The World that changed the bond

In the early 1980s, you could issue a Yankee and a Eurobond at exactly the same time, with the same coupon, but with a 50bp disparity in funding costs. The World Bank – the pre-eminent issuer of the day – started talking to banks, and finally convinced them that one deal into both markets – a Global bond – would be good for the market, as well as saving more than a few pennies for the issuer. Richard Jory reports.

The World Bank issued the first globally traded and settled bond in the financial markets in September 1989, satisfying its desire for investor diversification, but also for cheaper money. The further aim for the bank of getting its paper to trade in the US on a par with agencies was also achieved.

"It was not complicated; our view was not whether this would happen, but when it would happen," said Kenneth Lay, deputy treasurer and director of the World Bank.

After two years of preparations, the bank announced its intentions to issue the first global in June 1989, after convincing a group of 14 banks to give up a number of established franchises and embark on what one banker at the time described as "a massive fee-cutting exercise" under Deutsche Bank's leadership.

"We had become convinced by 1985 or 1986 that we were paying too much to do Yankees and still not getting broad US placement. We had to work out how to develop a real US market franchise," said Lay.

Kenneth Lay

"Colts [continuously offered longer-term securities] gave us continuous US presence; in one year we did US$1bn in more than 1,000 tickets. That gave us the basis for a global approach to begin eliminating the pricing disparity between US and European markets," he said.

Equal treatment of investors

The underwriting process for the new bond included consultations on pricing to ensure a reliable valuation, with no reallowances to investors or "soft dollar" arrangements, to ensure the equal treatment of investors. The confirmation of primary market orders at the issue price enhanced this equality.

"In the US, there were much richer fees – a 10-year Yankee cost 0.50% or 0.60%, and the fixed-price reoffer system meant that dealers kept the full gross spread. This was sustained by the virtual cartel that the five 'bulge bracket' firms enjoyed. So there was a lot of concern among the US houses that a global deal could import into the US the remarkably skinny fee structure in London that resulted from the combination of unfettered competition and the practice of reallowing fees to investors," said Lay.

"But the global didn't make everyone happy, especially about the fixed-price reoffer feature: Right after the first deal we got a letter from one of the London 'spiv' accounts that had been making a nice living taking down Eurobonds less the full fees and flipping them back into the market. He was very complimentary – said it was the best-prepared deal he'd ever seen – then went on to note that 'for all the reasons we discussed, I didn't participate . . .'" said Lay.

Give and take

Euromarket banks gave up lead manager fees and praecipuum, but were compensated by being able to buy bonds at the same price as the lead.

"Together with the opportunity to put their New York desks to better use, this particular factor may be why Eurobankers seem relatively comfortable with the whole scheme. US firms, on the other hand, may have to concede a cut of up to 50% in fees, and do not warm to the bypassing of their quasi-cartel," wrote IFR on June 10 1989.

Together, the improvements enabled the World Bank to reduce its US dollar borrowing costs by at least 5bp–10bp compared with traditional Eurodollar bond issues, and by at least 10bp–15bp compared with earlier issues launched exclusively in the US domestic market.

After trading on much finer terms in the Euromarket, and with the belief that it could trade at similar levels in the US and Asia with a large issue switching seamlessly between the domestic trading desks in all three regions, the World Bank issued the US$1.5bn 10-year to a rapturous reception from investors, who subscribed the deal seven times over.

"Eurobonds would usually trade at a 25bp spread on amounts of US$10m; we thought a 10bp or better bid-offer spread on amounts of US$25m could result with the new bond: it did, and we reduced transaction costs. Funding cost savings on our first global were around US$15m in NPV terms; development costs were around US$300,000," said Lay. "We assumed that the Yankee market was a non-starter for pricing, so we priced off Eurobonds. And after the issue, our Yankees began to tighten as well."

Trading as a home product

Liquidity was given a fillip by the ability to offer simultaneously in the US, Europe and Japan to ensure the broadest and most diverse investor base. The desired result was the issue of a bond that was traded on dealers' most active desks in each time zone, as a "home" market product.

