WORLD LEADER: THE BORROWER THAT SHAPED THE BOND MARKETS

The World Bank has always been at the forefront of the global debt markets, not just in terms of issuance but also in the leadership it has shown and its commitment to innovation, says John Geddie.

Some 25 years ago a newly-recruited funding officer at the World Bank sat down and started to pen a note to its board of directors explaining how the bank had been trying to improve bond offerings for investors.

For an entity whose main fiduciary responsibility was simply to get the best possible funding rates for its government shareholders, this may have seemed a somewhat extraneous exercise. But it was one that stuck with that funding officer through the years.

"When I look back, this is what we have been doing all along and it is the foundation of our borrowing strategy," said Doris Herrera-Pol, who is now head of capital markets at the bank.

It has been the World Bank's constant desire to find new and innovative ways to grow and service its investor base that, as a byproduct, has ensured it has always had access to the most diverse and competitive funding sources.

It is its conscientious approach to a pioneering vision that has allowed it to shape the capital markets as we know them today, and will continue to break new boundaries for many years to come.

The World Bank, as its name suggests, has always had a global outlook. Its first bond offering in 1947 was in US dollars, its second in Swiss francs in 1948, and by 1950 it had issued in sterling, Canadian dollars and Dutch guilders. Today, the World Bank has issued in 56 different currencies.

But the one thing it has never taken for granted is market access, and its experiences from as far back as the 1960s have served it well.

Under pressure

Its commitment to funding diversity was not solely altruistic, though. With the balance of payments problems making the US government particularly nervous about World Bank raising and exporting US dollars out of the country, the bank was under huge pressure to diversify.

The broadening of its funding sources was paramount to maintaining its growing loan commitments to developing countries, and Gene Rotberg was the man brought in to find a solution.

"It wasn't rocket science," said Rotberg, who took up the position of treasurer in 1968 and is now retired.

"We recognised early on that there were a lot of other central banks, outside of the US, beginning to accumulate dollar reserves, and they seemed eager to diversify outside of US government obligations," he said.

"We first went to Japan, which was booming because of its export market. With the consent of the government, we became the first foreign entity to borrow from the Bank of Japan."

This set the wheels in motion, and the World Bank started to tap into the savings of the country's trust banks, commercial banks and eventually insurance companies.

It then rolled out the same model in Germany, the Netherlands, Belgium, Canada and Austria, while also tapping the central banks of OPEC countries such as Iran, Saudi Arabia, Venezuela and Kuwait.

"We were in a very favourable position because governments wanted to expand the investment opportunities for their citizens, and there was no better place than the World Bank," said Rotberg.

"It got institutions throughout the world, particularly in Western Europe, used to the idea of holding debt instruments other than those of their own government or industrials."

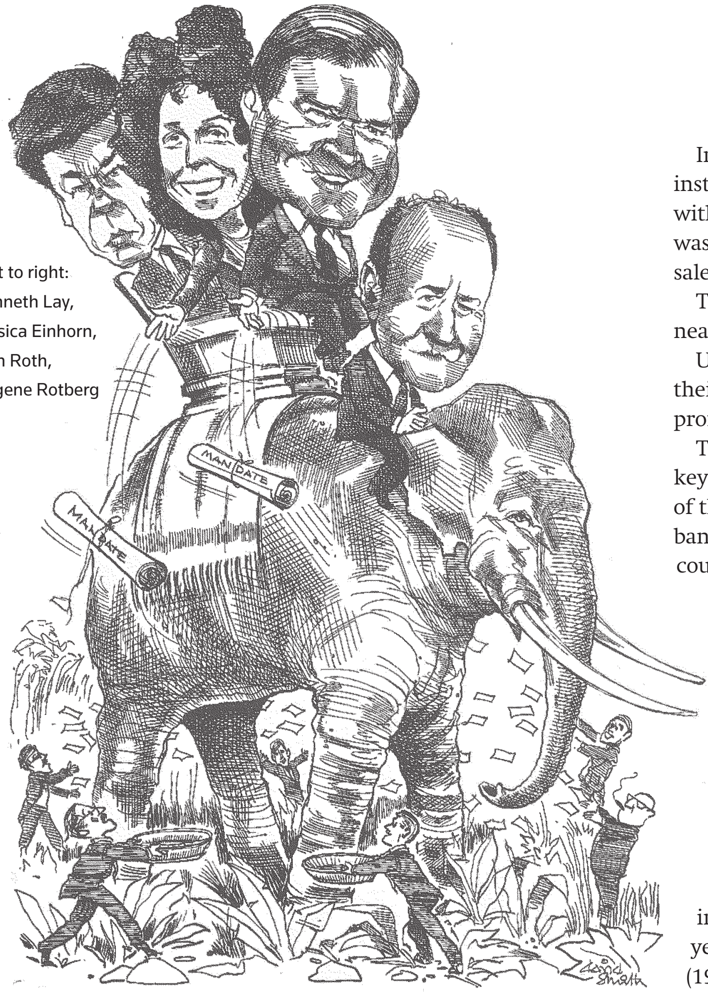
This attitude sowed the seeds for the expansion of the Euromarket from London, which would eventually allow the bank to issue its first Eurobond in 1980.

