ICAG DISCUSSION PAPER
ACCOUNTING IMPLICATION OF GHANA'S DOMESTIC DEBT EXCHANGE (GDDE) PROGRAMME ON BANKS

1. Background

Ghana is facing a challenging economic situation. Several factors including adverse external shocks (COVID-19, war in Ukraine) have exposed Ghana to a surge in inflation, a rapid exchange rate depreciation and have put public finances under severe pressure. The latest debt sustainability analysis has demonstrated that Ghana is faced with a significant financing gap over the coming years and that its public debt is unsustainable.

The Government is currently discussing the contours of a comprehensive international financial assistance package and a debt re-arrangement covering the country's domestic and external creditors. The objective is to reduce the excessive burden created by the county's public debt on the economy and reach the debt sustainability targets defined by the International Monetary Fund (IMF) for the period through 2028 and beyond.

To this end, Government announced a Domestic Debt Exchange Programme on Monday, 5th December 2022. The programme involves invitation to Eligible Holders to exchange approximately GHS137.3 billion of the domestic notes and bonds of the Republic, E.S.L.A. Plc and Daakye Trust Plc specified for a package of New Bonds to be issued by the Republic.

The following are additional highlights of the exchange:

- Existing qualifying domestic bonds as of 1st December 2022 will be exchanged for a set of four new bonds maturing in 2027, 2029, 2032 and 2037.
- Exchange consideration ratio of new bonds is 17% in 2027 new bonds, 17% in 2029 new bonds, 25% in 2032 new bonds and 41% in 2037 new bonds.
- The annual coupon on all of these new bonds will be set at 0% in 2023, 5% in 2024 and 10% from 2025 until maturity.
- Expected Settlement Date is 23 December 2022 when the Republic of Ghana will issue the new bonds to eligible holders. This Settlement Date can be extended by the Republic without offering eligible holders the right to withdraw their offers provided the new Settlement Date is not later than 3 January 2023 (the Longstop Date). The Republic can extend the Settlement Date beyond this Longstop Date and designate a new Longstop Date in which case withdrawal rights may be granted to eligible holders who submitted offers before such extension.
- Coupon payments will be semi-annual and will be paid on 30th June and 31st December
- Eligible holders of the old bonds maturing on or prior to the settlement date that have submitted an exchange offer that is still pending acceptance by the Government at the maturity date of those old bonds will receive a final interest payment and a final principal payment on those bonds in the usual manner and their exchange offers will be rejected.
- Eligible holders holding old bonds in respect of which an interest payment date will occur after an exchange offer is submitted but before the settlement date will receive payment of accrued and unpaid interest on the usual interest payment date. However, eligible holders holding old bonds for which an interest payment date will occur both after the exchange offer is submitted and after the Settlement Date will not receive any accrued and unpaid interest on those old bonds.

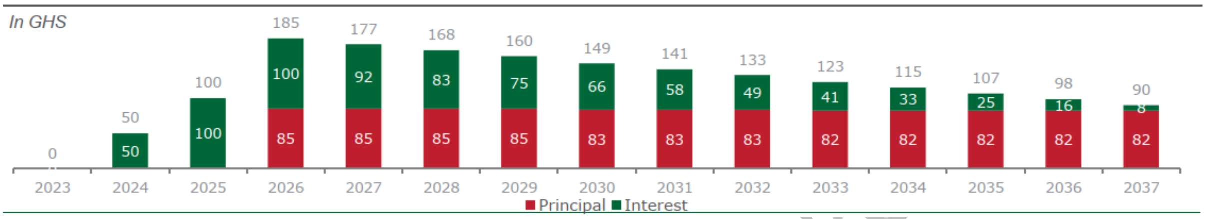
This domestic debt exchange is part of a more comprehensive agenda to restore debt and fiscal sustainability. External debt restructuring parameters will be negotiated in due course. The successful completion of this domestic debt exchange is a critical component of both the debt reduction programme and the IMF programme discussions; it will contribute to unlocking the support of the international community and will allow Ghana to achieve its debt targets.

