Covid-19: ITFA members share impact on trade finance portfolios, By Shannon Manders, ITFA Consultant – June 2020

As the trade finance industry gets to grips with the effects of Covid-19, we asked a selection of ITFA members to share their experiences of how the pandemic is shaping the management of their portfolios, what their focus will be over the next few months, and what kind of opportunities – if any – they might be pursuing.

The Covid-19-driven combination of a drop in demand for a number of commodities, supply chains being thrown into disarray, and lockdown measures affecting economies on a global scale will have a short and medium-term impact on the performance of many companies around the world. As such, it's no surprise that ITFA members on the whole are reporting an increased focus on managing risk and close monitoring of the situation as they await the full repercussions of the pandemic, which has yet to reach its peak in many countries.

Moreover, while most members note that switching to a working-from-home environment has been largely successful, in some cases it has required careful management of the operational risk where the existing processes could no longer be followed. Examples of this include finding new ways of executing documentation where a wet ink signature couldn't be applied, or where original documents couldn't be couriered within the usual timeframes. Some have also noticed that it is taking more time for transactions to materialise as remote working has not been as easy for all counterparts' decision-making processes.

Nevertheless, "it is still a business-as-usual approach on the whole", explains a London-based trade financier at a large global bank, who adds that the pick-up of business will largely be driven by the reopening of some countries ahead of others. "It is too early to tell if there will be any new opportunities as such, rather than a shift in the patterns. In many cases a decline in one sector will be compensated by a move, either temporarily or permanently, to another – pharmaceutical and PPE goods being very much in demand at present, for example."

Elsewhere, in the credit asset management space, the Channel Capital Advisors (CCA) team also notes that some clients have gained from the impact of the Covid-19 outbreak, whilst others have suffered a slowdown in their business. "In the former category, we have clients operating in the IT sector who are seeing an increase in turnover, whereas the latter category consists of, for example, metals and minerals traders who are experiencing what we believe is a short-term decline in revenue," they say.

In terms of investor relations, CCA says that they have witnessed a "heightened level of alarm" among investors, not helped by the collapse of companies such as Agritrade, Hin Leong and Phoenix Commodities. "Additional time and effort is therefore being expended on keeping the investors appraised of market developments."

A representative from a large global bank agrees that the oil and gas commodity traders are under "particular close scrutiny at present".

Because of the much-documented liquidity squeeze in the market, the team at investment advisor Africa Trade Finance reports that lenders are being more careful about choosing the opportunities that they wish to pursue. "Lenders are also expecting much higher yields for the risks they are taking. This is pushing prices higher at the expense of borrowers, who need more funding than ever to continue supporting their trade finance flows. With the situation and oil price trends changing from a week to another, there is clearly very high volatility. We are trying to adapt by bringing more flexibility in fixing pricing," they say.

Whereas prior to Covid-19, Africa Trade Finance was exploring and growing into new markets, it says it now has to adopt a wait-and-see approach with regards to new clients and markets, and that, going forward, a diversification of its client/market portfolio will be key.

Feedback from the insurance market also highlights a more selective approach to all risks – not just trade finance – with additional scrutiny being applied to all transactions, both new and pipeline.

Nevertheless, one major insurer reports that it remains open to opportunities, and that it is able to be “more entrepreneurial” with transactions with a trade focus. “The credit rating of the obligor has become more important than ever as we are looking at opportunities both from a relationship perspective but also with a strong transactional focus, whereby it is harder to subsidise a poor-returning transaction,” they say.

The same underwriter notes that from a portfolio view, the volume of requests received has remained constant to date, although it does expect an uptick in the next couple of months, mainly because it feels its clients are now moving into the next phase of securing the balance sheet, with the more capital-intensive transactions resolved. “Intriguingly, there has been a marked improvement in the credit quality of the risks we have been asked to support, with our clients evidencing the flight to quality which has been commentated on,” they say.

As the market copes with the pandemic, a dichotomy is emerging for the credit insurance industry. Much of global trade involves the import of goods and services by companies typically rated more poorly than their counterparties. As Covid-19 compresses sovereign credit ratings, and by extension those of the banks and corporates in those jurisdictions, surplus appetite for those obligors is eroded by limit caps driven by ratings. “In many cases, this leaves us over our appetite for the sovereign and thus struggling to support key clients,” says one underwriter. “While this paradigm may be the ‘new normal’, it is something we have not yet resolved and will be key in enabling us to manage our trade finance portfolio.”

Two ITFA members, LFC and Barclays, have shared comprehensive feedback on their current trade finance operations. These are their stories.

Simon Lay, London Forfaiting Company (LFC)

“LFC implemented its business continuity policy even before the formal lockdown was declared in March and staff began to work from home. We then focussed on intensive and continuous monitoring of our book and evaluating the impact of Covid-19 on our clients’ business models. We maintained regular dialogue with exporters, borrowers, rating agencies, and a wide range of market participants, using standard and alternative channels of information in order to adequately assess the risk positions and make appropriate strategic decisions to protect the performance of our book.

