Is the Bank of Ghana condoning insider dealing?

The banking crisis that keeps giving

Between 2017 and 2019, the government of Ghana closed down 9 commercial banks, 411 non-bank financial institutions, and 58 investment houses and fund managers (5 in April 2019 and 53 in November 2019). The policy intent was to avoid a disorderly collapse of these institutions in a fashion that could have destabilised the entire financial industry.

The cost to the government of this drawn-out exercise is not clear. At various times, different numbers have been presented.

In a presidential address to Parliament in 2021, a sum of 21 billion Ghana Cedis was mentioned. In 2023, the Governor of the central bank gave a figure of 25 billion Ghana Cedis.

All these numbers represented a dramatic escalation from the 16.8 billion GHS or 16.4 billion GHS that the Finance Ministry said was needed and assured the market won't be exceeded.

Why we can't pin down the cost of the crisis

Given that these banks were collapsed at definite moments in time, one would have thought that their liabilities must have been frozen at whatever they were at the point of their resolution. Yet, somehow, the government seems to learn with every passing month the true extent of the financial hole left by their collapse.

It was easy to understand when bailout costs jumped from 8.5 billion GHS in 2018 to 16 billion GHS – plus in 2020 because the exercise continued into and only ended in 2019. From 2020 onwards, however, the shifting numbers become harder to understand.

One explanation that seems reasonable to the objective mind is the state of the books left behind by the exiting bank executives. The detailed receiver reports go to excruciating lengths to explain how convoluted some of the asset-stripping, fund diversion, and round-tripping schemes were. See the below extract from one of the receivers' lamentations, for instance.

> The Receivers have commenced several legal actions to recover these monies from shareholders, directors, and customers of the defunct institutions. In collaboration with the Economic and Organised Crime Office (EOCO) and the Special Investigation Team (SIT) established by the Government, the Receivers of the defunct institutions are investigating some directors of the defunct institutions to trace and identify hidden and undisclosed assets financed with the resources of the defunct institutions. The Attorney General has commenced prosecution of certain individuals alleged to have been complicit in the failure of the defunct institutions. It is important also to mention that EOCO and SIT are continuing with their investigations to ensure that wrongdoings and impunity on the part of management, shareholders and related parties of these failed institutions face the full rigor of the law to serve as deterrent to others.

No one knows how to cover tracks better than an insider

A consistent thread in all the complaints about how hard it has been to trace, locate, and recover assets has been the spectre of "insider" or "related party" dealings. See yet another extract from the same report below.

> of recovery. Furthermore, some of the monies siphoned out of the institutions by related and connected parties that led to their insolvency, were used to acquire foreign assets in the names of those related and connected parties, making them difficult to trace and recover. Some of the loans were even fictitiously created and some directors are being pursued to recover such monies.

The terms "related" and "connected" parties in this context imply a broad category of actors, including but not limited to "insiders" like directors and managers. Definitions can encompass business associates and relatives of key management personnel and board members of a financial institution; entities with common ownership in a holding structure with the said financial institution; and subsidiaries or other affiliates in which significant equity is held.

Ghana's insider-triggered bank collapses are a global cause célèbre

It is safe to say that a major common theme across the 2017 – 2019 bank collapses was the role of related parties in various risky transactions undertaken by the financial institutions. So much so that Ghana is now a major case study for the likes of the World Bank and IMF when they look at the role of related parties in banking crises worldwide.

Section 1. Some Examples of the Role of Transactions with Related Parties in Banking Crises and Bank Failures 11

Ukraine (2014-2016) 11

Bulgaria (2014) 12

Moldova (2014) 13

Iceland (2008) 14

Ireland (2009) 15

Portugal (2014) 15

Ghana (2017) 15

Odebrecht and Meinl Bank (2010) 16

Section 2. Motivations behind Transactions with Related Parties: from bona fide to criminal 17

The billions upon billions of Ghana Cedis that the government says were lost through such insider and related party collusion in the banks have increased the appeal of the Ghanaian experience to scholars who have reacted with multiple studies.

What has the Bank of Ghana done about this?

Given the sheer scale of the financial pandemonium wreaked by all this siphoning of billions, one would imagine that the regulators would come very hard on insider dealing and related party collusion. Shutting the stable doors after the horse has bolted, however, won't be smart. Proactive risk management and prevention would make much better sense. So, what has the Bank of Ghana done in this regard?

