the large-scale withdrawal of major international banks from Africa's financial services landscape. Across the continent, African banks that had relied on correspondent banking relationships with financial institutions abroad to enable the provision of domestic and cross-border payments have been adversely impacted by the withdrawal of foreign banks from those arrangements. Those withdrawals have been prompted by the implementation of new regulations amidst more stringent compliance environment that arose in the wake of the global financial crisis of 2008.

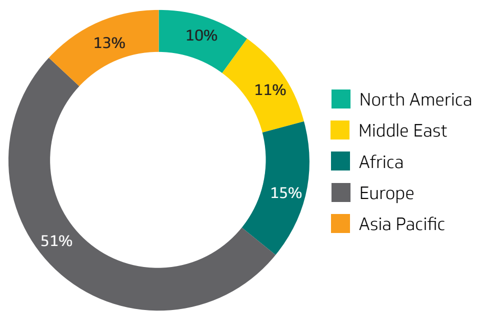
Figure 23 shows the percentages of correspondent banking relationships cancelled during the first quarter of 2020. Of the 125 banks that experienced cancellations to correspondent banking relationships, 87.2 percent saw cancellations of less than five percent. In about 5 percent of banks, more than 21 percent of their correspondent banking relationships were withdrawn. The main reasons for cancelling correspondent banking relationships during the first quarter of 2020 included increased risk perception associated with Africa's customer base as a result of COVID-19, decreased profitability or lower transaction volume due to COVID-19, changes in sovereign credit risk rating, inability to comply with pre-existing legal or regulatory requirements in correspondents' or issuing banks jurisdiction due to COVID-19 containment measures, and the inability to undertake customer due diligence due to COVID-19 containment measures. The findings are consistent with conclusions of both a 2015 AfDB study and 2018 Bérenger study indicating that the average rate of rejection of letters of credit, a key instrument used by banks in trade finance in Africa, was more than six percent.

Figure 23: Correspondent Banking Relationships Cancelled (%)



Source: Survey data

Figure 24: Correspondent Banking relationship cancellations, by region (%)



Source: Survey data

Europe, which remains the main source of trade finance to Africa outside the continent, accounted for more than 50 percent of total cancellations of correspondent banking relationships across Africa from January to April 2020 (Figure 24). The remaining correspondent banking relationships cancelled were almost evenly distributed across other regions, even though relatively more elevated in Africa, which accounted for 15 percent of all correspondent banking relationships cancelled. The survey shows that other factors contributed to diminished trade during the pandemic downturn and worsening the financing gap. Those factors included limited foreign exchange availability, deteriorating client creditworthiness, client Know Your Customer and anti-money laundering compliance issues, and decreased limits with correspondent banks. Limited foreign exchange liquidity (59.4 percent) and limits with correspondent banks (40.5 percent) emerged as the main reasons for rejecting trade finance applications in the context of challenged triggered by COVID-19.

Another important factor fuelling the persistent trade finance deficit in Africa is the imbalance between perceived versus actual credit risk. While global rejection rates of trade finance applications are less than 10 percent, in Africa the average rejection rate on overall trade finance applications is estimated at more than 15 percent. The higher rejection rate in Africa is not justified by historical data, which year after year shows that trade finance transactions are associated with low default probabilities.

Participating banks (about 65%) also indicated that existing regulations in their countries have contributed to low adaptability of their letters of credit (L/Cs) operations to the challenges posed by the COVID-19 pandemic. In light of the foregoing, and especially in the context of the pandemic, appropriate regulatory and policy measures are required to enhance access to trade finance.

Government Policy and Regulatory Response to COVID-19

In the tightening lending environment caused by the COVID-19 pandemic, private sector and trade practitioners are increasingly looking to governments to maintain open financing channels and ensure supply chains remain intact. Trade industry actors are looking for alternative (non-private) sources of short-term trade finance as well as official export credits for medium-to long-term projects. At the latest Business 20 (B20) meeting, members issued a Statement on Finance and Trade urging a global action plan to limit the impact of the virus on trade and the economy. The Statement set out a series of recommendations to support trade and trade finance, to ensure businesses have access to vital trade finance and can continue to export goods, and to bolster capacity to tackle the unfolding economic crisis.

