

World Bank: A decade of market patronage

It took little imagination to chose the World Bank as Borrower of the Decade. From its first Eurobond in 1980, to the hugely successful global issue in 1989, the supranational made an enormous contribution to the development of the international capital markets, identifying and opening new sectors, and sponsoring innovative concepts.

Throughout the 1980s, the World Bank sustained the tradition of achieving a competitive level of funding with every issue, while trying to be fair to all involved. The World Bank was the biggest issuer of debt during the 1980s, having raised over US\$100bn. Its regular need for access to the capital markets has clearly endowed it with a unique sense of long-term responsibility.

It would be wrong to confuse the Bank's attitude of fair play with altruism. It has a fiduciary responsibility to the 152 governments that make up its shareholders to obtain the best rates available, and is under constant pressure from these shareholders, whose guarantee gives the Bank its triple-A rating, to achieve ever more competitive funding. However, the numerous triple-A borrowers which have seriously damaged the financing levels available to them by succumbing to temptation and issuing debt that left investors with unpleasant memories has been a salutary example. Don Roth, the World Bank's treasurer, outlined the philosophy: "We care about pricing and the trading of our debt, and pay the utmost attention that our reputation isn't damaged simply because a sloppy performance upsets our investors." This realism comes from the knowledge that "if we have to pay more, the ones that are penalised are our clients — the world's poor."

Decade of change

The past 10 years saw enormous changes in the environment of the capital markets, with the World Bank exerting a substantial influence on the evolutionary process. Against a background of double-digit inflation in the US, high dollar interest rates, currency volatility and the surge in the US deficit, the bond market underwent a renaissance in the first half of the 1980s. The mathematicians hit town. The decomposition of a bond into its constituent parts —

cash flows, currency and credit risks — laid the foundations for the explosion in innovation which led to the growth of the synthetic market, as bankers responded to the demands of an increasingly deregulated and competitive environment.

Jessica Einhorn, the director of financial operations, who heads the World Bank's borrowing programme, explained how the Bank saw the whole picture: "We were privy to all new structures and developments.

Bankers and other borrowers regularly consult us and we were able to take a strategic view of innovative products, examine trends and pick out those instruments which were most appropriate." The World Bank's opinion probably carries more weight than any other authority in the market, and from this privileged position it was consistently at the cutting edge of developments.



Currency swaps

Nothing illustrates the World Bank's leading role better than the development of the currency swap market. Although not the first such transaction, the World Bank's legendary dollars-to-Deutsche marks/Swiss francs currency swap with IBM back in 1981 unquestionably gave the technique the seal of approval. Before the re-weighting of the dollar in its borrowing portfolio in 1987, the World Bank was the top US dollar swap payer; and for most of the 1980s it was the biggest and most prestigious currency swap counterparty in the world. Through its use of the swap market the World Bank developed swap insurance, which as a credit enhancement technique has made an enormous contribution to the depth of the market, increasing the pool of potential counterparties immeasurably.

Diversity

At present the World Bank could clearly satisfy all its funding needs exclusively in US dollars. However, the institution is committed to maintaining access to a

variety of currency sectors, and in 1989 funded itself across 17 different capital markets, compared with six in 1980. Kenneth Lay, head of sterling, US dollar and Canadian dollar funding at the World Bank, noted that the bank's policy was to maintain access in order to ensure future access, as well as to diversify the investor base. "From the point of view of our clients — the LDCs — if borrowing were heavily weighted in US dollars, the currency risk would be passed on to them, which is an unnecessary exposure," he added. He continued: "Also, since we are owned by the 152 governments of the world, there is an equal interest in utilising their discrete markets when they are in surplus."

The position of impartial adviser to governments has on a number of occasions given the World Bank the opportunity to advise on deregulation and open up new sectors. For example, it launched the first Euro-SKR deal and the second Matador, and was the first external borrower in Hong Kong in 1988. However, it has also made a concerted effort over the years to identify and tap fiscal surpluses before they were generally apparent, making a clear and very important contribution to the development of the market. For instance, long before the oil crisis the World Bank had engaged in dialogue with the Arab nations, placing it well ahead of the rush to exploit the flood of petrodollars.

Equally, the World Bank had spent a long time in Tokyo talking to Japanese bankers before the emergence of the Japanese fiscal surplus which did so much to shape the direction of Eurobond business during the 1980s. Eugene Rotberg, then World Bank treasurer, said he spent two months drinking tea as a prelude to business. However, the results were clearly worth it, as in 1972 the World Bank launched the first ever public bond issue in Japan, identifying a source of capital that has proved hugely attractive for countless other borrowers. The relationship with Japan continued, and in 1987 the bank launched the first ever Daimyo bond, seeking to tap a global market for yen securities, since the bond settles and trades in both Europe and Tokyo.

In the same manner, the World Bank added momentum to the internationalisation of the Deutsche mark bond market when it refined its traditional DM syndicate in 1986, streamlining it to 10 houses, six of which were the German branches of big foreign firms. Rene

Karsenti, senior manager in the World Bank's finance department, explained the background to the decision: "It was at a time of increasing international demand for the Deutsche mark, and in order to reach this offshore interest we felt it important to enhance the international distributive capacity of our syndicate."

