CLEARY GOTTLIEB

Ghana Guaranteed Bond Restructuring Risks May Undermine Appeal of Credit Enhancement Mechanism

Credit enhancements have been an effective way of attracting much-needed private capital to countries that might otherwise struggle to access markets.

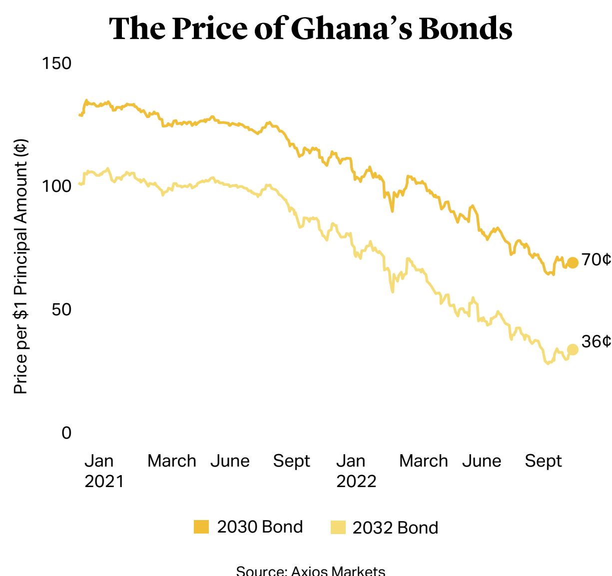
Via a guarantee, insurance, first loss facility or other mechanism whereby risk is assumed by the official sector, distressed borrowers have been able to increase their creditworthiness, lower borrowing costs or access funding they would otherwise not have access to.

These mechanisms include political risk guarantees, partial credit guarantees, partial risk guarantees, project-based guarantees, policy-based guarantees, first-loss provisions, contingent loans and viability gap funding. Each has its own pros and cons and the suitability of any one mechanism will depend on the particular circumstances of the relevant borrower.

Ghana's Bond Restructuring

However, the value of such arrangements to private investors has recently been called into question. In May 2022, investors appeared convinced that Ghana's 2030 Eurobond would be spared in any potential restructuring event as the economic fallout from COVID-19 became clear.

The bond, partially guaranteed by the World Bank, was trading close to par, compared with discounts to par of 40% and 60% respectively for two Ghanaian Eurobonds bonds due in 2029 and 2032.

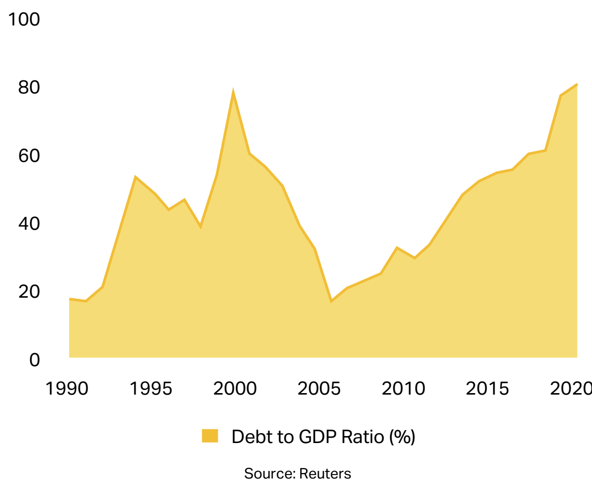


By the end of the year, investor faith in the guarantee – which protects $400mn of the $1bn bond's principal – was waning, with the 2030 issue trading at a 30% discount, while the two non-guaranteed bonds were changing hands for a discount of 70% and 80%, respectively.

More optimistic investors pointed to the experience of Ecuador, which excluded a bond partially guaranteed by the Inter-American Development Bank during its 2020 restructuring.