Presented below is a summary of the GDDE program and the implied debt service schedule

Package of 4 new bonds offered to domestic debt holders in exchange of their outstanding claims (against GoG, ESLA and Daakye), will have the following terms:

	Short bond	Intermediate bond	Medium term bond	Long term bond
Maturity	2027	2029	2032	2037
Amortization profile	2 equal instalments	2 equal instalments	3 equal instalments	5 equal instalments
Interest structure *(Applicable to all 4 new instruments)*	**0%** in 2023; **5%** in 2024; **10%** from 2025 onwards			
Allocation per new bonds *(% of the face value of old bond)*	17%	17%	25%	41%
Principal *(exchanged at par)*	No Haircut	No Haircut	No Haircut	No Haircut

Implied debt service schedule for an indicative GHS 1,000 exchanged, reflecting the smooth, extended repayment profile implied by new bonds



1.2 Objectives of this discussion paper

This paper has been prepared to assess the IFRS implications of the GDDE as announced by government. Key issues discussed in this paper include the following:

a. Whether or not the exchange program results in a substantial modification of the old bonds and how these should be accounted for
b. How the new bond should be initially recognised, classified, and subsequently measured
c. How Expected Credit Loss (ECL) should be assessed on the new bonds; and on the old bonds (for those bonds not exchanged)?
d. ECL assessment for other financial assets with the same counterparty
e. What disclosures should be made in the financial statements in respect of this transaction?

1.3 Exclusions

- This discussion paper only focuses on the accounting impact of the programme and does not cover any tax and legal implications of the programme
- The matters raised in this discussion paper are our interpretations of the relevant accounting standards on the Ghana Domestic Debt Exchange Program at high level based on information currently available publicly.
- No responsibility to any third party is accepted as the report has been prepared solely for the purpose of sharing our perspectives on the accounting implications of the programme as currently announced.

2. Whether or not the exchange program results in a substantial modification of the old bonds?

2.1 Where old bonds/existing bonds are not exchanged

- At the date of this paper, the GDDE programme constitutes an invitation to eligible bond holders to exchange the old bonds for the new bonds. The invitation to Exchange (as defined below) will expire at 4:00 p.m. (GMT) on 19 December 2022 (such time and date, as may be extended or earlier terminated by the Republic at its sole discretion with respect to each series of Eligible Bonds, the "Expiration Date"). Eligible Holders who validly deliver an Offer or Exchange Instruction on or before the Expiration Date will be eligible to receive on the Settlement Date (as defined above) the applicable principal amount of New Bonds. Government reserves the right to extend the Expiration Date with respect to one or more series of Eligible Bonds at its sole discretion.
- Where some or all eligible bonds are not exchanged (no offer or partial offers are made), or for any reason the exchange does not happen as envisaged under the GDDE programme, although there is no modification, there will be an IFRS 9 implication for the financial statements of the holders. Holders still have the legal rights to the terms of these old bonds so their continuous recognition in the books may not be an issue.
- The major concern/impact will be the recoverability of these assets given that the issuers are reneging on their commitments to honour the terms of these old bonds, which will be in doubt and or subordinated to the terms of the new bonds. Although holders of these bonds may have the right to resort to the law courts to enforce their rights, there is increased risk around the ability of the issuer/counter party to service this debt under the current economic challenges, which is the main reason for the debt restructure.
- **In this regard, we expect these bonds to be accounted for as credit impaired and categorised as a stage 3 exposure for the purposes of ECL assessment. It is unlikely that expected cashflows from these old bonds will exceed the cashflows under the terms of the new bonds announced by government under the GDDE.**

