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GHANA RESEARCH NOTE [REV]

The bank recapitalization exercise - a problematic enterprise

The pending recapitalization of five Ghanaian banks is ***fraught with commercial and fiscal risk****.*

1) 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 1.92 billion into five such lenders** that were deemed solvent but under-capitalized.

2) The *de facto* **bail-out is to be financed through the Ghana Amalgamated Trust** (GAT), a special-purpose entity, that will issue a 5-year bond[1] 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.

3) Now that the Administration has formally requested Parliament's approval[2] to issue the relevant sovereign guarantee, the Opposition has raised a number of cogent objections[3]. And there are a few **additional issues that could compromise the planned transaction**.

4) The **redemption value** of a 5-year zero-coupon bond, that generates initial cash proceeds of GHC 1.92 billion and yields 21% p.a., **is GHC 5.211 billion**. It is to be hoped that this is the issue size that GAT has started pre-marketing – and not the much touted figure of GHS 2 billion[4].

The same problem arises in relation to the sovereign guarantee, but with a slight twist[5].

GAT bond valuation

Parameter	Tranche 1	Tranche 2	Total
Coupon	0.00%	0.00%	
Maturity (yrs)	5	5	
Yield	21.00%	21.00%	
Nominal value	3,094,052,165	2,116,983,060	5,211,035,225
Relative size	59.375%	40.625%	100.000%
Issue Px	1,140,000,000	780,000,000	1,920,000,000

5) The **GAT bond is actually to be sold in two separate tranches** comprising, respectively, 40.625% and 59.375% of the total issue:

- **GHC 780 million** to recapitalize four institutions deemed sufficiently solid[6] to warrant only **70% coverage**.
- **GHC 1.14 billion** to recapitalize NIB, which is deemed so troubled as to require **100% coverage**.

This means that the **total guarantee amount required is actually GHC 4.576 billion**[7], as demonstrated in the table overleaf.

[1] To minmize the debt-service burden over the life of the instrument, a zero-coupon structure was selected.
[2] See Order Paper for the 21st sitting of the first meeting of Parliament; Feb. 5, 2019 - page 3.
[3] E.g. The Trust's stated holders of the share-holders appear to be state-owned entities like the Social Security and National Investment Trust (SSNIT).
[4] Since this would only generate total cash proceeds of GHC 736.9 million.
[5] Given nominal issue amount of GHC 5.211 billion, the corresponding guarantee would need to be in the same amount - if the entire GAT issue were covered 100%.
[6] I.e Agricultural Development Bank, Prudential Bank, Omni BSIC bank and Universal Merchant Bank.
[7] I.e. [(0.40625 x 70%) + (0.59375 x 100%)] x GHC 5,211,035,225

6) However, a review of last week's parliamentary proceedings indicates that the request from the finance minister is for approval to issue *"a sovereign guarantee of up to GHC 2 billion in favour of the Ghana Amalgamated Trust"*.

This means that the GAT bond now being marketed on the basis of said guarantee will entail **a high degree of unmitigated exposure** to the credit risk of this special purpose entity. In fact, **the guarantee requested will cover less than half of the GAT bond**, as illustrated alongside.

Logically, **there should be no takers** for such an instrument – unless the authorities bring considerable moral suasion to bear on the pension funds.

Analysis of sovereign guarantee

Portion covered	100%	70%	Total
Eligible principal[1]	3,094,052,165	1,481,888,142	4,575,940,307
Pro rata	67.616%	32.384%	100.00%
Guarantee request	2,000,000,000		Total
Principal covered[2]	1,352,313,167	647,686,833	2,000,000,000
Coverage shortfall (1-2)	1,741,738,998	834,201,310	2,575,940,307
Residual credit exposure	56.293%	69.405%	49.432%

7) The recapitalization exercise also entails considerable fiscal risk. This is because the **Government's intended exit from the GAT transaction is by liquidating the shares acquired** in the beneficiary banks as consideration for the respective bail-out.

But this 'strategy' is entirely dependent on a dramatic turn-around in the fortunes of each of the five marginal lenders – in what is likely to prove an increasingly hostile operating environment. Should a bid for the relevant shares[8] fail to materialize, **Ghana's tax-payers will be saddled with the burden of redeeming the GAT bond**.

[8] I.e. at a price that covers the accreted value of the zero-coupon bond.