The World Bank's high credit rating in the capital markets is beyond dispute. Its leverage is five times as strong as that of commercial banks. Its short-term money market turnover runs to several trillions of dollars a year. And its extraordinary ingenuity in diversifying and managing its liabilities is eventually reflected in a phenomenal profit that swells its own reserves and mainly goes to the developing countries in one way or another.

The profit machine that helps the poor

REMEMBER **Jessica Einhorn,** the 110-pound fragile looking young lady working in the World Bank Treasury, who can cascade 250 words a minute on how to create "synthetic instruments", or if you want, on "how to determine the right opportunities in the spectrum of credit differentials in the variable rates market?"

A bit puzzling? But you should really hear her explain in simple prose the advantage of a floating rate mechanism which will use as rate base a fixed percentage point of the differentials between US T-Bills and LIBOR. Einhorn is now examining this new rating device.

She and **Hani Findakly,** who came from Iraq to study engineering in MIT 17 years ago, and **Joseph Uhrig** form a team which, one might say, provides the agility, the brains and the profit-making instinct that the Bank now deploys successfully to penetrate the world market as a dominant force, and finally, to generate a 16% return on liquid assets of US$17 billion.

Today, the annual turnover of its money market operation ranges between US$3 and 4 trillion, which, by the way, should make the Bank one of the world's biggest institutional investors.

World Bank Treasurer Eugene H. Rotberg (facing page): Record borrowings, record leverage, record profits.

Uhrig, on the other hand, has the record of issuing one bond every two days — 170 in a year — in 25 different currencies.

Findakly and his colleagues swapped US$1.4 billion last year, and, aside from winning the recognition of being the world's largest user of the currency swap market, they made a hefty 540 basis point profit.

Uhrig, as the director on the liabilities management side, has been the longest in the Bank, followed by Findakly who entered the awe-inspiring precincts of the Bank only eleven years ago as a mere trainee — a member of the Young Professionals programme. Einhorn, the latest addition to the team, who is concerned with new instruments designing, came a long way through the State Department's office of the Under Secretary of Economic Affairs and later the US Treasury's International Monetary and Development Finance Office.

Their boss, **Eugene Rotberg,** Vice President and Treasurer, is pleased this summer with the US$1.137 million 1985 (year to 30 June) profit, "an all-time high" for the World Bank.

Interest rate drop

Says Rotberg, "I am particularly pleased because most of the profit came not from charges to the LDCs (loans), rather as the return on liquidity, and second, because of our low cost of borrowing which averaged at 7.89% only."

Borrowing short term, borrowing in floating-rate instruments, using swaps — all these added to the phenomenal profit. The Bank's very large equity base of US$9 billion also helped, but Rotberg will never miss pointing out the fact that large though the equity base is, the Bank could earn on it a return as high as 15%.

Admittedly, this was possible because of a substantial drop — from 14% to 9% — in interest rate on medium-term debts, which alone produced a US$360 million net capital gain.

No, this is not going to happen again this year. "Unless the interest rate drops another 5%, which is not possible", and therefore, Rotberg is looking to something in the range of US$800 to 900 million profit for the next year. "That will still be US$200 to 300 million higher than the level we were cruising during several years before last year," he explains.

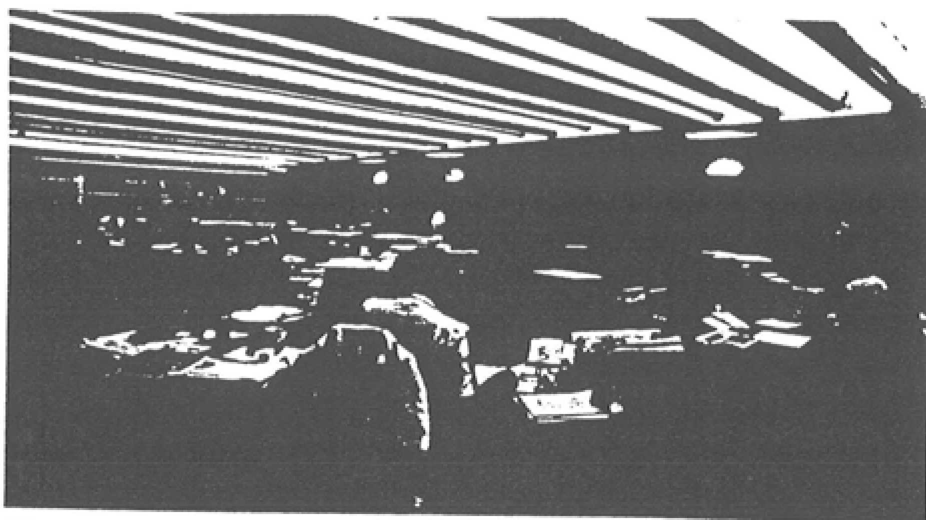
High credit status

The most unique feature in the balance sheet of the Bank, which attaches a high credit status to its bonds, syndicated loans, and discount notes — a recent innovation — and what is known as the Central Bank Facility, is that it maintains five times as strong a leverage as a typical commercial bank does.