Post-1985

During the second half of the 1980s there was a significant shift in the environment governing the market, which World Bank officials monitored closely. Quantitative bond analysis techniques passed from infancy to maturity, and the market began to look back to basics. Event risk, which accompanied the explosion in leveraged buy-out activity, forcibly focused the community's attention on credit quality, with treacherous volatility making liquidity of paramount importance. Together, these factors contributed to a major resurgence of the plain vanilla bond, evidenced by the general trend towards larger issues that exact a liquidity premium from investors.

"We... pay the utmost attention that our reputation isn't damaged simply because a sloppy performance upsets our investors."

Don Roth, World Bank treasurer

The World Bank was acutely aware of this, and embarked on a two-year project which culminated in its hugely successful US\$1.5bn global bond. This innovative structure not only achieved cheaper funding, but also employed a US-style syndicate process, with a fixed-price reoffer and negotiated pricing, which gave a very strong boost to the debate which had been bubbling under in Europe

all that year. It was New Zealand which brought the first fixed-reoffer deal to the Eurobond market, but there was no doubt among pundits that it had taken note of the World Bank's open endorsement of the concept and had consequently been considerably more relaxed about setting the precedent. Indeed, the World Bank's choice of the fixed reoffer for a deal that was so obviously critical to its reputation reflected sentiment among investors and intermediaries in the Eurobond market, and was a major statement of support for both: a display that other major issuers have since felt it necessary to follow.

However, the main aim of the global bond was to get the paper to trade on a par with US agencies in the United States, since the World Bank, with some justification, felt its credit warranted equal treatment, but had always met resistance from US investors. Don Roth jokingly described the support the World Bank received as increasing in direct proportion to the

distance from Washington. Basically, as Jan Wright, a senior treasury officer involved with the project, noted, the World Bank was borrowing on much finer terms in the Euromarket, and believed it could obtain its Euro spread in both North America and Asia-Pacific by creating a large issue that could be traded seamlessly between the domestic desks in all three centres. "When you examine what distinguished the global bond," she added, "the fact is that it was able to engage discrete domestic markets for dollars in different centres, as well as [being] accepted for general collateral purposes in the US."

Classy people

Both Don Roth, who took over the stewardship of the World Bank's treasury in 1987, and Eugene Rotberg,

who had run the show from 1968 before moving to Merrill Lynch, stressed that the key to the World Bank's position in the market was the tremendous calibre and commitment of the staff, many of whom were with the bank for the entire decade. "Virtually everything was in motion when I arrived," said Roth. "All I really needed to do was hop aboard the moving train." Rotberg was equally convinced that much of the credit for the World Bank's progress during the decade lay at the door of the treasury officers. "They really are classy people, and they don't treat bankers as adversaries."

Tighter spreads

Clearly, the World Bank has consistently taken a reasonable and responsible approach to its borrowing, which has earned it an unrivalled reputation for

Decade in a snapshot

- 1980: World Bank launched first Eurobond in June — US\$500m in two tranches, US\$300m 10-1/4% due 1987 and US\$200m 9-3/4% due 1985. Previously, the World Bank had found neither the arbitrage nor the variable price reoffering of the Eurobond market attractive.
- 1981: Executed first ever currency swap between two major institutions. The US\$210m 16% notes due 1986 were swapped with IBM into fixed-rate Deutsche marks and Swiss francs.
- 1982: Issued one of the first dual-currency bonds seen in the Euromarket, a Swiss franc/US dollar structure which paid interest and principal in US dollars, but incorporated an embedded currency option on the SwFr/US\$ exchange rate. Introduced the discount note programme to the United States
- 1983: Executed one of the first ever Ecu swap transactions.
- 1984: Brought zero-coupon bonds across the Atlantic to London, and launched issues in a variety of Euro-currencies.
- 1985: Launched a Treasury bond-linked floating-rate note in London. The concept was not widely applicable; but the sentiment — that a borrower whose credit was conspicuously superior to that of a mere commercial bank ought not to have to borrow on the basis of a benchmark set by an inferior credit (Libor) — was one that the market noted with interest.
- 1986: Reflecting increasing world demand for DM, the World Bank streamlined and internationalised its German syndicate.
- 1987: Launched first ever Daimyo bond in Tokyo, tapping both the domestic and the Eurobond markets in an early attempt at a global yen product.
- 1988: Opened the Euro-SKr market. Published discussion document first proposing the issuance of a global bond.
- 1989: Launched first ever globally traded and settled bond issue. Became the first external borrower to ever launch a HK\$-denominated bond.

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shrewdness tempered by a refreshing belief in fair play. But has the philosophy worked? Twenty years ago the Bank could borrow around US\$500m per annum. Since the beginning of the 1980s, it has been raising around US\$11bn every year, and substantially more in some; yet despite a very substantial increase in its demands on the lending community, funding has been achieved at ever tighter spreads. And despite all the upheavals that befell the

Bank's clients — revolution, famine and the LDC debt crisis — the support of the market for its best customer has never faltered. True, when dealing with an institution that has virtually every government in the world on its board, it is probably prudent to display commitment. However, the mutual respect that has grown between the World Bank and the market is unmistakable, and has placed the bank in a unique position to take a leading role in the development of the capital markets.

Alister Bull

Left to right:
Kenneth Lay,
Jessica Einhorn,
Don Roth,
Eugene Rotberg