IN APRIL 2023, INVESTOR FEARS WERE REALIZED WHEN GHANA CONFIRMED THAT IT WOULD INCLUDE THE 2030 BOND IN ITS FORTHCOMING RESTRUCTURING

However, in April 2023, investor fears were realized when Ghana confirmed that it would include the 2030 bond in its forthcoming restructuring. A missed a coupon payment on the note on April 14 triggered an initial $50mn payout from the World Bank on April 20, partially cashing out some of the investors.



Partial Guarantees: Unlocking Capital and Lowering Costs

There are several good reasons for thinking that providing partial guarantees to emerging market issuers from AAA-rated multilateral lenders is a good idea.

Lower borrowing costs is one such reason. When Ghana's 2030 bond was issued in 2015, a report from investment bank Rothschild & Co. said that the pricing benefit to Ghana had been somewhere around 150-200 basis points[1]. Another reason is being able to access the international capital markets at all. In Ghana's case, beyond pricing, the most important benefit was being able to borrow at a time when it would otherwise have been shut out of international capital markets.

150-200 Basis Points

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Data from six policy-based guarantees (PBGs) since 2011 and reviewed by the World Bank's Independent Evaluation Group (IEG) suggest that because of the guarantee element, they tend to mobilize more capital compared to development policy loans (DPLs)[2]. However, they have only been used by the World Bank a handful of times and sparingly by other multilateral lenders.

Some of that reticence can be attributed to the World Bank's experience with its first PBG, used by Argentina in 1999 to raise $1.5bn through a series of six $250mn zero-coupon bonds maturing from 2000 to 2004.

SEVERAL BALKAN NATIONS, INCLUDING SERBIA, MONTENEGRO, AND NORTH MACEDONIA, FOUND THEMSELVES UNABLE TO ACCESS CAPITAL MARKETS AND USED WORLD BANK PBGS TO BORROW BETWEEN 2011 AND 2013

[1] https://documents1.worldbank.org/curated/en/293331492579395041/pdf/114407-WP-PUBLIC-Rothschild-report.pdf

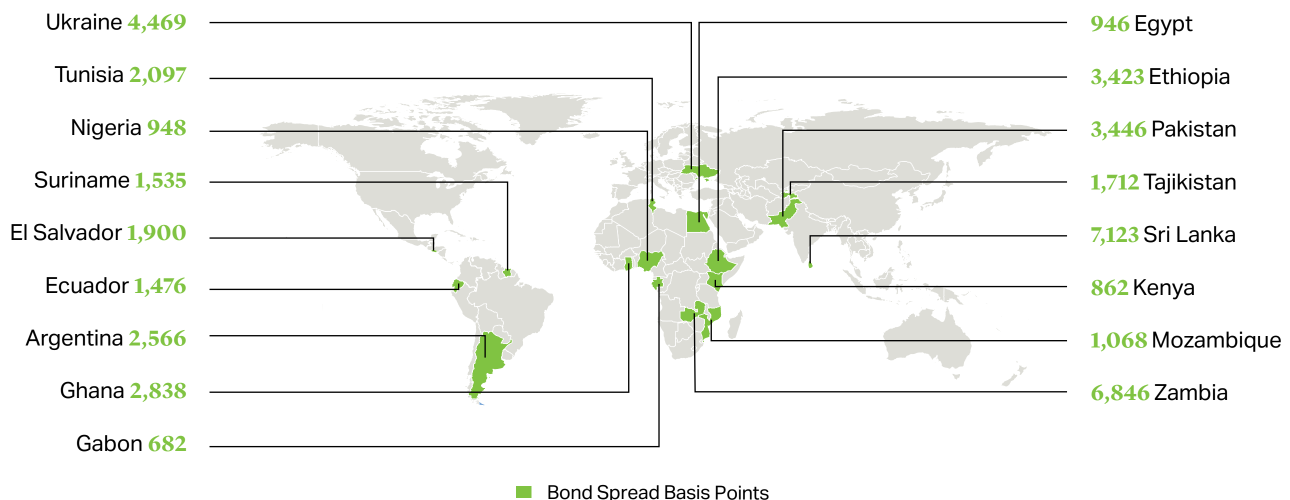
[2] https://ieg.worldbankgroup.org/sites/default/files/Data/reports/lp_policy_based_guarantees_102116.pdf

