TJWRICKETTS @ LAW

NEWSLETTER

MARCH 1, 2024

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REQUIREMENTS FOR COMMERCIAL PAPERS IN GHANA

Introduction

As part of efforts to improve the expansion of Ghana's securities market, the Ghana Stock Exchange (GSE) announced its readiness to launch a Commercial Paper Market (CPM) in Ghana. The development of the CPM is yet to be fully implemented on the GSE, with new and/or improved trading rules for commercial papers (CPs) in Ghana.

The current regulatory regime for CPs can be found in the Securities and Exchange Commission (SEC) Guidelines for Investment in Commercial Paper, issued on October 8, 2012 (the "Guidelines"), which prescribe the criteria for acceptance, restrictions, and other requirements for CP transactions in Ghana.

What is a CP?

According to the SEC, a CP is a money-market security with a fixed maturity of fifteen (15) days to two hundred and seventy (270) days. In generic form, a CP is a short-term financial instrument issued by banks or large corporations to meet working capital needs such as payroll, accounts payable, and inventories. That is, a company that needs quick funds to pay its workers, for example, may opt for a

CP payable in thirty (30) days rather than going for a traditional bank loan with high borrowing costs and cumbersome procedures. A typical example of a CP is a promissory note.

Who Can Issue a CP?

Although there is no general rule, CPs are mostly issued by financial institutions and large corporations because they have high credit ratings. There is trust that these organisations have the cash flow or liquidity to repay the debt within the short duration unlike small entities. Small entities may not have the liquidity or may struggle to raise the funds within a short period, increasing the risk of non-payment.

How are CPs Issued?

The issuer of the CP is the entity that is creating the short-term debt to fund its short-term cash needs. CPs are issued at a discount, which means that the CP is issued at a price that is less than the face value. When the CP reaches maturity, the investor will receive the face value amount of the instrument, even though they paid a lower discount amount at the time of purchase or investment.

What are the Requirements for Issuing a CP in Ghana?

The Guidelines provide the requirement of a CP that is acceptable to the SEC and that is required to be purchased by investors and /or fund managers. The requirements include, among others, the following:

a. it should be issued by a duly registered Limited Liability Company in Ghana;

b. the issuer must have tangible net worth of not less than Five Hundred Thousand Ghana Cedis (GHS 500,000.00) as per its latest audited financial statements which should not be more than fifteen (15) months old;

c. the CP must be denominated in Ghana Cedis;

d. it must be issued at a face value with a fixed coupon rate;

e. it must be issued for the prescribed maturity duration of fifteen (15) days to two hundred and seventy (270) days from the date of subscription;

f. the issuer must not have existing unretired CPs or overdue loans; and

g. a certificate evidencing the subscription or investment must be issued.

Return of Investor’s Capital

A CP becomes due at the end of the maturity period (15-270 days) at which date the issuer becomes liable to return investor capital or repay to investors the amounts stated on the face of the CP.

Is Security or Collateral Required?

CPs may either be unsecured or asset-backed. Unsecured CPs consist of promissory notes backed by the issuer’s promise to pay the face value on the maturity date specified on the note (This works where the issuer has a good reputation for paying its debts when due). On the other hand, an asset-backed CP is collateralized by other financial assets, making it a secured form of borrowing.

Advantages and Disadvantages of CPs

Some advantages of CPs include: (a) low repayment risks; (b) it provides a quick investment return to investors; (c) a company can directly issue the CP to targeted investors, or it can be done through banks/dealer banks; and (d) it is flexible, cost-effective, and reliable.

On the other hand, one needs excess liquidity to issue CPs, which makes it unattractive for low-income businesses. Furthermore, the proceeds from this type of financing can only be used for current assets or inventories and not for long-term or fixed asset needs.

Risk Mitigating Factors

Like any other form of financing and/or investment, issuing or investing in CPs may have some risks. One therefore needs to conduct thorough due diligence on issuing companies to ensure that they are in a position to return investors' funds upon maturity. Legal, tax, and operational compliance must also be assessed as they have the potential to affect an issuing company’s liquidity status.

Recommendations

CPs are a great source of short-term financing for businesses. Investors with excess liquidity are encouraged to make these funds available to businesses that are in need of short-term loans for investment returns. It is also recommended that a finance lawyer or a capital markets expert should be engaged to conduct the needed compliance checks and offer adequate advice for safe investments.