SSNIT INVESTMENTS SERIES

EIGHTH EDITION

INTRODUCTION

In this edition of the SSNIT Investments Series, we will focus on the Trust's Treasury investments (Treasury Bill and Fixed Deposits) which are managed by the Treasury Department under the Finance Division. Treasury investments are used to optimize the Trust's liquidity to ensure sufficient cash is available to meet all liabilities when they fall due.

OVERVIEW OF TREASURY INVESTMENTS

Treasury investments otherwise known as "government securities" are usually debt obligations of a national government and are backed by the "full faith and creditworthiness of that government", in this case, Government of Ghana.

The securities are issued by the Bank of Ghana (BoG) on behalf of Government for the financing of cash shortfalls and to redeem maturing securities. Government securities also assist in the development of the financial market by providing risk-free benchmark securities as reference for the issue of debt instruments in the money and capital market by corporates and non-government institutions.

Returns on treasury investments are known with certainty and comes with the assurance that Government will not default on their obligation. In view of this, they are best suited for risk averse investors as their primary goal is to preserve their investments. Investors are guaranteed the repayment return of both their principal and interest due at the end of maturity. However, due to the low risk of these debt instruments, returns are relatively low compared to other riskier investments such as stocks and corporate bonds.

Features of Treasury investments include:

- ✓ **Treasury yield** – It is the interest Government pays to borrow money for different lengths of time. It is also the return on investment expressed as a percentage on the Government debt/security.

- ✓ **Day count** – Day count conventions cover the way in which interest is calculated on investments. In Ghana, Treasury bill day count is 364 days in a year.

- ✓ **Issue price** – Treasury bills are issued at a discount, but redeemed at par. As discount securities, Treasury bills do not pay coupon interest. Instead, Treasury bills are issued at a discount from their maturity value; the return to the investor is the difference between the maturity value and the purchase price.

- ✓ **Repayment** – The repayment of the bill is made at par or face value on the maturity of the term.

- ✓ **Availability** – Treasury bills are highly liquid negotiable instruments that are available in both financial markets, i.e. primary and secondary markets.

- ✓ **Eligibility** – Individuals, firms, companies, trusts, banks, insurance companies, provident funds, state government and financial institutions are eligible to invest in Treasury Bills.

- ✓ **Tax Exempt** – Interest receipt on Treasury investments are not levied and so not subject to tax deductions.

TYPES OF TREASURY SECURITIES

- **Treasury Bills:** Treasury bills (T-bills) are short term money market instruments issued by a national government. They usually have maturities of less than one year. T-Bills are the most popular debt instruments in the country and are offered with maturities of 91 and 182 days. These instruments offer different returns and are usually issued at a discount, meaning instead of offering interest along with the repayment amount, purchasers are offered more money at maturity than the amount paid when purchasing the security.

  For instance if a T-bill is issued at a 10% interest rate, then a purchaser will buy a GH¢100 face value T-Bill for GH¢90 and receive GH¢100 at maturity. That is, initial price of GH¢ 90 plus GH¢10 in interest.

  The Government issues T-bills through auctions which are open only to licensed primary dealers mainly financial institutions. Individual investors then purchase the securities from these primary dealers in the secondary market. An investment that offers lower returns than T-Bills is not worthwhile.

- **Treasury Notes:** These debt securities are usually of maturity ranging from one year to two years. BoG issues 1-year and 2-year Treasury notes with investors earning interest semi-annually. On the maturity date, the investor receives the last coupon (interest) payment together with the nominal value of securities purchased. In other jurisdictions like the United States, Treasury notes are medium term debt securities with maturity ranging from one year to ten years.

- **Treasury Bonds:** These are medium term debt securities with maturity exceeding two years. Presently, the Bank of Ghana issues 3-year, 5-year and 7-year bonds, with the latter being the longest term security issued in Ghana. Bonds normally make semi-annual coupon payments and these securities are helpful to long-term investors. In the United States, treasury bonds are long term debt securities with maturity of more than ten years.

- **Treasury Inflation Protected Securities (TIPS):** TIPS are debt securities that provide protection against inflation. These securities make semi-annual interest payments with the payments rising with inflation and falling with deflation. Due to the built-in inflation insurance component, TIPs pay a lower rate of interest than standard Treasury securities of the same maturity. They are usually sold at 5-year, 10-year and 30-year maturities. The Bank of Ghana does not currently issue Treasury Inflation Protected Securities.

RISKS ASSOCIATED WITH TREASURY INVESTMENTS

- **Inflation risk:** Apart from TIPS, treasury investments may decline in value if inflation rises. In periods of high inflation, the real value of money invested in these securities will decline. The guaranteed principal and interest payments will be paid at maturity but will be worth less.

- **Interest Rate Risk**: This is the possibility of how changing interest rates affect the proceeds of an early sale of treasury investments especially in longer duration instruments. Treasury notes and bond prices are generally inversely related to interest rates. For instance, if 2 years ago an investor purchased a Treasury bond and interest rates have generally risen, a recently issued Treasury bond will have a higher interest rate and therefore the investor's Treasury bond will sell at a lower price. However, if the investor holds the treasury security till maturity, interest rate risk will not be a factor as he/she will get the entire principal at maturity.

- **Opportunity Cost:** Treasury investments are so safe that they don't need to pay high interest rates to attract investors especially risk averse investors. As a result of this, investors could lose out on the opportunity for a higher return on another investment.

- **Default Risk** – Despite Treasury securities being risk-free, Governments **could** default on their obligation in the event of political instability. Since the inception of Treasury operations in Ghana however, the Government has not defaulted on its Treasury debt obligations and there's no indication of a default in the near future.

FIXED DEPOSITS

Also known as term deposits, are usually offered for 91 days, 182 days or a year. However, unlike treasury securities, they involve investors lending to a bank or a financial institution. The interest rate is usually negotiable depending on the size of the deposit being offered and investment duration. Fixed deposits are backed by the credit rating of the institution and carry medium financial risk, due to the higher risk of default of the borrowing institution. Fixed deposits usually offer interest rates higher than the risk free rate/government treasury rate (e.g. T-bill rate plus a margin) due to the relatively higher risk compared to treasury securities.

SSNIT TREASURY PORTFOLIO VALUE & PERFORMANCE

The SSNIT Treasury portfolio mainly consists of Treasury Notes and Fixed Deposits. The portfolio value as at December 2017 was GH¢818.15 million representing 8.9% of the total investment portfolio.

Returns on SSNIT treasury investments are usually dependent on the Government's lending rates as well as rates on fixed deposits with financial institutions.

Performance is assessed by comparing the actual returns on the investment to a benchmark as stated in the Trust's Asset Allocation Policy. The current benchmark for the Portfolio is the 91-day T-bill rate plus a margin. The Treasury portfolio has over the past 5-year period (2012-2016) contributed on average, 14.3% to the Trust's gross investment income.