Whilst wholesale capital flight from both emerging and developed markets in the early stage of the crisis had an impact on some of our asset values in March, these recovered quickly in subsequent months as the market started to differentiate the relative risk values and to identify those transactions and borrowers which could withstand the negative fallout from Covid and would recover quickly once it was over.

During this time, we sold some assets in order to better balance our overall portfolio. However, these were relatively few and mainly we saw this as an opportunity to buy assets in new markets where pricing had increased from levels previously unattractive to us. Consequently, we were able to capitalise on the lack of secondary appetite for assets during this period.

Rather than stopping business, LFC was able to continue to selectively pursue new transactions and support longstanding customers, albeit with a more selective approach. We focussed on 'defensive' industries and regions, less affected by – or even benefitting from – the current turmoil. Examples were in the food, technology, healthcare and medical sectors or with exporters with access to multiple markets, who could switch their sales rapidly into safer markets. For example, textile exporters in Bangladesh initially suffered from the cancellation of retailers' orders from RMGs. However, some factories then switched to production of masks and PPE.

During this period, we observed a marked slowdown in secondary market activity and pricing levels, although higher, have been slow to reflect the increased risk levels from this crisis. Surprisingly, we did not observe many forced or distressed sellers, perhaps due to the expectation of a short-lived crisis or due to relationship factors. Of course, some sectors like football financing, oil-related risk countries and sectors reliant upon exports to the retail sector became much more difficult to finance, but we found other opportunities to ensure the portfolio was well balanced

We will continue our current strategy of slower but steady and measured growth until a clearer picture of the full effects of Covid-19 can be better evaluated in the regions where LFC has been most active, for example Africa, Latin America and Turkey. The crisis has underlined the vulnerabilities of economies which are insufficiently diversified and excessively dependent on single commodities, such as crude oil, and now face a much more challenging recovery. The significance of tourism to many countries has also been made starkly clear.

This period and our willingness to continue to book transactions has allowed LFC to re-enforce existing relationships, re-activate old ones and diversify our book into new geographies again. In addition, we have re-evaluated our working practices and tested our risk framework. Therefore, despite the challenges I would say we have taken positive learnings from this experience which will help us face new challenges in the future and to better appreciate some of the values we previously took for granted in life and in business!"

Karl Page, Barclays

"The challenges presented by Covid-19 to the servicing and financing of global trade have been extremely varied in their nature, and some were unprecedented in the industry.

Considering first the broader issues for our business, of course there has been a significant slowdown of underlying trade activity for the majority of our clients during the pandemic. However, this has been counter-balanced by the fact that our clients have needed us more; we have seen increased demand for more flexible financial solutions during these challenging times.

The key concern of Barclays has been that of access, especially for our smaller, more vulnerable clients. We have worked hard to ensure that clients can continue to access bank facilities, products and solutions where traditional channels have been disrupted.

Even in 'ordinary' times, the traditional manual, paper-based nature of trade finance has provided opportunities to fraudsters, but the Covid-19 situation has unfortunately increased those opportunities. Barclays has dedicated attention to designing a number of workarounds to support clients and counterparties working remotely. This involves solutions such as electronic signatures, electronic presentation of documents and claims, and physical delivery of documents to alternate locations.

Although technology is set to change the way trade finance operates, trade today is still heavily reliant on the manual processing of paper documents. What now, in some cases, seem to be quite antiquated ways of operating have been disrupted virtually overnight, and this disruption brings with it new logistical, operational and legal challenges.

The majority of Barclays' trade finance operational resource is located in India, and the business was able to successfully transition many hundreds of people from the office to working from home. The fact that we have been able to manage this disruption and control the risks, in the context of this massive transition, is something we are very proud of.

Examples of the types of challenges we have experienced are the physical delivery of documents into countries with strict lockdown measures, and the return of original documents before cancellation of guarantees can be confirmed. Also, the requirement for wet signing of certain documents, in particular negotiable instruments such as bills of exchange and promissory notes, has presented difficult challenges.

We have implemented various measures to help solve these problems, including asking clients to consider amending LCs to allow for email presentation of documents, permitting clients to use digital signatures when applying for trade products and also facilitating the acceptance of LC confirmation/discounting requests from both clients and non-clients where wet signatures have not been possible. Where wet signatures have been critical, we have adopted external digital signing solutions.

In summary, our experience at Barclays during this difficult period has been challenging but rewarding. We have been amazed to witness the speed at which new technology and processes have been adopted by the banks and clients around the world. We envisage this acceleration of digital solutions will provide a timely boost to the industry, and it has certainly provided impetus to the digital re-platforming of our trade business which is taking place this year. In addition to that, this period of closer, more in-depth engagement with our clients has given us new insights and perspectives, and our prime focus going forward will be how we support the future client needs that have emerged over the last few months."