2.2 New bonds/Where the invitation to exchange is accepted

- Where the offers are accepted, new contracts will be established between the new issuer (GoG) and corporate holders of these eligible bonds.
- Based on IFRS 9 principles where the contract terms of debt instruments are modified, an assessment is performed to ascertain if the new terms are "substantially different" from the old terms i.e., if the modification is significant or not.
- IFRS 9 states that in some circumstances the renegotiation or modification of the contractual cash flows of a financial asset can lead to its derecognition although there is no explicit guidance on when a modification of a financial asset leads to a derecognition.
- In assessing whether there is a substantial modification the holders may, but is not required to, analogise to the guidance on the derecognition of financial liabilities (IFRIC updates, May 2012, and September 2012).
- The IFRS9.3.3.2 paragraph regarding derecognition of financial liabilities from which the analogy is drawn states that, an exchange between an existing borrower and lender of debt instruments with substantially different terms or a substantial modification of the terms of an existing financial liability shall be accounted for as an extinguishment of the original financial liability
- **If the guidance for financial liabilities is applied by analogy to assess the exchange of the old bonds for the four (4) new bonds, <u>we expect this to result in a substantial modification</u>** due to the following:
    - ✓ A holder of a single bond or a holder of portfolio of bonds will receive, in exchange for the old bond or portfolio of old bonds, four bonds with different maturities and cash flow profiles in accordance with the terms and conditions of the GDDE program.
    - ✓ All of the bondholders are to receive the same restructuring deal irrespective of the terms and conditions of their individual holdings. This indicates that the individual instruments, terms and conditions were not taken into account. The different bonds (series) were not each modified in contemplation of their respective terms and conditions but were instead replaced by a new uniform debt structure; and

- ✓ The terms and conditions of the new bonds are substantially different from those of the old bonds. The changes include many different aspects, such as significant extension of the maturity date of the bonds and reduction of the coupon rates.
- Consequently, we expect that the old assets be derecognised, and a new asset recognised for the new bonds

2.3 Accounting for the substantial modification/derecognition

- IFRS 9 B5.5.25 states that in some circumstances, the renegotiation or modification of the contractual cash flows of a financial asset can lead to the derecognition of the existing financial asset in accordance with this Standard. When the modification of a financial asset results in the derecognition of the existing financial asset and the subsequent recognition of the modified financial asset, the modified asset is considered **a 'new' financial asset**.
- This '**new'** asset should be measured at fair value in accordance with the requirement of IFRS 9.5.1.1 which states that, except for trade receivables within the scope of paragraph 5.1.3, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.
- As indicated in section 2.2 above, the old bonds need to be derecognised and the new bonds recognised as 'new' financial assets.
- The accounting entries posted in respect of the derecognition will vary slightly depending on the classification of these existing bonds. Derecognition of the old bonds will result in an overall gain or loss equal to the difference between:

  For financial assets classified at amortised cost:
  - The amortised cost of the old bond; and
  - The fair value of the new asset

  The overall gain or loss is recognised in profit or loss as derecognition gain or loss and presented on the face of the statement of profit or loss and other comprehensive income as prescribed by IAS 1 paragraph 82.

  For financial assets classified at FVOCI:
  - carrying amount (measured at the date of derecognition); and
  - The fair value of the new asset

  The cumulative gain or loss previously recognised in OCI in respect of the derecognised financial asset is reclassified from equity to profit or loss as a reclassification adjustment. The overall gain or loss is recognised in profit or loss and presented in a line item based on the banks' accounting policies.

  For financial assets classified at FVTPL:
  - carrying amount (measured at the date of derecognition); and
  - The fair value of the new asset

  The overall gain or loss is recognised in profit or loss as part of the changes in fair values of FVTPL instruments.

- The gross carrying amount of a financial asset is reduced when there is no reasonable expectation of recovery. A write-off constitutes a derecognition event. Write-offs can relate to a financial asset in its entirety, or to a portion of it [IFRS 9 paragraphs 5.4.4, B3.2.16(r) and B5.4.9]. From the exchange program memorandum, we understand that all interests accrued on the old bonds for which settlement is due after 23 December 2022, will be forfeited or forgiven by the bondholders. This will constitute forgiveness of a portion of the existing contractual cash flows, thus the amounts accrued in relation to these interests should be written off before the assessment of a substantial modification takes place because the bondholders have no reasonable prospect of recovery of those cash flows. The amount written off should be recognised in profit or loss.
- It is also important to note that, bond holders are required to perform an ECL assessment on the old bonds to the date of derecognition to ensure that the carrying amount being used for the derecognition reflects the carrying amount at the date of derecognition.