One of the biggest announcements following the onset of the COVID-19 pandemic came from the Basel Committee on Banking Supervision (BCBS), which oversees the prudential regulation of the banking industry, setting out regulatory recommendations for governments and supranational institutions to implement, with the aim of ensuring the stability of the financial system. In March 2020, the BCBS announced the deferral of Basel III implementation, with the view to ensuring that banks will have additional resources to commit to mitigating the unprecedented impact of COVID-19 on businesses and the wider economy.

At the global level, the 37 member countries of the Organisation for Economic Co-operation and Development, along with their export credit agencies (ECAs) took a number of measures aimed at bridging financing gaps. They increased the capacity of ECAs for trade support, expanded working capital programmes, introduced new facilities to boost trade, and introduced more flexibility to the terms and conditions of official support, which appears to be most widespread across OECD countries. Even though many of the measures appear to focus on existing transactions, some are also directed towards new and potential transactions. Additionally, measures meant to increase the availability of working capital financing as a response to the observed shock in supply seem extremely popular among ECAs.

Across Africa, response has generally been a combination of fiscal and monetary policies accompanied by favourable prudential requirements designed to promote access to finance while ensuring financial sector stability. In the regulation and policy space, there has been a conscious adoption of loose monetary policy underpinned by reduction in bank and policy rates across the board to boost availability of liquidity within the financial system to support trade and economic activity. Some central banks introduced one-year extension of moratorium on facilities, while others in some jurisdictions established special funds in support of small and medium enterprises, healthcare and pharmaceutical industries and households.

In their role as regulatory institutions, central banks across the continent have been proactive in applying macro prudential policies and adopting flexible measures to allow for better crisis management, the survey found. Some macroprudential measures put in place include reductions in primary reserve requirements, extension of regulatory forbearance, capital conservation buffers, cash reserve ratios, and central bank rates. Commercial banks have also been granted some flexibility during the pandemic downturn in adherence to regulatory and compliance requirements of the central banks.

The central banks have extended deadlines for filing returns, reduced supervisory burden, and instituted regular virtual meetings to minimise face-to-face interaction during the crisis. Additionally, in some countries, commercial banks are required to perform quarterly operational assessment, as well as comply with IFRS 9 in the context of COVID-19 with the view to accounting for expected losses on the back of the pandemic. Other central banks recommended more flexibility in the application of Basel III standards for the banking industry to enhance capital conservation and liquidity buffers. All these measures have so far been very effective in helping banks carry on their daily operations, thereby potentially averting a banking crisis.

The survey also showed that central banks introduced countercyclical buffers and short-term lending facilities to address financing challenges emanating from the pandemic downtown. Some central banks, for example, revised the Interbank Foreign Exchange Market Rules aimed at supporting interbank trading in foreign exchange. This ensured market discipline and allowed for more measured adjustment to exchange rate fluctuations in this period of market stress. Measures were also introduced to foster price and exchange rate stability, including the adoption of transparent foreign exchange auction systems and strict adherence to monetary policy frameworks in place. Some central banks extended the deadline for commercial banks to meet new higher minimum capital requirements to afford them sufficient time to meet the new threshold without destabilising the sector.

Box 1: E-commerce and trade finance in the context of the AfCFTA

Modernisation and digitisation of the trade system calls for enhancing systems of electronic purchase orders in the supply chain and other trade processes, including freight forwarding, customs house brokerages, customs clearance, payment of duties and taxes, and compliance. This vision of a fully automated trade finance and settlement process supported by logistics has recently been brought forward within the context of the AfCFTA as a driver of increased levels of intra-African trade and deeper integration (ECA 2019). The need to promote the use of e-commerce in the context of the AfCFTA through the incorporation of an e-commerce protocol during the third phase of negotiations was agreed to by African Union (AU) member states during the 33rd AU Ordinary Session held in February 2020 in Ethiopia. The protocol will leverage the e-commerce industry on the continent, facilitating online business and trade transactions, reducing potential digital barriers, and promoting the interoperability of FinTech and technology systems at the national, regional, and global levels.

