SETTLEMENT OF TRADE TRANSACTIONS THROUGH PAPSS IN NIGERIA:

USE OF FOREIGN EXCHANGE PROVIDED BY THE CBN AND RELATED MATTERS

Introduction

By way of background, the Central Bank of Nigeria ("CBN") issued a guideline titled "Guidelines on the Operations of Pan-African Payments and Settlement System (PAPSS) in Nigeria" on 11th October, 2021 (the "Guidelines") for the settlement of intra-African trading transactions. The objectives of the Pan-African Payments and Settlement System (the "PAPSS") are, among other things, to facilitate the implementation of the African Continental Free Trade Agreement ("AfCFTA"), boost cross-border transactions across Africa and facilitate payments for such transactions. The PAPSS was introduced by the African Export-Import Bank ("AFREXIM") in partnership with the West African Monetary Institute to support the initiation of cross-border payments in local currencies between senders and beneficiaries initially within West Africa.

To provide clarification on how the features of the PAPSS will be implemented in Nigeria, the CBN issued a Circular titled "Re: Introduction of the Pan African Payments and Settlement System (PAPSS)" on 25th July, 2023 (the "Circular") to provide additional clarifications on the application of the Guidelines and settlement of PAPSS transactions using FOREX to be provided by the CBN.

We have examined in this regulatory update the clarifications provided by the CBN in the Circular and their impact on the settlement of PAPSS-settled trade transactions.

Features of the PAPSS

Some of the key features of the PAPSS, as set out in the Guidelines, include the following:

(a)   supporting cross-border payments in the local currency of the customer in the sending country, and receipt in the local currency of the beneficiary country;

(b)   inter-bank settlement of transactions will be in United States Dollars ("USD") based on a multilateral netting arrangement;

(c)   the inter-bank net settlement would be based on pre-funding by participating financial institutions, through the domestic Real Time Gross Settlement System;

(d)   AFREXIM will be the settlement agent, and each central bank will maintain a settlement account with AFREXIM to settle eligible transactions from its country on a net basis;

(e)   each central bank is to determine the eligible transactions for which foreign exchange ("FOREX") will be provided; and

(f)   participating commercial banks may also operate a USD settlement account with AFREXIM to settle obligations for payments in respect of ineligible transactions, for which, in the case of Nigeria, the CBN will not provide FOREX.

Overview of the Circular and Comments

Pursuant to the provisions of the Circular, the CBN stated that the following conditions shall apply to PAPSS transactions to be settled using FOREX to be provided by the CBN:

(a)   All eligible PAPSS transactions shall remain trade-backed. This means services cannot be settled through the PAPSS. The trade transactions are also to be goods of African origin. Only eligible transactions can be settled through PAPSS.

(b)   The eligible payment mode shall be bills for collection. This means that the PAPSS can only be used to settle trade transactions with instalment payment terms. It cannot be used for trade transactions backed by letters of credit.

(c)   The limit per customer shall be USD 20,000.00 per quarter. Multiple applications through authorised dealers are not allowed. This does not restrict Nigerian banks from using USD sourced from other sources to settle transactions through PAPSS on behalf of a customer.

(d)   The limit per authorised dealer shall be USD200,000.00 per quarter. This is the aggregate USD which the CBN will provide to each authorised dealer to settle PAPSS transactions for their customers on a quarterly basis. Authorised dealers are free to use USD from other sources to settle PAPSS transactions.

(e)   For the settlement of PAPSS transactions by CBN, authorised dealers shall obtain the approval of CBN for USD cover before initiating payments on PAPSS.
The CBN further stated in the Circular that authorised dealers are allowed to maintain a USD settlement account with the PAPSS settlement bank to settle PAPSS transactions. Authorised dealers can use their independently sourced USD to settle such PAPSS transactions. The CBN will not provide FOREX to settle such transactions.

Importance of the Circular

The Circular provides much-needed clarity for authorised dealers and entities engaged in intra-African trades who want to use PAPSS for the settlement of such trades.

