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GHANA RESEARCH NOTE

The Ghana Amalgamated Trust - a flawed strategy[1]

*The Government's plan to recapitalize five local banks is **deeply flawed**. Proceeding with its implementation **will almost certainly saddle the exchequer with significant unbudgeted costs** [2].*

■ Background

When the majority of Ghana's indigenous banks failed to meet the new minimum capital standards that took effect in December 2018, **the authorities decided to inject a cumulative GHS 1.992 billion into five such lenders** that were deemed solvent but under-capitalized.

The recapitalization is to be **financed through the Ghana Amalgamated Trust (GAT)**, a special-purpose vehicle, that will issue a 5-year zero-coupon bond backed by a sovereign guarantee. The issuance proceeds will be injected into the five banks in consideration for a corresponding equity stake. At or before the bond's maturity, the relevant shares will be liquidated and the proceeds used to redeem the instrument.

■ Hardly a private-sector solution

The authorities have presented the Ghana Amalgamated Trust solution as **'a private-sector approach'** to recapitalizing the five banks. However, this assertion is belied by the Trust's ownership structure that lists as shareholders:

- Social Security & National Insurance Trust (SSNIT) – 43.48%;
- State Insurance Company (SIC) – 19.70%;
- National Investment Bank (NIB) – 19.70%;
- AccreCon Consulting – 12.39%;
- National Trust Holding Company (NTHC) – 4.73%

To all intents and purposes, the **GAT special purpose vehicle is a state-owned enterprise -** with no assets.

■ Conflicts of interest

It is clear from the remarks made by the Finance minister[3] that Ghana's **pension funds are expected to subscribe for the lion's share**[4] of the GAT bond. As the country's largest pensions administrator, the Social Security & National Insurance Trust will almost certainly be called upon to purchase a correspondingly significant portion of the total issue. However, as GAT's largest shareholder, **SSNIT would then find itself on both sides of the prospective transaction**, a clear conflict of interest.

Another conflict worth flagging is the fact that **the largest intended beneficiary of the recapitalization exercise holds an interest of approximately 20% in GAT**: the National Investment Bank.

[*] This report is an update of an initial note published on Mar. 15, under the heading *"A problematical transaction"* and incorporates information contained in *"GAT Bonds – raising GHC 2 billion to recapitalize Ghana's indigenous banks"*, the marketing brochure produced by transaction advisor, Algebra Securities Ltd.

[2] I.e. on top of the GHC10 billion cost of resolving 7 failed banks in 2017/18.

[3] See *"Pension funds investors to reap from GAT – Ofori-Atta "*, posted by Haotags on Mar. 15, 2019.

[4] A number of pension administrators have objected to being dragooned in this manner. See *"Pension funds for GAT took us by storm – Trustees"*, posted by 3news.com; Jan. 26, 2019.

Uncertain exit

Per the relevant marketing literature[5], two exit options will be available to the Trust. In the base case, it is expected to **liquidate its shares in the recapitalized banks** in five years' time and use the proceeds to redeem the maturing bonds. However, this 'strategy' rests on the premise that, during the intervening period, each of the five banks will have experienced **a sufficiently dramatic turn-around to boost its valuation by a multiple of 2.714x**[6].

For the troubled lenders in question, operating in an increasingly competitive environment, this is **a highly questionable assumption**[7]. Should it fail to materialize, GAT will be forced to invoke the sovereign guarantee, **making the Ghanaian taxpayer responsible for paying off the bonds**.

A less-than-compelling proposition for investors

The finance minister has assured Parliament that pension funds subscribing to the GAT bonds stand to realize very attractive returns. However, **no responsible fiduciary would ever consider making such an investment** - unless subjected to extreme moral suasion.