The already expanding mobile money technology across the region is being accelerated by COVID-19 and steadily shifting towards digitalisation. Even though the survey showed that several countries already employed mobile money in the digital space before the pandemic, central banks are taking advantage of the current environment to implement policies that promote a cashless approach to transactions as a preventive strategy to sustain the delivery of financial services without exposing potential clients to the risk of the COVID-19 virus. In some countries, fees were waived for smaller value transactions across the digital space. On average, the volume and size of digital transactions, especially mobile money, has increased substantially over the past few months. Central banks highlighted the importance of establishing a synchronised regulatory policy framework across Africa for digital financing, since without digital processes and documents, the ability to provide trade finance remains a challenge amid the restrictions to contact, travel, and shipping imposed to limit COVID-19 transmission.

The Increasing Relevance of Digitalisation

Even before the COVID-19 outbreak, digitalisation had emerged as the path to addressing the challenges of liquidity constraints associated with excessive reliance on US dollar for cross-border trade transactions in Africa. Afreximbank's Pan-African Payment and Settlement System (PAPSS) was developed in partnership with the African Union to take advantage of digital technologies to make it possible for African companies to clear and settle intra-African trade transactions in their local currencies. COVID-19 will accelerate the use of digital technologies in the financing of trade across the region and around the world.

Technology and digitisation could play a crucial part in addressing adverse unintended consequences of COVID-19 on trade finance. The use of technology and digitalisation accelerated and mainstreamed by COVID-19 could contribute significantly to achieving the right balance between efficacy and the capacity of banks to provide trade finance. The survey finds that the pandemic is steadily compelling banks to reconfigure their processes towards digitalisation to offer more services on digital platforms. This finding is in line with conclusions of a 2020 study by the International Chamber of Commerce which showed that more general use of online platforms and services for day-to-day tasks, combined with the relaxation of rules for original documentation by allowing the use scanned and other electronic documents, could enhance the delivery of trade finance products and services.

The push for increased digitalisation in the trade finance arena could alleviate some of the sector's regulatory concerns, help to increase efficiency, and decrease costs. For example, third party database platforms could be used to collect Know Your Customer information, helping banks better conduct due diligence activities and reduce costs. A typical illustration is the African Export-Import Bank's MANSA repository platform, which provides a single source of primary data required for the conduct of customer due diligence on African entities, financial institutions, corporations, and small and medium sized enterprises. This contributes significantly to reducing the high cost associated with undertaking customer due diligence activities. The platform also provides complementary collection of information on investment in Africa, country profiles, and traded products and services of African countries. It provides key insights into Africa and deepens positive perceptions of the continent with the view to altering the risk perceptions of Africa, ultimately promoting and increasing trade in Africa.

Banks and businesses across the continent also need to fully embrace evolving financial technologies, which can extend trade finance facilities (e.g. use of marketplace lending) to informal traders and other small businesses. This could also boost efficacy in the provision of trade finance. Online platforms, payment processors, and telecom companies could build upon existing business relationships and make use of their customer knowledge. The use of financial technologies in trade finance is still nascent but holds great potential to enhance the efficacy and capacity of trade finance providers to serve wider customer bases. For the technologies to realise their full potential, coherent and coordinated action, especially from the regulatory and policy angle, is required through broader stakeholder consultation.

Creating an environment conducive to the expansion of trade and trade finance in Africa requires broad cross-sectoral reforms across the continent. Reforms to the banking and financial services sectors, as well as to the regulatory environment, could contribute to strengthening existing infrastructure, including technical infrastructure such as internet connectivity. About 75 percent of Africa's people lack access to internet and thus access to critical and timely information, services, and knowledge. Promoting digitalisation will also complement the expansion of accessible internet connectivity to individuals and businesses across the continent. Achieving these goals will require substantial investment from both the private and the public sectors.