In 2021, it issued an "exposure draft" for corporate governance guidance in the financial industry in which it mooted the following regulation.

Related Party Transactions

25. The Board shall disclose the nature and extent of transactions with related parties (including intra-group transactions) and indicate:
    a. whether the transactions have been reviewed by the Board of the RFI to assess risk and are subject to appropriate restrictions;
    b. whether the transactions are conducted on non-preferential terms/basis; and
    c. whether the transactions comply with applicable legislation and other requirements such as those prescribed under sections 67 to 70 of Act 930, regarding exposure limits for loans to related parties and staff.

The draft eventually matured in 2022 into a definite standard on disclosure requirements for financial institutions about their dealings with insiders and related parties.

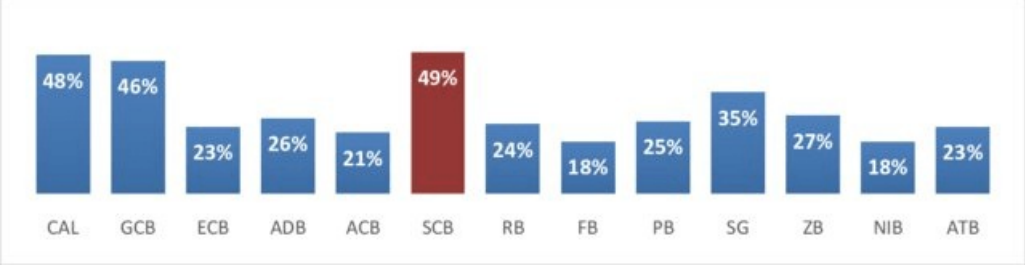
18. Related Party Transactions

The Board shall disclose in the Audited Financial Statement, the nature and extent of transactions with Related Parties (including intra-group transactions) and provide at a minimum the following:

(1) whether the transactions have been reviewed by the Board of the RFI to assess risk and are subject to appropriate restrictions;
(2) whether the transactions are conducted on non-preferential terms/basis; and
(3) whether the transactions comply with applicable legislation and other requirements, regarding exposure limits for loans to Related Parties and staff.

Sadly, not enough

Just around the time this effort commenced, Ghanaian scholars like John Mawutor of UPSA had provided evidence showing that most banks in Ghana were not complying with related party disclosure rules. In his sample, no bank hit even 50% of the required benchmark.



Meanwhile, the Basel Committee on Banking Supervision, a supranational standards-setting taskforce, has updated its guidance on the related parties matter via its Core Principles for Effective Banking Supervision (specifically, *principle 20*).

Principle 20 – Transactions with related parties

40.46 Principle 20:[55] To prevent abuses arising in transactions with related parties[56] and to address the risk of conflicts of interest, the supervisor requires banks to: enter into any transactions with related parties on an arm's length basis;[57] monitor these transactions; take appropriate steps to control or mitigate the risks; and write off exposures to related parties in accordance with standard policies and processes.

Footnotes

[55] Reference documents: BCBS, Corporate governance principles for banks, July 2015; BCBS, Principles for the management of credit risk, September 2000.

[56] Related parties should include:

(a) the bank's subsidiaries and affiliates (including their subsidiaries, affiliates and special purpose entities) and any other party that the bank exerts control over or that exerts control over the bank;

(b) the bank's major shareholders, including beneficial owners;

(c) the bank's board members, senior management and key staff, corresponding persons in affiliated companies, and parties that can exert significant influence on board members or senior management; and

(d) for the natural persons identified in (a) to (c), their direct and related interests and their close family members.

[57] Related party transactions include on-balance sheet and off-balance sheet credit exposures; dealings such as service contracts, asset purchases and sales, construction contracts and lease agreements; derivative transactions; borrowings; and write-offs. The term "transaction" should be interpreted broadly to incorporate not only transactions that are entered into with related parties but also situations in which an unrelated party (with whom a bank has an existing exposure) subsequently becomes a related party.

40.47 Essential criteria:

(1) Laws, regulations or the supervisor set out a comprehensive definition of "related parties" that should at least consider all of the elements detailed in footnote [56]. The supervisor may exercise discretion in applying this definition on a case by case basis.