2.3.1 Assessing fair value of the new bonds

- The fair value of an asset is a market-based measurement, not an entity-specific measurement (IFRS 13.2). It must reflect or estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (IFRS 13.2).
- When an asset is acquired in an exchange transaction, the transaction price is the price paid to acquire the asset (an entry price). In contrast, the fair value of the asset is the price that would be received to sell the asset (an exit price). Entities do not necessarily sell assets at the prices paid to acquire them.
- In many cases the transaction price will equal the fair value (e.g., that might be the case when on the transaction date the transaction to buy an asset takes place in the market in which the asset would be sold). When determining whether fair value at initial recognition equals the transaction price, an entity considers factors specific to the transaction and to the asset. The transaction price might not represent the fair value of an asset if the transaction takes place under duress, or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty [IFRS 13 paragraph B4].
- Although the GDDE is a voluntary program, government is expecting that all banks participate. The success of the program is critical to securing IMF funding and restoring macro-economic stability. For those entities not participating in the GDDE program, they will continue to hold the old bonds. Per new regulations issued by the Bank of Ghana, holding onto old bonds appear to have more adverse consequences for the holders. For instance, whilst the risk weights attached to the new bonds will be set at zero percent for Capital Adequacy Ratio computation, old bonds will be at 100%. The new bonds will also be fully deductible in determining the financial exposure of banks to counterparties under section 62(8) of the Banks and Specialised Deposit-Taking Institutions Act, 2016 (Act 930), while old bonds will not be deductible for that purpose.
- The conditions surrounding the exchange suggest the banks are compelled to accept the terms under the program due to the financial difficulty of the issuer. The terms of the exchange are generally on conditions that the banks would not otherwise have accepted under prevailing market circumstances. The transaction price in this instance is not reflective of the fair value of the new bonds.
- **Accordingly, the fair value of the new bonds must be determined with an appropriate valuation technique.**

2.3.2 Valuation techniques

The price of bonds is typically measured using techniques that fall under the market approach and/ or the income approach. The valuation approaches that may be considered include:

1. *Market Approach*

This valuation approach uses the prices and other relevant information generated by market transaction involving identical or comparable instruments. Under this approach, the price of the new bonds is based on either:

- the price of a bond from quoted prices on the bond market or stock exchange by a comparable issuer, or
- the price of a similar bond issued by a comparable issuer on an unquoted market.

This approach may not be appropriate to be used by the banks in valuing the new bonds because there is no principal or advantageous market for these bonds since they come to replace all Government bonds currently on the market.

2. *Income Approach*

This valuation technique converts future cash flows or income streams to a discounted amount. The value is determined on the basis of the value indicated by current market expectations about those future amounts, discounted to their present value. The common technique under the income approach that is used to measure the value of unquoted bonds is the discounted cash flow method (present value technique).

Under this method, the value of the bond is measured by discounting the estimated future cash flows of the bond using a rate of return that comprises the time value of money and the risks of the investment such as, credit risk, liquidity risk and other risks. This is based on assumptions that are inherently uncertain because they reflect estimates of the future rather than known amounts. Even contractual cash flows that may appear certain at first glance contain risk because of uncertainty about the ability of the counterparty to meet its contractual obligations. For example, contractual cash flows on a bond are subject to a risk of default. A risk premium is therefore included in the fair value measurement to reflect the amount that risk-averse market participants would demand to be compensated for the uncertainty of the cash flows [IFRS 13 paragraph B15].

An active market is yet to develop for the new bonds thus the discounted cash flow method under the income approach would be a more suitable valuation approach for determining the fair value of the new bonds.

IFRS 13 paragraph B.12 describes two approaches to applying a discounted cash flow method:

- ***the discount rate adjustment technique [IFRS 13 paragraph B18]***
  This technique requires discounting the contractual or promised cash flows using a risk-adjusted rate. These cash flows are conditional upon the occurrence of specified events (e.g. contractual or promised cash flows for a bond are conditional on the event of no default by the debtor). The discount rate used in the discount rate adjustment technique is derived from observed rates of return for comparable assets or liabilities that are traded in the market. Accordingly, the contractual, promised or most likely cash flows are discounted at an observed or estimated market rate for such conditional cash flows (i.e. a market rate of return)

- ***the expected present value technique [IFRS 13 paragraph B23]***
  This technique requires discounting either:
  - Method 1- the risk-adjusted expected cashflows using a risk-free rate, or
  - Method 2 - the non-risk adjusted expected cash flows using a risk-adjusted rate (this rate is different from the rate used in the discount rate adjustment technique).