"It was crucial that there be a real book passing between the US and European markets. These people in London and New York were not talking," said Lay.

The substantially larger size than earlier offerings also ensured improved liquidity. "The investor base comprised central bank reserve managers, major high-grade fixed-income managers; and some middle market US accounts that had become familiar with the World Bank through our highly successful Colts programme," said Lay.

In the secondary market, the US dollar global tightened from 37.5bp spread to US Treasuries at the time of the issue, to 24bp or 25bp within a few days. The spread stabilised at that level, establishing a new relative value position versus US Treasuries – inside US agencies and the bank's old Eurobonds by about 15bp.

The first US dollar global was the most actively traded issue in Euroclear for the month of October, and the most actively traded non-government issue for the rest of 1989.

Technically speaking

The greatest technical innovation came when connecting Fedwire with the Euromarket clearing systems with newly automated links, to permit low-cost clearing of trades across time zones.

"A major problem was that the infrastructure was not integrated. It revolved around two systems: in the US, the Fedwire; and in Europe, Euroclear and Cedel (now Clearstream). The links between the two systems were slow and cumbersome, took two to three days, and needed manual intervention," said Lay. "There was very little Eurobond activity on US trading desks – when London markets closed, it was very tough to get a price in the US, and vice versa."

The second global bond – also from the World Bank – was, by its own admission, priced too tight on expectations created by the blow-out, first deal. This was not sufficient to damage a path that would now be trodden by other issuers and also extended into currencies other than the US dollar.

The World Bank's global bonds were intended to provide another trading vehicle and enhanced liquidity to the yen market; the results are apparent in turnover data. "After the initial US dollar global, we did a New Zealand dollar global, which was also very successful; then a first yen global in 1992 and after that a first Deutsche mark global," said Lay. "The issue when launching in local markets, especially in the emerging markets, is how local regulators want the market to develop."

Daily turnover figures for the World Bank's yen global bonds compare favourably with side-issue JGBs: the yen global bonds' trading volumes frequently exceed those of the most active non-benchmark JGBs on the Tokyo Exchange.

"The low transaction costs, diverse investor base, dealer sponsorship and large size of World Bank global bonds have all contributed to the bonds' deep secondary market liquidity," according to the World Bank.

The bank's first global Deutsche mark bond was launched in October 1993 and "produced an order book with an uncommonly widespread, international diversification," said the bank. "Trading data suggest that, since its issuance, the World Bank's DM Global bond has established itself as the most liquid instrument in the DM market, after government paper . . . since launch [DM Global bonds have] accounted for more than one third of aggregate Euroclear turnover volume for the most actively traded euro- and global DM issues."

"Wherever the market was open to do so, we tried to issue in the global format," said Lay.

The World Bank stamped its mark on the global yet again in the middle of June 2004 with a US$1bn five-year issue that was its first public bond since May 2003. As ever, the deal was created to maintain name recognition with investors. ■

The International Bank for Reconstruction & Development (World Bank)

Amount: US$1.5bn
Maturity: 10 years
Coupon: 8.375% (payable semi-annually)
Issue/fixed reoffer: 99.55
Spread at reoffer: 37.5bp
Launch date: September 18 1989
Payment: October 4 1989
Rating: AAA (Moody's); Aaa (S&P)
Fees: 35bp
Listing: Luxembourg, New York
Governing law: New York
Denominations: US$1,000
Negative pledge: Yes
Cross-default: No
Sales restrictions: None
Market sector: Global
Lead managers: Deutsche Bank, Salomon Brothers
Co-managers: The First Boston Corp, Goldman Sachs, IBJ International, Merrill Lynch Capital Markets, JP Morgan Securities, Morgan Stanley, Nomura Securities, Paribas Capital Markets Group, Shearson Lehman Hutton, Swiss Banking Corp Investment Bank, UBS Phillips & Drew Securities, Yamaichi Securities