(2) Laws, regulations or the supervisor require that transactions with related parties are not undertaken on more favourable terms (eg in credit assessment, tenor, interest rates, fees, amortisation schedules, requirements for collateral) than corresponding transactions with non-related counterparties.[58]

(3) The supervisor requires that transactions with related parties and the write-off of related party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's board. The supervisor requires that board members with conflicts of interest are excluded from the approval process for granting and managing related party transactions.

(4) The supervisor determines that banks have policies and processes to prevent persons benefiting from the transaction (and/or persons related to such a person) or who otherwise have a conflict of interest from being part of the process of granting and managing the related party transaction.

(5) Laws or regulations establish, or the supervisor sets on a general or case by case basis, limits for exposures to related parties[59] or require such exposures to be collateralised or deducted from capital.[59] When limits are only set on aggregate exposures to related parties, those are at least as strict as those for single counterparties or groups of connected counterparties under Principle 19.

(6) The supervisor determines that banks have policies and processes to:

(a) identify individual exposures to and transactions with related parties as well as the total amount of exposures; and

(b) monitor and report on them through an independent credit review or audit process.

The supervisor determines that exceptions to policies, processes and limits are reported to the appropriate level of the bank's senior management and, if necessary, to the board, for timely action. The supervisor also determines that senior management monitors related party transactions on an ongoing basis, and that the board also provides oversight of these transactions.

(7) The supervisor obtains and regularly reviews information on aggregate exposures to related parties. Supervisors require banks to report (or the supervisor acquires this information through other means) individual related party transactions that are material (eg those exceeding a specified amount or a percentage of the bank's Tier 1 capital).

Footnotes

[58] Exceptions may be appropriate for certain transactions between entities within a banking group when the supervisor considers this to be consistent with sound group-wide risk management. An exception may also be appropriate for beneficial terms that are part of overall remuneration packages.

[59] For this purpose, exposures should be calculated consistently with Principle 19 [BCP40.43].

[60] The supervisor may exclude banks' exposures to certain entities within the banking group where the supervisor considers this to be consistent with sound group-wide risk management.

40.47(2) of Core Principle 20 clearly impugns the practice of giving favourable treatment to bank insiders. To the extent that these principles are minimum standards, it can be argued that the proper regulatory practice in Ghana would be to top this benchmark by instituting even more stringent criteria. And certainly not in the flabby way that section 18 of the Bank of Ghana's Corporate Governance Directive sets even the bare disclosure requirement.

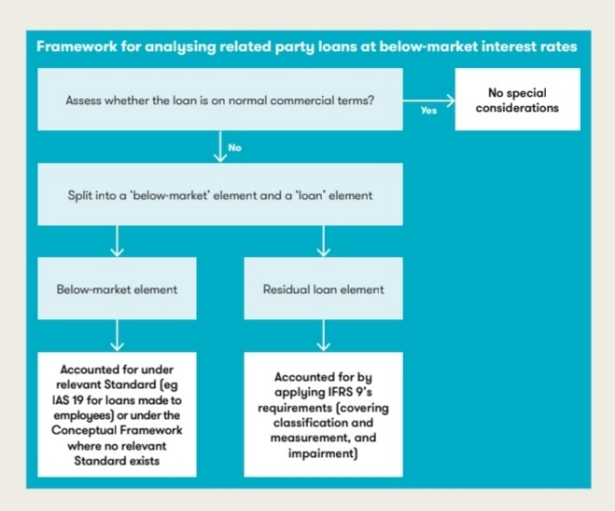
In a recent scan of a disclosure document issued by a Ghanaian bank, I saw some information on the rates at which the bank lends to employees, senior bank executives (including executive directors), and independent directors.

Some banks in Ghana are given loans to insiders at 1% interest rate

Bank (GHS'000)	2020	2021	2022
Loans and advances to executive directors and their associates – Average Interest Rates	5%	5%	5%
Loans and advances to non- executive directors and their associates – Average Interest Rates	-	-	1% - 5%
Loans and advances to employees – Average Interest Rates[2]	5% - 10%	5% - 10%	5%

I was very surprised to see that some non-executive directors of banks in Ghana are borrowing at interest rates as low as 1% from banks on whose boards they serve.

I can live with low-interest loans to employees because I believe that the accounting standards deal with them in a satisfactory manner. Consider, for instance, the advice below by Grant Thornton, a big accounting firm.



In simple terms, the component of a loan given at below market rates (such as the interest) is simply regarded, according to the relevant standard, as an "employee benefit" and recorded and reported as such.