  This technique uses as a starting point a set of cash flows that represents the probability-weighted average of all possible future cash flows (i.e., the expected cash flows). The resulting estimate is identical to expected value, which, in statistical terms, is the weighted average of a discrete random variable's possible values with the respective probabilities as the weights. Because all possible cash flows are probability-weighted, the resulting expected cash flow is not conditional upon the occurrence of any specified event (unlike the cash flows used in the discount rate adjustment technique). In theory, the present value (i.e. the fair value) of the asset's cash flows is the same whether determined using Method 1 or Method 2. When using an expected present value technique to measure fair value, either Method 1 or Method 2 could be used. The selection of Method 1 or Method 2 will depend on facts and circumstances specific to the asset or liability being measured, the extent to which sufficient data are available and the judgements applied.

The technique observed to be commonly used by banks in Ghana for valuing government bonds is the discount rate adjustment technique whereby the contractual cashflows are discounted using yields available from the bond market. This approach is preferred over the expected present value technique because the discount rate adjustment technique avoids the complexities of determining multiple sets of cash flows with appropriate probability weights.

We expect banks to discount the contractual cash flows of the new bond using a yield to maturity calculated from the market yields of the old bonds at date of measurement. The yield to maturity of the old bonds is considered the appropriate discount rate since it currently reflects the risks and uncertainty associated with the Government of Ghana and it maximises the use of relevant observable inputs and minimise the use of unobservable inputs. In determining the yield to maturity, banks should consider the suitability of old bonds based on their proximity of the maturity date to the respective new bond to be priced. For example, for the bond maturing in 2027, the old bonds which have a maturity close to 2027 are a suitable choice. Banks may also refer to an old bond which is slightly shorter running and another old bond which is slightly longer running and then interpolate the yield between these two bonds to the exact maturity date of the new bond.

2.3.3 Categorisation of fair value

IFRS 13 establishes a three-level fair value hierarchy based on the inputs to valuation techniques used to measure fair value. The inputs are categorised into three levels - the highest priority is given to unadjusted quoted prices in active markets for identical assets or liabilities, and the lowest priority is given to unobservable inputs [IFRS 13.72].

- Level 1 inputs: Unadjusted quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date.
- Level 2 inputs: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3 inputs: Unobservable inputs for the asset or liability [IFRS 13.76, 81, 86, A].

The level into which a fair value measurement is categorised in its entirety is determined with reference to the observability and significance of the inputs used in the valuation technique. Categorisation into Level 1 can only be achieved through the market approach using quoted prices in an active market for an identical asset or liability, without adjustments.

Considering that there is no active market for the new bonds, the fair value measurement will, at a minimum, fall within level 2 of the hierarchy. The fair value measurement may be escalated to level 3 depending on the level of significant unobservable inputs used in the measurement.

3. **Staging and ECL implications for the new bonds**

3.1 Staging considerations

When the modification of a financial asset results in the derecognition of the existing financial asset and the subsequent recognition of the modified financial asset, the modified asset is considered a 'new' financial asset [IFRS 9 paragraph B5.5.25]. Accordingly, the date of the modification is treated as the date of initial recognition of that financial asset when applying the impairment requirements to the modified financial asset. This typically means measuring the loss allowance at an amount equal to 12-month expected credit losses until there is a significant increase in credit risk.

<u>However, in some unusual circumstances following a modification that results in derecognition of the original financial asset, there may be evidence that the modified financial asset is credit-impaired at initial recognition, and thus, the financial asset should be recognised as an originated credit-impaired financial asset [IFRS 9 paragraph B5.5.26].</u>

Per Appendix A of IFRS 9, an asset is credit-impaired if one or more events have occurred that have a detrimental impact on the estimated future cash flows of the asset. The following are examples of such events:

- significant financial difficulty of the issuer or the borrower.
- a breach of contract - e.g., a default or past-due event.
- a lender having granted a concession to the borrower - for economic or contractual reasons relating to the borrower's financial difficulty - that the lender would not otherwise consider
- is becoming probable that the borrower will enter bankruptcy or other financial reorganisation.
- the disappearance of an active market for that financial asset because of financial difficulties; or
- the purchase of a financial asset at a deep discount that reflects the incurred credit losses

Several of the above-listed events have occurred in relation to the Government's bonds. As documented in Section 1 Background, the Government is in significant financial difficulty which is the genesis of the GDDE program. Furthermore, the GDDE program is essentially granting a concession to the Government that the banks would not otherwise consider. The coupon rates and maturity of the new bonds being offered in exchange for the old bonds are significantly lower. The Government has also been downgraded by the ratings agencies which reflects worsening assessments of the country's credit risk.