- ### Inadequate credit protection

The sovereign guarantee that Parliament has authorized in favour of the Ghana Amalgamated Trust is in an amount of **"up to GHC 2 billion"**. Although identical to the bond's prospective issuance proceeds, **this is nowhere close to the amount required to cover the GAT bonds.**

Table 1: GAT bond valuation

Parameter	Tranche 1	Tranche 2	Total
Coupon	0.00%	0.00%	
Maturity (yrs)	5	5	
Yield	21.00%	21.00%	
Issuance proceeds	1,247,000,000	744,000,000	1,991,000,000
Face value	3,384,458,816	2,019,276,150	5,403,734,966
Relative size	62.632%	37.368%	100%

Source:
Algebra Securities
Rhombus Advisors

The GAT bond is to be sold in **two separate tranches** comprising, respectively, 62.63% and 37.37% of the total issue:

- GHC 1,247 million to recapitalize NIB, deemed so troubled as to require 100% coverage;
- GHC 744 million to recapitalize four institutions[8] seen as requiring only 70% coverage.

In actual fact, the size of **the sovereign guarantee required is GHC 4,798 billion** – approximately 2.40x the amount authorized by Parliament.

As can be seen in Table 2, each bond tranche will entail an enormous degree of **unmitigated credit exposure**[9] **to what is essentially a shell company**. Such a grave deficiency is unlikely to escape even the most cursory due diligence by prospective investors.

[5] See *"GAT Bonds – raising GHC 2 billion to recapitalize Ghana's indigenous banks"*, op. cit. p.13.
[6] Reflecting the cumulative accretion of the zero-coupon bond after five years, i.e. $[1+.105]^{(2x5)}$.
[7] Even less plausibly, the alternative exit is via an early redemption option, exercisable at GAT's election, after three years.
[8] I.e. Agricultural Development Bank (GHC 127 mm); Prudential Bank (GHC 250 mm); Omni BSIC Bank (GHC 120 mm); and Universal Merchant Bank (GHC 247 mm). Source "GAT Bonds ...", op. cit, p. 4.
[9] I.e. 58% and 71% for Tranches 1 and 2, respectively.

Table 2: Analysis of sovereign guarantee

Parameter	Tranche 1	Tranche 2	
Portion covered	100%	70%	Total
Eligible principal[1]	3,384,458,816	1,413,493,305	4,797,952,121
Guarantee approved	2,000,000,000		Total
Principal covered[2]	1,410,793,076	589,206,924	2,000,000,000
Coverage shortfall (1-2)	1,973,665,740	824,286,381	2,797,952,121
Residual exposure	58.316%	70.821%	51.778%

Source: Algebra Securities, Rhombus Advisors.

Relative value

The 21% p.a. yield that the GAT bond offers is **totally inadequate, from a relative-value perspective**. Backed by the full faith and credit of the Republic, the Treasury's most recent **2-year bond was issued[10] at a yield of 19.75%**. At only 125 b.p. less than the return offered on GAT's partially guaranteed bond, it is clearly the more attractive investment.

In addition, the zero-coupon instrument is **approximately 2.8x more susceptible to interest-rate risk** than the GoG 'alternative'[11]. In the event of an upward shift of 100 b.p. across the GHC yield curve, holders of the GAT bond would experience **a mark-to-market loss of 4.41%, versus a hit of only 1.57%** for holders of the Treasury bond.

■ Conclusion: back to the drawing board

In view of its numerous deficiencies[12], **the GAT bond will struggle to attract investor interest**. However, all indications are that pension fund administrators are already having their arms twisted by the Finance minister. The catch is that **the authorities will then be morally obliged to make these hapless creditors whole**, when the Trust proves incapable of redeeming its maturing bond.

This will have the effect of **transferring on to the fiscus the costs of the recapitalization exercise** ... that the SPV mechanism was specifically designed to keep off-balance sheet. In other words, it is clearly **time to return to the drawing board**.

[10] This is because the 5-year zero has a Macaulay duration (the conventional measure of interest-rate sensitivity) of 5.00, whereas the 2-year Treasury bond weighs in at only 1.75.
[11] See Results of Tender 1623, conducted on Mar. 8, 2019.
[12] It is worth noting that the GAT bond will enjoy far less liquidity than the Treasury's benchmark issues and so should offer a yield premium of 75-100 b.p. for this deficiency alone.