

1982

A Swiss twist for the World Bank

By offering investors an attractive currency hedge, this voracious borrower proved it could successfully tap the same market for four deals in four months.

by Té Revesz

The invitation telex read, "This is essentially a Swiss franc investment." But Crédit Suisse, one of the transaction's three managers, described it as really a "Eurobond in disguise." Whichever it is — the first Euro-Swiss franc issue or simply a domestic Swiss franc obligation with a twist — the deal's three Swiss managers felt obliged to add a detailed set of comments to the invitation, explaining to potential underwriters just how it would work.

The deal: \$100 million in dollar-dominated, Swiss franc-linked bonds issued by the World Bank on April 19. The leitmotif: "additionality" — the term used by both the borrower and the underwriters to refer to the bank's search for additional takers of its paper.

Normally there would be nothing particularly remarkable about the World Bank returning once again to the Swiss franc well. The supranational is one of the biggest borrowers in the Swiss capital market — indeed, some would say, too big. As of February 1982, the bank was carrying roughly \$1 billion in outstanding Swiss franc obligations. Between February and April of this year, the voracious borrower racked up three more issues, totaling \$1700 million. And right on the heels of the latest one — a \$1300 million private placement — came the April 19 deal. "Any market regularly tapped suffers from indigestion," observes Olivier Brunet, senior vice president of Banque de Paris et des Pays-Bas, which handled the World Bank's Eurobond debut two years ago. Adds Roland Hengartner, associate director of Swiss Bank



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Corp. International in London, "Under normal circumstances not even the World Bank can have four deals in four months in the same market."

Something extra

Clearly something extra was needed, not only to relieve the jaded appetites of investors already holding large amounts of

World Bank paper but also to attract those who normally wouldn't buy it at all. Last year, when the bank was up against similar resistance, it initiated a series of innovative currency swaps worth approximately \$1 billion (*Institutional Investor*, December 1981). And while the swaps were grabbing the limelight, World Bank vice president and treasurer Eugene Rotberg was quietly working with the Swiss National Bank and Switzerland's Big Three universal banks to concoct a new kind of offering palatable to both the Swiss authorities and to new investors.

What Rotberg was after was a new audience — investors wary of the Swiss market and the currency risk but nonetheless tempted by the franc's potential for appreciation, especially if they could be assured that the downside risk would be minimal. For a start, Rotberg zeroed in on dollar-based investors and created what he calls "a Swiss franc investment payable in dollars."

"There are some institutions whose activities are in dollars and which want to keep their assets in dollars," says Rotberg, "but which wish to have, in effect, a Swiss franc financial asset." So how do you overcome the psychological barriers of this skittish group of institutional investors? Offer them a bond that allows them to realize the benefits of any Swiss franc appreciation while avoiding the risks of any devaluation. The mechanics are simple — but daring.

The \$100 million offering was split into seven-year dollar-denominated notes of \$5,000 and \$50,000, with a coupon of

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6.625 percent. At the April 19 pricing, the principal and interest were given a fixed Swiss franc value based on the Swiss franc-dollar rate of that date — Sfr1.97=\$1. In the case of the \$5,000 bonds, this translated into Sfr9,850 with a fixed annual coupon of \$331.25, or Sfr652.56. The World Bank guaranteed that on each monthly coupon maturity date, investors would receive the dollar amount necessary to purchase the same number of francs as on April 19, 1982, or the original dollar amount, whichever was greater.

If, for example, the franc appreciated to Sfr1.70 to the dollar, on any coupon date the investor would receive not the \$331.25 of the original issue (which at that point would purchase a mere Sfr580.56), but \$383.86. The same would hold true at the redemption of the bonds. Conversely, if the Swiss franc were to depreciate, the investor would continue to receive the full dollar value of the interest and principal amount. (Thus, if there were an appreciation of the dollar, the Swiss franc-based investor would see his interest yield rise, plus capital appreciation upon conversion back into francs.)

In return for the protection offered against a potential dollar slippage, the World Bank was able to charge a small "premium" in the form of a below-market interest rate. Although there were no completely comparable issues at the time, the World Bank figures the deal saved it between 25 and 50 basis points.

"I've always liked the idea of multicurrency options," notes Rotberg, who first suggested the idea to Swiss Bank Corp. (the lead manager) a little over a year ago. "I've looked to one day giving the investor the privilege after the fact of choosing one of perhaps half a dozen currencies, whichever was revalued the most. And this seemed a simplified version."

Besides the dollar protection, the World Bank and its three Swiss managers added several other features new to Swiss public offerings. In order to broaden the issue's appeal, the maturity was set as seven years, instead of the nine-year minimum required under Swiss law. ("Nine years is on the high side if you look at the Euromarket," suggests Hengartner.) Another unusual feature was the amount: At \$100 million the offering was nearly double the usual Sfr100 million issue.