The CBN has made it clear that bills for collection will be the only acceptable method of payment for PAPSS transactions. The implication of this is that PAPSS is only for intra-African trades that are to be settled on an instalment basis. It does not include trades that are backed by other means, such as letters of credit-backed transactions.

Notwithstanding, any other lawful trades that are not eligible for settlement through the PAPSS will still be validly consummated and settled through other existing traditional means of settlement, including with FOREX purchased in the Investors & Exporters Window (subject to providing the appropriate prescribed documentation under the CBN Foreign Exchange Manual 2018 (as amended)). The prescribed documents are required to be provided before trades are initiated on the PAPSS.

Furthermore, the additional clarification provided by the CBN serves to establish clear guidelines and controls for the use of PAPSS and CBN-provided USD.

Key Points to Note on PAPSS-settled Transactions in Nigeria

Based on a combined reading of the Guidelines and the Circular, the key points that participants should note are as follows:

(a)   **Trade Backing:** By emphasizing that PAPSS transactions remain trade-backed and are eligible transactions, the CBN aims to ensure that the transactions conducted through PAPSS are legitimate and relate to genuine intra-African trade activities backed by bills for collection. This helps prevent misuse of the system for non-trade-related purposes or for ineligible transactions, which could defeat the essence of the PAPSS initiative.

(b)   **Applicable Exchange Rate:** The prevailing exchange rate at the Investors and Exporters Window as published by FMDQ shall be used in cross rates conversion between USD, Naira, and third currencies within Africa for inbound and outbound payments. No other exchange rate is permitted.

(c)   **Payment Mode:** The designation of bills for collection as the eligible payment mode would ensure a standardised method for settling PAPSS transactions for traders who wish to use the PAPSS to settle eligible intra-African trades.

(d)   **Transaction Limits:** Setting limits on the amounts per customer and per authorised dealer helps manage and control CBN FX liquidity and reduces the risk of misuse. The limits are, however, insufficient to cover large volumes of trade within Africa.

(e)   **Preventing Multiple Applications:** Prohibiting multiple applications through authorised dealers would ensure fair and equitable access to the PAPSS system by eligible traders and FX from CBN. This would help prevent any abuse of the system.

(f)   **Approval for USD Cover:** Requiring authorised dealers to obtain CBN approval for USD cover before initiating payments on PAPSS would help to ensure adequate FOREX reserves to support the settlement of PAPSS transactions. This would prevent the execution of transactions in PAPSS when there may be inadequate FOREX to settle such transactions.

(g)   **USD Settlement Account by Authorised Dealers:** Allowing authorised dealers to maintain a USD settlement account with the PAPSS settlement bank means that authorised dealers are allowed to use FOREX from independent sources to settle intra-African trades without the backing of CBN. This would help ensure that, in addition to the CBN, there is a diversified source of FOREX to settle PAPSS transactions.

(h)   **Export Proceeds:** The exported proceeds repatriated to the CBN under PAPSS are subject to certification by the processing bank as being repatriated by the exporter. All existing rules and regulations applicable in the official FOREX market shall continue to apply.

Conclusion

The clarifications provided by CBN in the Circular are laudable as they are aimed at enhancing transparency, promoting the efficient use of PAPSS for intra-African trade transactions backed by bills for collection, managing CBN FOREX reserves efficiently, and preventing potential misuse of PAPSS. By establishing clear guidelines and controls, the CBN seeks to foster confidence in the PAPSS initiative and support sustainable economic growth within Nigeria and the broader African continent. This will potentially drive the ease of intra-African trades and settlement for such trades and promote the objectives of the AfCFTA.

The limits for both customers and authorised dealers are, in our view, quite low and not sufficient to cover a wide range of transactions and deepen intra-African trades. We hope that, depending on how the adoption of PAPSS is progressing, the CBN may have cause to reassess the current limits in the future and hopefully increase both to higher numbers.

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