1981-82

Peter Montagnon on how innovation broadens choice for borrowers

Fresh techniques by World Bank

INNOVATIVE techniques are often the last refuge of borrowers in the international capital markets. They resort to them only when other, conventional forms of borrowing are exhausted. As a result, many hastily conceived ideas often fail.

This, says Mr Eugene Rotberg, treasurer of the World Bank, is a pitfall which his organisation tries to avoid. The bank, which will raise more than $10.5bn this year, is the largest single borrower in world bond markets. That means that it pays to open up as many options as possible so that the bank is not forced to use any one market when conditions have turned against it, he says.

With two major innovations approved by its board this week, the bank is doing just that. It has signed up a deal with Aetna Casualty and Surety Company of the US to insure swap transactions with single A and double A rated counterparts. It has also launched a scheme for the continuous issue of securities in the US with maturities ranging from three to 30 years and more.

Both these techniques will add to the bank's range of choice in international borrowings. Bankers say they also capture the increasingly sophisticated mood of a marketplace that is now deeply concerned with breaking down old barriers and developing a continuous business free of constraints of time, national boundary and market sector.

The World Bank is no stranger to the pioneering role. In 1981 it was the first to arrange a currency swap when it exchanged dollar obligations with Swiss franc bonds launched by IBM, the computer manufacturer. More recently it has attempted to launch floating rate notes priced at a margin over the US Treasury Bill Rate, which it regards as less volatile than the conventional London interbank rate (Libor).

That has not been such a successful experiment. This time round, however, the World Bank has again introduced new ideas which could well have a greater impact and could well encourage imitators elsewhere in the market.

The Aetna deal will greatly expand the range of counterparties with which the bank can engage in swap transactions. At present these either have to be triple A rated, or else the swap has to be guaranteed by a top quality commercial bank. The Aetna insurance scheme will upgrade other borrowers to this status at minimal cost, spreading the risk into the insurance industry and, incidentally, squeezing the commercial banks which have become used to earnings guarantee fees on swap business.

Moreover, the bank says the insurance scheme creates a counterparty with a credit rating even better than a straightforward triple A status. For the bank to be at risk, the insured counterparty would have to default at the same time as Aetna itself was in difficulties.

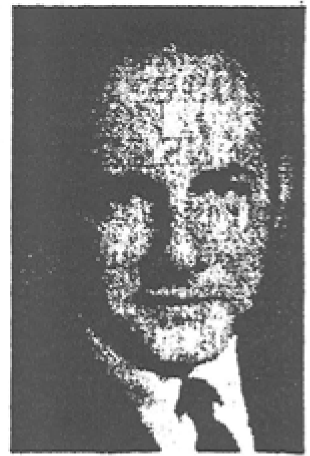
The World Bank intends to arrange about $2bn worth of swap transactions a year, Mr Rotberg adds. That gives it a relatively small share in the market, but the impact of its move could be great. First, it creates a new degree of standardisation of swap counterparties. Second, the fact that one bank—Morgan Guaranty—has been appointed to clear payments under the scheme could give a boost to the growing secondary market in swaps.

The World Bank's second innovation is one which it has christened Colts, or continuously offered longer-term securities. Up to an initial amount of $500m the bank will sell interest-bearing fixed rate securities in the US domestic market. The idea has grown out of the fast-expanding market in medium-term notes in which two to four year paper has until now predominated.

In a bold application of commercial paper market techniques to the bond market, the World Bank is now to offer securities of up to 30 years and even longer through four agents—Goldman Sachs, Merrill Lynch Capital Markets, Salomon Brothers and Shearson Lehman. Investors will be able to choose the precise day of maturity, though interest payment dates will be pre-set to ensure that paper is tradeable.

Eventually the bank hopes to offer variable rate securities and zero coupon paper as well through this mechanism. But it already offers a glimpse into a brave new world in which borrowers raise money, not through one particular deal but through a continual relationship with investors wishing to match their portfolios with precisely tailored cash-flow needs.

"We will continue to do large bond issues, but this gives us constant access to the market," Mr Rotberg says. "You have an immediate response daily to any maturity."



Mr Eugene Rutberg: constant access to the market

That, of course, makes the traditional process of bond syndication look cumbersome and out of date. So far the World Bank is only dipping its toe in these waters, yet a glance at the way the syndicated loan market has been overwhelmed by the advent of Eurocommercial paper ought to be enough to make any bond syndication manager sit up and think.

In the longer run, what the World Bank is doing could easily put them under the same sort of pressure as their colleagues in the moribund loan market.