At the same time, local and regional banks across the region are entering into correspondent banking relationships to take advantage of growth opportunities created by the exodus from the continent of large international banks. But the trade finance needs are significant and continental, and Development Finance Institutions (DFIs) need to intervene by increasing their support to commercial banks engaged in trade finance activities. For instance, Afreximbank's correspondent banking and trade services, driven by the continent's trade finance gap, continue to grow in response to the reduction or withdrawal of trade finance lines by international banks. To deepen this function in response to the continent's deficit of trade finance, the Bank set up a unit, the Trade Services Unit, to design and introduce appropriate products in line with the Bank's mandate and positioning such products under the broad umbrella of the Afreximbank Trade Finance Facilitation Facility (AFTRAF). The overarching objective of the Bank's correspondent banking initiative is to enhance confidence of counterparties in the settlement of international trade transactions for extra and intra-African trade. The implementation of AFTRAF is carried out through five product lines: LC Confirmation with discounting and refinancing options; Bank to bank Irrevocable Reimbursement Undertaking (IRU); Promissory Notes and Bills of Exchange Aval; Bonds, Guarantees and Indemnities (BGI); and Trade Confirmation Guarantee. The deployment of these products to African financial institutions has contributed to increasing trade and corresponding banking services across the continent. About 130 African commercial banks in 34 member countries are currently part of the AFTRAF programme, with the goal to have 550 African commercial banks onboard by end of 2021.

Availability of data is key to establish an environment that favours positive linkages between trade finance and trade in Africa. As the survey results show, the primary reasons for bank rejection of trade finance applications in Africa during the period were insufficient collateral and client creditworthiness. Also needed are efforts to strengthen data systems within the continent, including from credit bureaus, company balance sheets, and electronic accounting systems. Data could be leveraged from alternative sources, such as mobile providers, social media, and behaviour patterns. With increased availability of data, trade finance providers will be able to make more precise risk assessments that eventually could lower interest rates and the cost of trade finance across the continent.

Chapter 6
Conclusions and Recommendations

The COVID-19 pandemic has set Africa on its first recession in 25 years and created an unprecedented challenge for trade and trade finance. The global health crisis has not only disrupted the flows of goods across supply chains, but it also has heightened balance of payment pressures and liquidity constraints in the region. A large-scale withdrawal of major international banks from correspondent banking relationships precipitated by the pandemic has exacerbated persistent large trade financing gaps in Africa.

This survey, which covers the first four months of 2020—including April, when global trade recorded its largest contraction on record—sheds light on the dynamics and challenges of trade finance in Africa in the wake of the COVID-19 crisis. The survey also aims to inform the design of interventions to address market challenges and to effectively engage African financial institutions, trade finance intermediaries, regulatory authorities, and national authorities, in order to accelerate efforts to bridge the region's trade finance gap.

Findings suggest that the various measures implemented to counter the spread of the pandemic (such as social distancing, lockdowns, and border closures) severely affected businesses and trade across the region, either directly or indirectly through financing and payment channels. Across Africa, several businesses and exporters have struggled to meet financial and commercial obligations and to remain viable in the face of falling global and domestic demand, delays in processing trade transactions, and heightening liquidity constraints. During the initial and highly disruptive phase of the crisis, banks encountered difficulties in submitting proper documentation (e.g., customs documents, invoices, and bills of lading) to support the processing of trade operations. Consistent with historical trends, in which businesses tend to shift back to trade on letters of credit (L/Cs) during crises, demands for L/Cs increased between January and April 2020, and so did the rejection of L/Cs.

Another challenge highlighted by the survey is the increasing rate of cancelations of correspondent banking relationships during the first four months of 2020, compared with the same period the previous year. The withdrawal of international banks from the correspondent banking relationship businesses was already a major problem across the continent. The pandemic downturn exacerbated the problem, with a growing number of international banks becoming even more reluctant to take on payment risks in countries where economic conditions were deteriorating. About 40 percent of the survey respondents attributed the sharp increase in the rejection of L/Cs requests to decreases in credit lines / limits from foreign correspondent banks.

Similarly, and consistent with global trends, the survey results show that African small and medium enterprises were particularly affected by limitations in the supply of trade finance. Higher rates of rejection of trade finance applications tend to be detrimental to small applicants and therefore unfavourable to these smaller businesses. Equally important, the survey results show that geography, as well as bank ownership structure and type, are important drivers of large variance in the rejection rates.

