SSNIT INVESTMENTS SERIES

SEVENTH EDITION

INTRODUCTION

The focus for this edition of the SSNIT Investments Series will be on the Trust's Loan portfolio, managed by the Fixed Income and Financial Advisory Services (FIFAS) Department. Loans are generally credit facilities extended by lenders who perform the intermediary role of channeling funds from surplus spending units to deficit spending units in an economy. These investments provide a return in the form of periodic interest payments until the expiration of the loan tenor.

OVERVIEW OF LOANS

Loans are debt financial instruments provided by an organization or individual to another entity at an interest rate. In a loan agreement, the borrower initially receives or borrows an amount of money, called the principal, from the lender, and is obligated to pay back or repay an equal amount of money to the lender at a later time. Secured loans are backed by an asset (e.g. a car, building or Treasury bill) as collateral whereas unsecured loans or signature loans are only supported by the borrower's creditworthiness, rather than by any type of collateral.

Loans are generally evidenced by an agreement (loan agreement). The Loan Agreement is a legal document/contract which outlines all the terms and conditions pertaining to a loan transaction, and consummates the lending/borrowing or business relationship between the lender and borrower. The Loan Agreement specifies, among other things, the principal amount of funds borrowed/lent, the interest rate the lender is charging, tenor, collateral and dates of repayment.

Some key features of loans:

- *Principal Amount* – This is the amount of money the lender gives the borrower. Depending on the schedule of the loan, the principal amount could be paid evenly over the duration of the loan, or as a one-off payment on the loan's expiration. In other words it is the amount on which interest is calculated.

- *Interest rate* – The amount charged by the lender (expressed as a percentage of the principal) to compensate for opportunity cost and the perceived risk of the borrower. Interest rates are normally noted on an annual basis but the interest payment could be varied per the terms of the loan to meet the requirements/expectations of both parties (i.e. quarterly, semi-annually or annually).

  Typically, interest rates reflect only the nominal interest charged on a loan, and does not take into account, other expenses. However, where fees and other costs/expenses are factored in the interest rate determination, the resulting effective rate is the Annual Percentage Rate (APR).

  Interest rates may either be fixed, providing a fixed stream of regular interest payments over the life of the loan, or floating, providing varied interest amounts per each payment period over the tenor of the loan. To minimize the risk of interest rate fluctuations, interest rates on loans with floating interests are reset at the commencement of each repayment cycle (i.e. monthly, quarterly, semi-annually or annually) to protect both the lender and borrower.

- *Maturity Date* – This is the date on which the (final) indebtedness or amount payable under a loan transaction (outstanding principal and interest) becomes due for repayment to the lender and ends interest computation. This is the set date at which the final loan amount, and any accrued interest is (re)paid to the lender.

- *Credit Rating* – It is the assessment of the riskiness of the borrower. The better the rating, the lower the expected risk and therefore, the lower the interest charged; all things being equal.

- *Collateral* – This is a property or other asset that a borrower assigns to a lender to secure the loan. If the borrower defaults in making the promised loan (re)payments, the lender can fall on the collateral. Since collateral offers some form of comfort to the lender in case of default, loans that are secured by collateral generally have comparatively lower interest rates. A lender's claim to a borrower's collateral is called a lien.

- *Moratorium* - It is the time period when the borrower is not required to make any (re)payment. In other words, a waiting period before which scheduled principal and interest repayments begin.

Types of Loans

Loans vary because each has specific intended usage. They can differ by length of time, by how interest rates are calculated, by when payments are due and by a number of other variables. Some of the loan types include;

- *Student Loans* – These are offered to college students and their families to help cover the cost of higher education.

- *Mortgage Loans* – They are loans distributed by banks and other financial institutions that enable consumers buy homes they can't otherwise pay for upfront. Mortgage loans usually have the lowest interest rates of all loans given the stability of the attached security. A mortgage is tied to a borrower's home, meaning he/she risks foreclosure if there is a default.

- *Auto Loans* – These are credit advanced by banks and some car dealership companies to help consumers buy vehicles they can't pay for upfront. Like mortgages, auto loans are tied to the borrower's property and risks losing the vehicle if he/she defaults in payments.