Based on the assessments of the factors above, it is reasonable to expect that the new bonds should be classified as originated credit impaired.

We acknowledge an alternative argument that new bonds issued would be considered as cured by the framework of the restructuring and would be in stage 1, with changes in credit risk monitored over its life. Proponents of this approach would argue based on the IMF programme which government is in the process of signing up to. The key driver of the current distressed restructure is the unsustainable debt levels. Government's ability to demonstrate debt sustainability is a key precondition for a Fund Programme. The impact of a successful IMF programme and improved debt sustainability can be factored into the estimates of recoverable amounts of the new bonds going forward as part of the ECL assessments in the future.

3.2 Initial recognition of originated credit-impaired assets

On initial recognition, originated credit-impaired assets do not carry an impairment allowance. Instead, lifetime ECLs are incorporated into the calculation of the effective interest rate [IFRS 9 paragraphs 5.5.13, A and B5.4.7]. This requires banks to determine the cash shortfalls or the expected cash flows under the new terms in calculating the effective interest rate of the new bonds at initial recognition.

3.3 Subsequent measurement of originated credit-impaired assets

The ECLs for originated credit-impaired assets are always measured at an amount equal to lifetime ECLs. However, the amount recognised as a loss allowance for these assets is not the total amount of lifetime ECLs, but instead the changes in lifetime ECLs since initial recognition of the asset [IFRS 9 paragraphs 5.5.13 and 5.5.14]. No impairment expense or allowance is recognised if, in subsequent periods, experience and expectations about the collectability of cash flows are unchanged from expectations on initial recognition.

Favourable changes in lifetime ECLs are recognised as an impairment gain, even if the favourable changes are more than the amount, if any, previously recognised in profit or loss as impairment losses.

If the Government can secure IMF Management and Executive Board Approval for an IMF program and the creditworthiness of the Government improves, the banks may revise their assessment of the expected cashflows from the new bonds and record an impairment gain.

4. ECL assessment for other financial assets with the same counterparty

Banks have other exposures with the same counterparty (the Government) such as:

- Cocoa bills;
- USD denominated local notes;
- Other domestic non-marketable debt;
- Treasury bills; and
- Loans to State Owned Enterprises (SOEs) that are backed by the Government.

The Government is in significant financial difficulty, and it is likely that payments for these instruments may be affected by the current challenges. Consequently, we expect this to be reflected in the staging of these exposures and a zero percent loss rate will be difficult to justify going forward.

Per Issue 1 of the Domestic Debt Exchange FAQs released by Government on 5 December 2022, there is clear indication from Government of its intention to exchange domestic non-marketable debt and Cocoa bills, under comparable terms at a later stage. The Government also intends to exchange USD-denominated local notes at a later stage. These instruments therefore exhibit characteristics of being credit-impaired and should fall under Stage 3 in the ECL assessment. Given that there is no communication on the exact terms of the restructure, we expect the ECL assessments to estimate expected cashflows in a pattern similar to the instruments under the GDDE programme.

Regarding Treasury bills which are exempted from the programme, we expect these to be classified in stage 2 and lifetime ECL assessed. Banks must assess cash shortfalls on these instruments in line with their credit risk management policies and recognize an impairment allowance which is more than nil.

In respect of loans to SOEs that are backed by the Government, banks carrying these exposures should assess them on a case-by-case basis. A minimum of stage 2 classification will be expected for those loans to institutions whose repayment depend solely or mainly on government funding. Depending on the nature and source of government funding linked to the ability of these institutions to repay, these debts may end up being classified as credit impaired in stage 3.