Mutual respect

But despite the rapid expansion of its borrowing programme, the World Bank always kept investor relations at the forefront of its strategy.

Rotberg remembers one particular example of the World Bank's good faith that involved a private placement with Societe Generale de Belgique, a five-year deal denominated in Belgian francs.

Having signed the terms in Brussels, Rotberg returned to Washington to get final approval from the board. But in the intervening period the Belgian central bank hiked its discount rate substantially, turning the deal sour for the investor. Robert McNamara, the then president of the World Bank, immediately sent Rotberg back on a plane to break the terms of the contract and save the investor from any potential losses. But it proved to be a fruitless journey.



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

Review of the 1980s

"They were adamant. They said a deal's a deal and they wouldn't be persuaded otherwise," said Rotberg. "I think that epitomised the kind of relationship we had with investors. It was one of mutual respect."

Creative spark

The World Bank has always been a willing and honest counterpart, and it was that reputation that led to it negotiating a crucial deal with IBM in 1981 – a deal that, in essence, marked the birth of the cross-currency swap market.

With US dollar interest rates at record highs during the period, the World Bank had turned its attention to currencies with the lowest available nominal rates. There was a concern, however, that its heavy issuance in Deutsche marks and Swiss francs was beginning to saturate those markets. The solution it came to was to get another Triple A rated entity to borrow in Swiss francs, while the World Bank issued in US dollars, then exchange the proceeds and take up the others' obligation. The swap market was born.

Ken Lay, who worked with Rotberg and went on to become treasurer of the bank in 2006, credits Rotberg with encouraging an open environment in the treasury that has kept the creative juices flowing.

"Everyone that has taken up that job after Gene has recognised that it was your main obligation to maintain that atmosphere. It is very rare for a public entity to show this type of innovation," said Lay, who joined the bank in 1982.

Global ambitions

Over the course of the 1980s, Lay was central to some of the World Bank's greatest achievements – most notably, the creation of the Global bond.

In the late 1980s, there was a significant difference in the institution's cost of financing in the Eurobond market compared with the Yankee market. This was partly because in the US there was a fixed price reoffer, whereas in London the underwriting and sales commission was far more competitive.

This, of course, frustrated the World Bank, and it embarked on a nearly two-year long mission to eliminate the disparity.

US banks voiced their opposition, of course, reluctant to give up their fees, and undermine the quasi-cartel that had operated so profitably.

The World Bank quickly realised though, that the key to the deal would hinge on convincing investors of the benefits of greater liquidity. Over the period, bank staff met with 125 portfolio managers in 16 different countries.

A couple of weeks before the deal was launched in September 1989, Lay personally wrote to all those investors and thanked them for their involvement in the process.

Those same investors subscribed the deal seven-times over, and those lucky enough to get their hands on some of the US$1.5bn of 10-year bonds were rewarded for their loyalty with more than 10bp in performance over the first few days of trading. The bond was the most actively traded on Euroclear for the month of October, and the most actively traded non-government issue for rest of the year.

The bankers came round, having clearly underestimated how in touch the World Bank was with the buyside. The following years witnessed the first Global bonds in New Zealand dollars (1990), yen (1992), and Deutsche marks (1993).

Honest broker

To this day, the World Bank remains one of the largest and most frequent international borrowers in the world, issuing hundreds of transactions every year to meet a funding volume responsive to market stress. At the height of the most recent global financial crisis in 2009, the bank borrowed US$44bn to service its lending. This year it will borrow US$24bn.

What has remained constant over the years, however, is the level of innovation, ensuring its investors have access to a range of bespoke products and exotic currencies, while its shareholders have access to the most competitive levels of funding.

For example, in recent years the World Bank became the first foreign issuer to launch bonds in Mexican and Chilean pesos (2000) and was the first to launch a bond in the new Turkish lira (2003), while it also later became the first supranational to offer so-called socially responsible products (2005) and eventually launched the first ever Green bond (2008).

With the help of the World Bank, there is now better access to financial markets than there has ever been before, and as a result, many of the bank's borrowers have paved their own way.

But the financial support the bank provides is just one part of the equation. It now has a whole ream of sophisticated products and services to offer to its clients, such as its MultiCat programme, which allows countries to insure themselves against natural catastrophes through the capital markets, or its RAMP programme, which advises central banks on managing their foreign currency reserves.

"Market access comes and goes, and when things get a bit more difficult the borrowers still have us," said Herrera-Pol.

"But the majority of effort here at the World Bank now is in knowledge transfer. We help find development solutions for our clients by putting to use all the leading-edge products in the market. We do this effectively because of our reputation as the honest broker." ●