Such juicy deals for independent directors are very risky from a fiduciary standpoint

My considered view is that such an accounting treatment as allowed for employees becomes untenable in the case of directors, especially independent directors, due to the special risks and conditions attaching to their remuneration.

Section 72(f) of the substantive Corporate Governance Directive (2018) issued by the Bank of Ghana itself emphatically rejects the notion of motivation or performance-based compensation for non-executive directors.

d) A committee of independent directors shall determine the remuneration of executive directors;

e) Executive directors shall not be entitled to sitting allowances and directors' fees;

f) Non-executive directors' remuneration shall be limited to directors' fees, sitting allowances for Board and committee meetings and shall not be performance-related.

In that light, I simply do not see how below market interest-rate loans to Directors can be justified in terms of the regulations.

It is worthwhile to mention that, in India, such preferential treatments have been more or less outlawed altogether by the famous section 185 of the 2013 Companies Code.

185. Loans to directors, etc.

(1) No company shall, directly or indirectly, advance any loan, including any loan represented by a book debt to, or give any guarantee or provide any security in connection with any loan taken by,—

(a) any director of company, or of a company which is its holding company or any partner or relative of any such director; or

(b) any firm in which any such director or relative is a partner.

(2) A company may advance any loan including any loan represented by a book debt, or give any guarantee or provide any security in connection with any loan taken by any person in whom any of the director of the company is interested, subject to the condition that—

(a) a special resolution is passed by the company in general meeting:

Provided that the explanatory statement to the notice for the relevant general meeting shall disclose the full particulars of the loans given, or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security and any other relevant fact; and

(b) the loans are utilised by the borrowing company for its principal business activities.

Explanation.—For the purposes of this sub-section, the expression "any person in whom any of the director of the company is interested" means—

(a) any private company of which any such director is a director or member;

(b) any body corporate at a general meeting of which not less than twenty-five per cent. of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or

(c) any body corporate, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.

Insider bank loans may even be illegal in Ghana

It could be strongly argued that section 185 of Ghana's own Companies Act (2019) outlaws the practice of below-market rate loans.

The Companies Act, 2019 (ACT 992)

Section 185: (1) Subject to this section, the fees and any other remuneration including salary payable to the directors in whatever capacity, shall be determined from time to time by ordinary resolution of the company, and not by a provision in an agreement.(2) The fees payable to the directors as directors shall be deter- mined from time to time by ordinary resolution of the company and not in any other way.(3) Unless otherwise resolved, the fees payable to directors accrue from day to day and the directors are entitled to be paid the travelling and other expenses properly incurred by the directors in attending and returning from meetings of the directors or a committee of the directors or general meeting of the company or otherwise in connection with the business of the company.(4) Where a director holds any other office or place of profit under the company in accordance with section 183 or 184, the terms of the appointment may provide for the remuneration in respect of the appointment but that director is not entitled to a remuneration additional to the fees to which that person is entitled as director un- less the terms of the appointment to that office have been approved by ordinary resolution of the company.(5) The registered constitution of a company may make provision for benefits payable to directors including(a) compensation for loss of employment as director or former director;(b) insurance benefits; and(c) other indemnities.

The Act, by making directors' remuneration fixable **only** through company resolutions, may well have eliminated the option of providing undercover benefits through direct/bilateral loan agreements between the company and the director.

Why then does the Bank of Ghana continue to tolerate insider-favouring loans of the type being discussed?

When an independent director gets a loan at 1% interest rate from a bank that would normally lend to him or her at 35%, it is as good as getting a benefit worth roughly 35% the value of that loan.

Condoning scratch-my-back culture in Ghanaian banks will lead to another crisis

Such a lucky director would clearly, in such circumstances, be receiving favourable treatment that could impair their judgment when they need to exercise strict oversight over management actions.

Shrewd but crooked managers could actually use such undercover benefits to emasculate the Board and its powerful committees (especially those with influence over the bank's credit posture) and remove a major preventive screen against other, perhaps larger-scale, underhand dealings.

In the current context in Ghana where disclosure is weak and some banks seem to be flouting the requirement to publish the details of such sweet and juicy deals, the risks are compounded multifold.

If the central bank is genuinely keen on stamping out insider and related party dealings, and thereby to avert another string of bank collapses, it cannot continue to close its eye, as it has done all this while, to one type of such practices that could actually undermine the effort.