First, and foremost, there is the US$17 billion cash which Findakly and his 16-member dealing-room managers unleash in the high-speed r.p.m. of the short-term global dollar market to produce a turnover in excess of several trillions a year. Of course, it attracts market attention.

Hardly ever though, the shareholders or the press point out the fact that the Treasury has shown an extraordinary ingenuity not

Skilled money managers take advantage of the global market for the benefit of the poor.



The World Bank Treasury dealing room is a centre of high-power activity, with a bank of computers and hot lines. Of its 16 traders, seven are Ph.Ds and seven MBAs.

only by diversifying its liabilities in scores of currencies, but by adapting itself to amazing skills in swaps and other depository transactions. Most notably, it is now avoiding the traditional commercial bank route of LIBOR-based products. For example, last year the strategy of liability management — there are four division chiefs under Uhrig who look at groups of different currency denominations and borrowing instruments — achieved no less than a 0.37% spread between the return on loans and cost of debt.

Rotberg quite pertinently asserts that the spread between the return on his liquidity and cost of funds is ten times better, 3.96%, which should make the Bank the most profitable financial institution in the world. And, he sees no inconsistency between this performance and the Bank's role as an institution serving the cause of the poor.

All for the LDCs

The profit, he says with just pride, goes to the LDCs. "We are here to take advantage of the market, bring the perception of skilled money managers into play, and basically predict the interest rate in a moving market, and pass on the benefit to the countries that need low-cost loans." (Last year the outstanding loan averaged 9.04%, 94 basis points higher than the previous year, but including commitment charges and front-end fees.)

The credit doesn't go entirely to the Treasury management. Even Rotberg is willing to concede that. The very nature of the Bank has given it access to the credit markets of various member countries. The low cost of funds can be attributed also to the attention the Bank has traditionally focused on creditworthiness, the quality of its own loan portfolio, the care shown towards lending, and the rate of return on the projects it has supported during the last 40 years. And notably there has never been a default, maybe just some insignificant delay, in the principal and the interest that come back to the Bank's coffers. (The repayment amounted to US$6 billion last year.)

The result, in brief, is the world of a difference that has taken place in the last 20 years, especially in the capacity of the Bank to leverage its shareholders' "usable capital" to attract private investors' money from a widespread, global marketplace. Twenty years ago, the Bank matched member governments' resources with funds raised from the market, on a 50:50 basis. Says Rotberg: "Today it's in a much, much greater multiple." Last year the numbers were: government supplied resources, the paid-in capital and reserves, totalled US$8.2 billion, while outstanding borrowings from the market were in excess of US$50 billion. Twenty years ago, given the paid-in capital plus reserves at US$2.7 billion, the Bank was able to borrow from the market exactly the same amount.

Global strategy

With the emergence of the global capital market, it began to shift its lending to a variable rate system — one of the wisest, anticipatory moves by the Bank. Now it is moving increasingly towards variable rate borrowings, too, but with an innovative flair for using the US Treasury Bills rate, instead of LIBOR, as the benchmark.

In the opinion of the Treasury, papers using T-Bill interest rates as the benchmark will always be preferred to LIBOR. The latter being essentially a bankers' rate, investor preference in the short-term market is likely to move to instruments pegged to T-Bill rates. Rotberg says, bills of quality issuers will begin to see the wisdom of moving increasingly to the T-Bill benchmark. Even so, to make the Bank's issue more market-oriented, the Uhrig-Findakly-Einhorn team is now playing with yet another idea — a more innovative, flexible rate base. The concept is of a floating rate that will have the hybrid character of being, in a way, based on both benchmarks, LIBOR and T-Bills. It will float on a fixed percentage point of the spread between the two.

Innovations in the pipeline

These innovations take time, careful research, and an intense collaboration between the Bank and a variety of leading underwriters. For example, a similar process preceded the Bank's venture into an interest-rate swap which it did for the first time the other day.

This year soon, the Bank will go to the market for term financing, bearing T-Bill based interest rates, but featuring a new appetite-whipper. After the first six months of the purchase, the bills become almost like cash certificates, salable after two months and rates adjusted likewise. Yet, it will offer the Bank the advantage of term-financing because a group of underwriters will back it up with a term-financed fund. The next move is to look into currency option related financing.

But the real big bang may come when the Treasury finally presents its recommendations to the senior management for making its debut in the futures market. At the moment, the team is weighing its risk-reward aspects as carefully as possible, but at the same time being dictated by the perception that "locking into an interest rate of borrowing without actually having borrowed" which is what in Rotberg's words is the basic motive behind any futures deal, can enhance the Bank's liquidity and increase the prospect of profit. Einhorn puts it in a different way, "You can't be in one area of the market without developing a good understanding of the other area, in the same market."

The philosophy behind all these innovations in borrowings has always been that one has to look at the structure of one's debt — and the requirement of having to go to the market annually for US$10 to 12 billion — and see what might appeal to investors. "To