- *Personal Loans* – They are loans without any designated purpose, used for any personal expenses. Like other loans, personal loan terms depend on the consumer's creditworthiness and history.

- *Small business Loans* – These are granted to entrepreneurs and aspiring entrepreneurs to help them start or expand their business.

- *Term loans* – These are secured loans advanced from financial institutions that have specified repayment schedules with fixed or floating interest rates.

The Trust loans are basically term loans advanced to Corporate entities, District & Municipal Assemblies and the Government.

Risks associated with Loans

Loans, like other financial instruments are exposed to some level of uncertainty. There are several types of risks associated with loans, including:

- *Interest Rate Risk* – This is pertinent to fixed interest loans and results from fluctuation of prevailing rates relative to the agreed rate charged on the loan. If the prevailing rates are higher than the agreed rate, the lender loses while the borrower gains and vice versa.

- *Default Risk* – Borrowers could default on their obligation to make principal and interest repayments if they are unable to raise the needed cash when due. Loans advanced to governments are usually considered risk-free, but, all other loans are subject to default risk.

- *Inflation Risk* – When loan repayments are fixed over the tenor of the loan, the real values of the repayments fall if there is a persistence increase in the general price levels over the holding period.

Generally, a higher compensation (interest rate) is demanded by lenders if the risk profile of the borrower is high.

It is also worth noting, that, loans are considered to be more risky compared to other financial securities like bonds. In the event the borrower is liquidated, bond holders will be paid first before any other investment security is considered. However, compared to equity (shareholder money), loans are less risky.

SSNIT LOAN PORTFOLIO

The SSNIT loan portfolio is managed by FIFAS and valued at GH¢1.17 billion as at November 2017. This represents 12.8% of the Total Investment Portfolio and 37.3% of the Fixed Income Portfolio. Consideration is usually given to requests from Corporate Entities, District and Municipal Assemblies and Government. The current loan portfolio has twenty five (24) cases made up of twenty two (22) Corporate loans and two (2) Government loans. As at November 2017, 87.6% of the loans portfolio comprised Corporate Loans whilst the remaining 12.4% were Government loans.

Due to confidentiality clauses in the Agreements, we are unable to disclose the details of the Trust's loan portfolio.

Aside providing financial returns to the Trust, the loans advanced by SSNIT also contribute to the socio-economic development of some key sectors of the economy.

See Table 1 for some of the socio economic impact of the loans extended by the Trust on the economy.

Table 1 – Socio-Economic Impact of loans extended by the Trust

Loan	Economic impact	Social impact
Corporate Loans	▪ Job creation to improve livelihood and expand contribution base of the Trust Scheme ▪ Expansion of core businesses to increase revenue and pay dividends ▪ Has enabled a number of businesses become competitive	▪ Improvement to business profitability enables higher corporate social responsibility interventions.
Government Loans	▪ Job creation to improve livelihood and expand contribution base of the Trust ▪ Huge sports tourism potential with positive multiplier effects via tourism inflows ▪ Source of government revenue from road tolls.	▪ Repositioned Ghana on the world soccer map having hosted very high profile soccer matches ▪ Redirected the exuberance of the youth within the country from socially destructive vices into talent unearthing pursuits ▪ Has helped in reducing the housing deficit facing the country. ▪ Provision of safe roads to minimize the occurrence of road accidents. ▪ Provided safe housing units for some security services personnel, doctors and other medical staff.

Performance of SSNIT Loan Portfolio

Interests on the SSNIT loans are compounded monthly and amortized over the loan tenor. When a borrower defaults, the interest in arrears is added to the principal amount and interest is recomputed on the new principal.

Performance of the Trust Term Loans is assessed by comparing the actual returns on the loans to a benchmark as stated in the Trust's Asset Allocation Policy. The current benchmark for the Trust's loan portfolio is the 3-year fixed rate plus a margin. The loan portfolio over the 5-year period (2012-2016) has on average, accounted for 34.3% of the total annual gross investment income of the Trust.