The pandemic also has widened trade imbalances and exacerbated foreign exchange liquidity shortages in

Africa. Foreign exchange illiquidity, in particular for US dollar-denominated supply, constitutes a major constraint for banks engaged in trade finance, with 59 percent of survey respondents identifying lack of access to foreign exchange as a reason for the increasing rate of declines of L/C applications. These COVID-19 challenges could reverse the previous trend of narrowing trade financing gaps across the region. Africa's trade financing gap had fallen to a (still prohibitively high) total of US$81 billion in 2019, down from US$91 billion in 2014.

The survey also highlighted the benefit of countercyclical support extended by development finance institutions (DFIs) in the midst of the COVID-19 crisis. Across the world, DFIs provided bold and swift responses to alleviate liquidity constraints and support trade. In Africa, the African Export-Import Bank (Afreximbank), African Development Bank, Eastern and Southern African Trade and Development Bank, and International Finance Corporation stepped up their support to attend to urgent trade financing needs and provided support for domestic and international banks to maintain their trade finance operations. Other key supportive measures were extended by these and other banks, including prudent loan restructuring where necessary to sectors or firms heavily affected by the crisis. Across the banking industry, restructuring took the form of renegotiated terms (maturity, interest rates, and fees), moratorium policies, or grace periods / payment deferrals.

In another trend, COVID-19 has accelerated the process of digitalisation, which is set to fundamentally transform the trade finance business across Africa and globally. Although evidence suggests that a growing number of African banks are adopting digital solutions to increase efficiency and reduce the costs of trade transactions, the digital infrastructure gap between Africa and other regions of the world could emerge as a major constraint within the continent. In this regard, there is a need for African banks and local regulators to collaborate in their effort to align with international best practices and regulations. Facilitating the adoption of digital or partially digital solutions recommended through the International Chamber of Commerce (ICC) Working Group on Digitalisation in Trade Finance could support and even boost trade financing across Africa. African regulatory authorities are expected to demonstrate greater flexibility and act as enablers by allowing digital approval and transmission of trade finance documentations. In the same vein, the adoption by African jurisdictions of the United Nations Commission on International Trade Law's Model Law on Electronic Transferable Records could be accelerated to provide a sound legal basis for the use of e-documents in trade finance transactions.

Furthermore, the negative impact of the COVID-19 pandemic on Africa's trade and the accompanying dearth of US dollar liquidity reinforce the urgency of taking bold initiatives to implement the African Continental Free Trade Area. The Afreximbank-led Pan-African Payment and Settlement System could emerge as the cornerstone of policy initiatives to alleviate the constraints associated with Africa's excessive reliance on hard currencies for cross-border trade and could eventually accelerate the growth of intra-African trade post-COVID-19.

The bold and swift measures taken by DFIs to sustain the financing of African trade should speed up the process of the region's economic recovery after the pandemic. But should the outbreak persist (in the form of second or repeated waves in the absence of effective treatment or vaccines as well as other challenges of accessing vaccines such as logistics, financial and supply-side issues) and result in a protracted economic recession, then the liquidity crisis could morph into a solvency crisis, with many borrowers across different sectors facing sharp collapses in their incomes, and hence difficulty in repaying their obligations as they come due. The priority for regulators should be to continue to strike the right balance between preserving financial stability, maintaining banking system soundness, and sustaining economic activity. In the meantime, national authorities, financial regulators, financial institutions, and DFIs should consider accelerating the deployment of supply chain finance programmes—with an emphasis on payables finance—that have the potential to unlock finance to small and medium enterprises.

At the same time, there is also an urgent call on central banks across Africa to enhance their coordination and collaboration towards a uniform regulatory framework, to address the challenges posed by the pandemic to economic activity, trade, and businesses.

Finally, central banks in collaboration with the national bankers' association should explore establishing a framework for a structured dialogue with leading confirming banks in Africa, in an attempt to provide an information platform that will keep the banks abreast of market conditions and policy developments and ensure that they maintain adequate engagement levels during and after the pandemic crisis.

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