FUNDING

Spreading it around

Despite coming off the second-lowest funding volume in nine years, the World Bank's first Islamic debt transaction and retail tailored trade with La Poste indicated its maintained emphasis on development and innovation. **Andrew Stein** reports.

Although the International Bank for Reconstruction and Development (IBRD) remains one of the market's most high-profile borrowers, the World Bank's funding arm has not been immune to the reduction in funding volume over the past two years amid increased savings rates.

The IBRD tapped various markets for an equivalent of US$13.1bn in its 2005 fiscal year, within its projected U$12bn-$15bn range at the start of the year and a 12% increase from its 2004 volumes. However, the amount of issuance remains well short of the lofty volumes achieved in the late 1990s when funding topped the US$20bn level amid strong loan demand from Asia following the region's liquidity crunch.

Like many borrowers have done over the past several years, the World Bank's constituents have continued to refinance older fixed-rated debt so that they may take advantage of the current low long-term rates. The pre-payment of debt has increased liquidity and reserves at the World Bank, which has a three-year funding target based on projected cashflows from lending activities. The Bank's financial policies also require that it to maintain liquid reserves of over US$30bn.

At the end of its 2005 fiscal year, the World Bank had about US$102bn in liabilities outstanding and a swap book with a notional principal amount of US$80bn. The IBRD is again anticipating funding volume in the US$12bn-$15bn range for 2006.

Currency diversification jumps

Despite the similarities to 2004, the World Bank 2005 funding year featured an expanded focus on issuance in emerging markets currencies, a solidified retail presence in Japan and the issuance of securities linked to specific indices or distribution channels.

In its mandate to execute deals that provide it with the lowest cost of funding, the IBRD placed transactions in 12 currencies in 2005, the most markets since it issued in 13 currencies in 2000. Issuance in US dollars again led the way with 40%, up from 37% the previous year. But the largest increase came in the category consisting of other currencies, which jumped to 17% from 4% in 2004 as the IBRD conducted transactions in countries including South Africa, Hungary, Poland, Turkey, Brazil and Malaysia.

The Malaysian ringgit issue of M$760m (US$200m) was the first Islamic debt issuance from the World Bank. The transaction followed the Bai Bithaman Ajil principle where investors are able to purchase the securities on a deferred payment basis or instalments over a pre-agreed period.

The five-year bonds priced at 3.58% for a 3bp discount to Malaysian government securities. On a Libor basis the issue printed at Libor minus 26bp. The book on the issue was about two times covered with investment managers taking 59% of the allocation, followed by insurers at 22% and financial institutions at 19%.

Although the issue was the first Islamic transaction for the IBRD, its sister-funding arm of the International Finance Corp (IFC) had previously issued the securities. The IFC has distinct funding requirements from the IBRD and provides funding to private entities, while the IBRD provides funding to governments.

Developing new products

In addition to tapping new markets, the IBRD continued its tradition of developing new products, one of which is a retail-oriented product issued in conjunction with the French postal agency La Poste in early June.

The transaction comprises a five-year fixed-rate issue from La Poste with a coupon that increases every six months. Investors can withdraw their funds at any time without penalty.

La Poste will then use the proceeds from the notes, which were sold over one month, to purchase an IBRD bond. Leading up to the offering the IBRD anticipated the bond to La Poste would be at least US$10m and likely in a range of US$15m-$25m. However, it has exceeded expectations with a total of approximately US$30m.

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"We wanted to do a transaction that reached out to retail and La Poste has exceptional outreach with its extensive network," said Ivan Zelenko, head of derivatives and structured finance at the World Bank. "We wanted to offer a product that would not only offer financial value, but also provide value for socially responsible investors with communication about the World Bank's initiatives."

Officials from the World Bank added that the concept of the trade with La Poste can be redistributed and the entity is looking at additional transactions based on the structure.

While a regulatory change in Japan allowing commercial banks to distribute securities to retail investors has also solidified the institution as borrower-of-choice among retail channels with its Uridashi bonds. About 7% of the IBRD's funding in 2005 was secured in yen, down from 11% a year earlier amid the continued focus on retail investors.