Argentina defaulted on its bonds in October 2002, triggering a $200mn pay-out by the World Bank. However, Argentina then failed to reimburse the World Bank within the 60 days that would have allowed the guarantee to be reinstated for the next bond in the series. Investors were left exposed on the remainder of the bonds, and the markets responded by selling off a similar bond issued by Colombia in 2001 with a World Bank PBG. It would take almost another decade before the World Bank would again provide a similar sovereign guarantee.

In the wake of the global financial crisis of 2008 and tighter capital requirements under Basel III, several Balkan nations, including Serbia, Montenegro, and North Macedonia, found themselves unable to access capital markets and used World Bank PBGs to borrow between 2011 and 2013. Albania, Angola, and Ghana also tapped the World Bank for PBGs in 2015, followed by Pakistan in 2016.

While investors in the Balkan PBG bonds did not face the same fate as those who had advanced money to Argentina, a review by the IEG rated only one of the four as "Satisfactory", with two rated "Moderately Satisfactory" and one "Moderately Unsatisfactory"[3].

Developing Nation Bond Spreads Topped 1000 Basis Points in 2022



Source: Reuters

Implications for Future Credit Enhancements

There are a number of other factors staying the hand of the World Bank as it considers whether to use PBGs more widely, including a deeply held belief that such mechanisms are not needed by sovereign borrowers except in the case of certain countries that are otherwise unable to access international capital markets. Even then, some public officials believe it is easier for the official sector to lend directly as opposed to providing credit enhancements to the market.

There are also concerns that it is too difficult to establish criteria for such credit enhancements that can be fairly applied across countries, and that if PBGs are used too liberally, they would weigh on the credit ratings of the multilateral development institutions or other IFIs that provide them.

The decision by Ghana to include[4] its World Bank's guaranteed bond in its restructuring also raises the question of whether the market will value the credit support embedded in these instruments sufficiently to lower the cost of capital that these sorts of instruments are intended to achieve.

[3] https://ieg.worldbankgroup.org/sites/default/files/Data/reports/lp_policy_based_guarantees_102116.pdf

[4] Ghana's 2030 bond contains a collective action clause (CAC) that says it can be aggregated with other bonds during a restructuring, meaning it is likely to receive the same haircut as non-guaranteed bonds. Ghana is seen as unlikely to repay the World Bank within the required 60 days, adding a further layer of risk to the restructuring process as repayment terms are agreed.

THE IMPLICATIONS OF GHANA'S RESTRUCTURING FOR THE CONTINUED INCLUSION OF CREDIT ENHANCEMENT FEATURES IN FUTURE DEVELOPING MARKET BOND ISSUANCE ARE AS YET UNKNOWN, BUT THEY COULD BE SUBSTANTIAL

The implications of Ghana's restructuring for the continued inclusion of credit enhancement features in future developing market bond issuance are as yet unknown but they could be substantial. While we expect bonds guaranteed by the official sector or with some other type of credit enhancement will continue to hold attraction for investors, the benefits to sovereigns in terms of borrowing costs may be diminished if other sovereigns treat them as indistinguishable from non -guaranteed instruments when it comes to debt restructuring.

While investors in the Ghana bond have got what they paid for in terms of the guarantee, they have been disabused of any implicit expectation that while the bonds are only partially guaranteed, they will be excluded altogether from a restructuring.

Contacts

Richard J. Cooper
Partner
New York
T: +1 212 225 2276
rcooper@cgsh.com

Jorge U. Juantorena
Partner
New York
T: +1 212 225 2758
jjuantorena@cgsh.com

Juan G. Giráldez
Partner
São Paulo
T: +55 11 2196 7202
jgiraldez@cgsh.com

Ignacio Lagos
Associate
New York
T: +1 212 225 2852
ilagos@cgsh.com

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