DEALS

Shearson Lehman goes it alone

A clever three-part deal for the World Bank saw the investment bank dispense with the traditional Euromarket syndicate.

by Henny Sender

The World Bank brings about 150 transactions to international capital markets every year. But it was one of the final deals of 1985 that made the largest headlines, for both its unique structure and the politics behind it.

"We wanted longer maturities," says Kenneth Lay, senior financial officer at the bank. "We said we'd give the prize to whoever could meet that need." The prize proved to be an unusual one: sole lead managership of the offering. And it was claimed by an untraditional recipient of World Bank largess, Shearson Lehman Brothers.

Shearson Lehman's de St. Phalle: Eliminating risks through full control

World Bank's Rotberg: Large groups aren't magical

The deal consists of three parts that together resemble a 30-year bond but at much less cost to the issuer. The creation of Shearson Lehman senior vice president John Dasher, the transactions capitalize on the relative cheapness of long-term zero-coupon instruments versus conventional issues. "The arbitrage had been staring us in the face since zeros were created," says Dasher, who fretted for two months that the opportunity would suggest itself to rival bankers before Shearson Lehman could get the nod from the bank.

Coordinated concoction

The financing is a highly coordinated concoction including a conventional fifteen-year, $200 million Eurobond coupled with a 30-year serial zero-coupon issue that has a redemption value of $500 million and fifteen parts that mature annually starting in 2016, the year after the Eurobond falls due. The $40.5 million in proceeds from the zeros go to purchase a stripped U.S. Treasury obligation with a face amount of $200 million. The Treasury issue matures at the same time as the Eurobond and will be used to pay it off.

The arrangement results in a steady annual flow of payments, mimicking the interest payments on a conventional bond; after the Eurobond matures, the World Bank begins fifteen years of annual payments of about $20 million to pay off the zeros. Moreover, "the issue washes out. There is no principal payment in the middle," points out the bank's treasurer, Eugene Rotberg. And thanks to the arbitrage, the total cost is far lower than with conventional 30-year money — by some 40 basis points over the life of the issue.

Though rival investment bankers all dutifully applauded the structure, it was the method of distribution that attracted the most comment. Shearson Lehman took full control of the Eurobond offer, without recruiting any co-managers or underwriters, the first such solo undertaking in the Euromarkets.

Sole lead managership is perhaps the logical outgrowth of the increasing dissatisfaction over the way issues are traditionally brought to market, according to the head of syndicate at a major bank. The World Bank's Rotberg agrees: "There is nothing magical about large managing or underwriting groups. They take the paper and then sell it in the gray market at a substantial discount from the offer price."

But by retaining full control, "we eliminate the risk that we would face selling pressure from co-managers," explains François de St. Phalle, who heads international capital markets at Shearson Lehman. "They might rush to the brokers to get rid of their liability. Now if anyone does offer the bonds, they are creating short positions, and we can always take away their ability to cover."

Still, the deal is not without risks — it just presents different ones. The most critical concern is that the issue could prove illiquid in the secondary markets. "If the market ignores the issue and investors perceive this, the issue may be penalized," warns one London banker.

The extent to which the other Euromarket houses are participating in the secondary market is the subject of some debate. Shearson Lehman Brothers International head Jacques Gelardin claims six to eight houses are making markets in the issue, but a banker at another major house has found only three others committed even tentatively.

Politics as well as discontent played a part in determining the distribution arrangement. Bankers say it was simpler to give the whole issue to Shearson Lehman than to grapple with the complex etiquette that dictates how the World Bank's traditional bankers participate in its offers. For example, the World Bank usually has Deutsche Bank run the books for its Eurodollar deals, according to Lay. Notes one banker: "The World Bank has to be concerned with what Deutsche Bank thinks. After all, the D-mark market is the one in which the World Bank is most active, and it depends on Deutsche Bank for access to it."

Rotberg is confident that investors will seek its paper regardless of the departure from the usual syndication techniques, but whether this new wrinkle will become standard practice remains to be seen. For Shearson Lehman, there is some concern that in a market where reciprocity is critical, it will find itself cut out of deals by rival investment banks. "When we need the Street distribution system, it helps that other banks know they are not just being asked for the bad deals," says Shearson Lehman's de St. Phalle. "We are mindful of our relations with the other banks. But this was a unique situation."

Well, not quite. Shortly after the deal was announced, Shearson Lehman brought Credit Lyonnais to the Euromarkets in a similar transaction and once again acted as sole lead manager. ♜