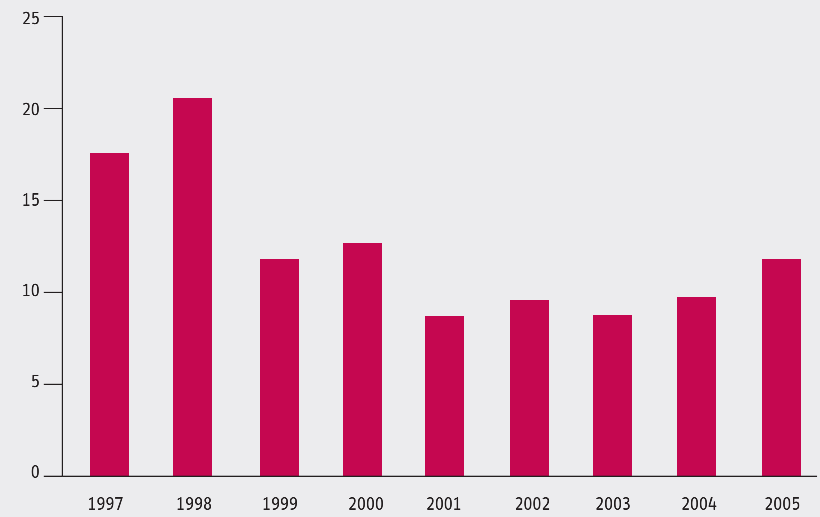
Fortunate timing on long bond

Although the IBRD maintained its pattern of only issuing one global bond offering per year, its 2005 issue drew considerable attention as it was the first 30-year offering from the IBRD since 1993 and one of the few benchmark-sized bond issues to price this year.

The US$750m offering was priced at 22bp over US Treasuries and drew a broad investor base with 50% of the book going to North American-based investors, 35% to European accounts and 15% to Asian buyers. By investor type, money managers received the largest allocation of 40%, followed by insurers and pensions at 25%, banks at 20% and central banks and official institutions at 15%.

At the time of the trade, the relatively flat credit curve and continued spread tightening had fund managers viewing long-dated corporate issues as risky trades, with spread compression looking somewhat overdone at the long-end. The World Bank dollar 30-year highlighted those investor concerns, with bankers reporting a large chunk of interest in the bond coming from investors switching out of similarly-dated corporate issues and into the safer credit.

Number of currencies in World Bank issuance



Source: IMF

"We were extremely fortunate with the timing of our 30-year bond," said Doris Herrera-Pol, head of capital markets for the World Bank. "We do not have duration targets on our funding issuance and we responded to investor enquiries. US-based investors seeking credit trades and duration trades drove the transaction, whereas other recent globals had been driven by Asian demand."

Amid the move up in credit quality at the time, some active money managers balked at the pricing of the IBRD 30-year. One market participant contended that a well-timed purchase of the 30-year Treasury bond would work just as well as the World Bank offering.

Despite the warm reception for any global offering, the World Bank has been limiting itself to one global issue per year as it looks to develop additional funding channels. "Our trend of one global per year has allowed us to stay on the radar screens of our mainstream institutional investors, while allowing us to raise the bulk of our financing through retail transactions and developing markets," said the World Bank's Herrera-Pol.

Taking the leads

The IBRD has a steady rotation of under-writers leading its deals, although JP Morgan, Citigroup and Morgan Stanley having some bookrunning role in two of its last three global transactions.

"When choosing lead managers for our global bond offerings, we look for houses with strong market credentials, product delivery capacity and commitment to the issuers. That commitment is measured not only in terms of the volume of funding deals that they bring to us, but also what innovations they may come up with to address a particular issuer or investor need," added Herrera-Pol.

The IBRD focuses on secondary market performance for its global offerings through liquid two-way flows and spread performance. "We emphasise the latter since when our bonds perform well investors wanting to sell them will have plenty of bids," said Herrera-Pol. A non-deal roadshow also bolstered the credit's conviction that would receive a degree of performance in the secondary market, despite the potential for increased market risk at the back of the curve.

Several linked structures also made appearances in the IBRD's 2005 fiscal year. The credit issued US$10.4m in seven-year notes linked to the performance of the S&P 500 to US-based investors. The bonds carried an annual coupon of 1.15%, and upon maturity investors receive 100% of the principal and a supplemental payment linked to the average annual return of the index.

In response to investor inquiries, the IBRD issued ¥8bn of principal-protected securities. The issue is linked to Deutsche Bank's Emerging Market Liquid Eurobond index and carry a 15-year tenor.

By its statutes, the World Bank cannot take currency risk and must limit its exposure to interest-rate risk. Thus, the IBRD deploys funding to its 184 member countries in US-dollar denominated packages with floating interest rates, and swaps the proceeds from its liabilities to match those assets.