Foreign participation

Most significant, for the first time in nearly two decades, the Swiss National Bank permitted the World Bank and its Swiss managers to invite foreign underwriters to participate. The inclusion of the foreign underwriters was a key step in the World Bank's quest for "additionality,"

and by issue date, 45 of the 80 underwriters were domiciled outside Switzerland. "The deal was structured just like a Eurobond," explains a Crédit Suisse manager, "not just . . . with Swiss houses, but with international ones." In addition, the issue is to be listed not only in Basel, Geneva and Zurich but in London as well — another first.

For its part, the Swiss National Bank imposed some fairly tough guidelines. Even though foreign banks were allowed in, the issue had to be "done" in Switzerland and managed by Swiss-domiciled banks. Even the invitation telexes had to be sent from Switzerland. "This way we have the best overview, the best information and the best control," maintains Martin Klaus, a divisional director at the Swiss National Bank. Even if it was "more or less close to a Eurobond issue, the line between the franc and the dollar is so narrow that it becomes a Swiss franc issue," he adds. In fact, although the issue is denominated in dollars, it will be quoted in francs on the three Swiss exchanges.

Was the World Bank successful? On the surface, yes. The issue sold out at par and was trading at just over 103 in the secondary markets in mid-May. Initially, however, one of the managers had experienced some difficulty in launching the issue. The Crédit Suisse officer who himself found the new mechanism "intellectually stimulating" also found he had to undertake a "PR effort to sell it. . . . Investors want predictability, and this deal was an animal in between."

Yet Rotberg's underlying aim — attracting new investors — was not so successful. According to Swiss Bank Corp.'s estimate, only 20 to 25 percent of the original placement was made outside Switzerland. "I'm not sure the reasoning was valid," muses the Swiss National Bank official. "As far as I know, the investors were more Swiss franc based than dollar based. The original idea, to reach new investors, was probably not very successful because the issue was so close to a Swiss franc issue. If you look at the coupon, it was a Swiss franc coupon."

And it is unlikely that the franc will be revalued by the amount of the interest rate differential. "If we thought it would," says Rotberg, "we wouldn't have issued the bond." But, he adds, "We may be wrong." (From Rotberg's point of view, it's going to cost the bank either 6.625 percent in francs or 6.625 percent in dollars, and neither alternative is particularly troublesome to him.)

The issue's managers believe the unfavorable exchange rate situation, not the coupon, dampened the enthusiasm of non-Swiss investors. At Sfr1.97 to the dollar, conventional wisdom suggests the

Swiss currency is unlikely to drop much further, thus blunting the desire for a safety net. "If the rate had been Sfr1.70 to the dollar, it would have been very attractive indeed," asserts the Crédit Suisse officer.

Paribas's Brunet, however, takes a sharply different view. He suggests that the offer failed to attract more non-Swiss investors because of the way the deal itself was structured. Specifically, none of the non-Swiss banks was allowed to take part in the management group. "If one wants to create an international issue," argues Brunet, "one doesn't just invite three banks from one country to manage it." The underwriters were invited in for only very small amounts, which, in turn, does not trigger or "motivate" their sales forces — nor does it engender a sense of responsibility.

Thus, Brunet reasons, the issue did not achieve as broad a reception as it could have if the management group had included some large, active non-Swiss banks. "Nonetheless," maintains Swiss Bank Corp.'s Hengartner, "we did feel a fresh wind blowing on this placement, coming from people who had not taken the World Bank's paper before. Another time it will be easier."

Will there be another time? For their part, the Swiss managers are ready, willing and able. "After all," says Hengartner, "we have quite some work invested in this." But Swiss monetary authorities remain very cautious. "It was an exception under the capital export rules that are currently valid," points out Swiss National Bank's Klaus, "and we do not intend to make future exceptions — at least not in the near future." The managers' own estimates of the time that might elapse before the next "exception" occurs range from three months to four years. Interestingly, however, Klaus notes that a 1979 exception made on behalf of the World Bank — permission to issue Swiss franc notes and place them with foreign central banks — is now generally allowed "because we changed our capital-export rules."

The most obvious candidate for a second run is the World Bank, which is "always treated as a special borrower" by the Swiss monetary authorities. But the World Bank is not alone. The Swiss National Bank is also a member of the Asian Development Bank and the Inter-American Development Bank. Concedes Klaus, "If they come to us and ask for a special operation, we would treat them the same way we treat the World Bank."

Meanwhile, Rotberg is looking at "any multicurrency cocktail that would produce a nominal rate of 1 percent. Therefore, say, with respect to principal repayment, we would guarantee to give [investors] enough dollars to buy whichever currency has revalued the most from among the designated ones. That, I assume, would have as much appeal as gold — on which no interest is paid — if not more. I think about it — among other transactions." ■