5. Financial statement disclosures

We expect the following disclosures in the 2022 financial statements at a minimum:

- Accounting policy on substantial modification of a financial asset leading to derecognition (IAS 1.121, IAS 8.10)
- Amount of derecognition gain or loss (IAS 1.82)
- The amount reclassified upon derecognition from accumulated other comprehensive income to profit or loss for the period (IFRS 7.20)
- Description of reasons for or events leading to the derecognition (IFRS 7.20A)
- Fair value disclosures on new assets (IFRS 7.28)
- Policy on credit impaired assets and how any significant judgements on this policy have been applied to this situation.
- Disclosures on impact on regulatory ratios and capital management
- Disclosures on estimation uncertainty
- No impact is expected on the statement of cashflows

6. Other considerations

- **Regulatory forbearance**
  - ✓ Although we are yet to see the full-scale impact assessment for industry, we believe the impacts of the restructure on financial reporting for banks with significant exposures will be extremely material and will most likely result in these institutions reporting capital below regulatory thresholds as well as ratios below regulatory capital adequacy ratios.
  - ✓ Given that a significant proportion of this loss to be reflected through income statement is not direct cashflow in year 1, Bank of Ghana should consider a regulatory forbearance that could exempt the use of the resulting losses from the restructure in the assessment of capital adequacy calculation and measurement of capital of banks and grant a dispensation where this is adjusted through this assessment over the period of the restructure.

- **Systemic risk considerations**
  - ✓ Banks will need to consider the systemic impact of the debt restructure on other aspects of their portfolios not directly impacted by the GDDE. These include exposure to the contractors on government projects, exposure to entities that have used the affected bonds as collaterals etc.

7. Summary of key conclusions:

a. Existing qualifying bonds not exchanged under the programme should be accounted for as credit impaired and categorised as a stage 3 exposure for the purposes of ECL assessment. It is unlikely that expected cashflows from these old bonds will exceed the cashflows under the terms of the new bonds announced by government under the GDDE programme.

b. Where the invitation to exchange under the programme is accepted, new contracts will be established between the issuer (GoG) and corporate holders of these eligible bonds. The new terms result in a significant modification for which reason the existing bonds need to be derecognised and a new financial asset recognised in respect of the new bonds.

c. The amounts accrued in relation to interests on the old bonds which will be forfeited should be written off and recognised in profit or loss.

d. Holders of these bonds are required to measure ECL to the date of derecognition to determine the carrying amount at the date of derecognition.

e. The difference between the carrying value of the old bonds at the date of derecognition and the fair value of the new bonds should be recognised as derecognition gain/loss in profit or loss.

f. Fair values of the new bonds should be determined by discounting the contractual cash flows of the new bond using a yield to maturity calculated from the market yields of the old bonds at the date of measurement.

g. The new bonds should be carried as originated credit impaired. On initial recognition, originated credit-impaired assets do not carry an impairment allowance. Instead, lifetime ECLs are incorporated into the calculation of the effective interest rate. This requires banks to determine the cash shortfalls or the expected cash flows under the new terms in calculating the effective interest rate of the new bonds at initial recognition. No impairment expense or allowance is recognised subsequently if expected cash flows are unchanged from expectations on initial recognition. Favourable changes in lifetime ECLs are recognised as an impairment gain.

h. There is increased credit risk around other instruments issued by the same counter party which need to be assessed in the context of the counter party's current financial condition. Domestic non-marketable debt and Cocoa bills which Government has indicated intention to restructure under comparable terms at a later stage and USD-denominated local notes in respect of which a restructuring intent has been communicated should be classified as credit impaired and ECL assessment performed based on the estimate of cash shortfalls.

i. Treasury bills which are exempted from the programme, are expected to be classified in stage 2 and lifetime ECL assessed. Impairment allowance is expected to be more than nil.

j. In respect of loans to SOEs that are backed by the Government, banks carrying these exposures should assess them on a case-by-case basis. A minimum of stage 2 classification will be expected for those loans to institutions whose repayment depend solely or mainly on government funding. Depending on the nature and source of government funding linked to the ability of these institutions to repay, these debts may end up being classified as credit impaired in stage 3.

k. Banks will need to consider the systemic impact of the debt restructure on other aspects of their portfolios not directly impacted by the GDDE. These include exposure to contractors on government projects, exposure to entities that have used the affected bonds as collaterals etc. The ECLs of these exposures should be evaluated in line with the banks' credit risk management policies.

l. Bank of Ghana should consider a regulatory forbearance that could exempt the use of the resulting losses from the restructure in the assessment of capital adequacy calculation and measurement of capital of banks. This dispensation can allow these losses to be adjusted over the period of the restructure.