| | |
|---|---|
| **Folder Title:** | McNamara correspondence - 1972 (1 of 2) |
| **Folder ID:** | 30247418 |
| **Series:** | Support and communications of the Office of the President and senior staff |
| **Dates:** | 12/29/1971 - 12/12/1972 |
| **Fonds:** | Records of the Office of External Relations |
| **ISAD Reference Code:** | WB IBRD/IDA EXT-04 |
| **Digitized:** | 12/22/2021 |

91000 - 003 VPE McNamara Correspondence, 1972

Members of the New York Stock Exchange

One New York Plaza
New York, NY 10004 (212) 747-7026

**Salomon Brothers**

William E. Simon

January 27, 1972

Dear Siem:

Enclosed is the study that you requested on the International Bank Lending and Financing Plans for this decade.

We would indeed welcome the opportunity to discuss this paper in detail with you at your convenience.

I look forward to seeing you very soon.

Sincerely yours,

Bill

Mr. S. Aldewereld
Vice President, Finance, and Director
of Projects
International Bank for Reconstruction
and Development
1818 "H" Street, N. W.
Washington, D. C. 20433

I gave Mr Hittmair a copy

COMMENTS AND SUGGESTIONS

ON THE FINANCING PLANS OF THE

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

We are very pleased to respond to your request for our suggestions on your financing plans in the 1970's, and we particularly appreciate your recent comprehensive briefing and background material. They were of invaluable assistance in clarifying your operations and objectives and, therefore, in helping us to formulate our response. In assessing your prospective lending and financing requirements in conjunction with the broad changing pattern of economic and financial activity in the U.S., we are grouping our response into four categories. These are: (1) your economic and financial assumptions, (2) the IBRD's financial standing, (3) the market performance of your bonds, and (4) the financing strategy for the remainder of the 1970's.

Your Assumptions on the Economic and Financial Environment

Your memorandum on "The Scale of IBRD Financial Operations, FY74-78" and the underlying credit and economic background contained in "U.S. Capital Market Developments and Outlook" is an excellent starting point for assessing your strategy. They place in clear perspective the growth of the U.S. credit markets with the growing borrowing requirements of the IBRD. Your conclusion that in the future the IBRD's borrowings will continue to be only a very small fraction of total effective credit demands in the U.S. is irrefutable, even if the underlying economic and financial assumptions should vary drastically from your estimates. In addition, the analysis puts into sharp focus the credit flow equilibrium generally in the industrialized countries, which the IBRD should continue to be able to tap for funds to offset at least part of the shortfall in other countries which do not have the high credit standing of the Bank or commercial access to funds.

We understand from your briefing that we need only comment on your assumptions on the economic and financial environment where it is vital to the financing of the Bank. Nevertheless, we thought you might be interested to know that your profile of the U.S. economy and financial markets is very similar to the results of the study which the Stanford Research Institute recently completed for us on "The Financial Markets In 1975." A copy of this study is enclosed for your exclusive review only. We would appreciate it if you would keep this study strictly confidential and return it to us eventually.

The differences between the Stanford study and your projections is mostly one of shading and, in most instances, not of major substance. The Stanford Institute projects somewhat more real growth and larger inflow of funds to deposit-type savings banks in 1975. It also foresees very substantial improvement in internal cash generation by business which would limit the growth of external financing by business.

There are, however, economic and financial aspects that long-term projections cannot and should not be expected to assess which still are crucial in the development of a financial strategy. One is the continued cyclical nature of the U.S. economy and its implication for the IBRD. Unless stabilization techniques in the U.S. are vastly improved, it seems highly likely that the imperfect policy mix will contribute to more rather than less volatility in the credit market. Moreover, in view of the decision of the current Administration to intervene in the economy directly as evidenced by the New Economic Program, it should be recognized that the risks have now increased significantly for intervention directly in the credit markets when future monetary restraint might escalate interest rates sharply. Politically, it will be far easier and palatable to allocate credit than to set wages and prices. As you know, a Federal Committee on Interest and Dividends is already functioning, although it has promulgated few regulations thus far.

It should also be noted that there is a discernible shift in the composition of credit demands which will facilitate the allocation of credit when it becomes a political prerequisite or, at a minimum, intensify at times the competition for funds. The umbrella of the Federal Government has already been placed over our mortgage market (frequently the largest demander of credit) through subsidies and Federally sponsored credit agencies. The Federal financing umbrella may also be placed over our municipalities if their problems remain acute.

To the IBRD, the "Federalization" of more of our credit markets is important because this process creates very effective demanders of credit, offering highly marketable obligations with high quality which can be offered to the investors in the obligations of the IBRD issues. One such investor, the state and local retirement funds which are probably now the largest institutional buyers of IBRD issues, might occasionally shift its preference away from your issues when the political pressures intensify to purchase Federally supported issues during periods of tight money. Thus, it seems to us that there is a need to build into your financing program substantial flexibility and contingency liquidity.

Another important emerging development is the intensified management of bond portfolios. This is because of the pressure on institutions to maximize income and the increasing size and depth of our bond market which facilitates bond switching and trading to enhance portfolio performance. Thus investors will favor obligations that are highly marketable. For the IBRD, this would suggest incorporating in your financing strategy measures designed to preserve the marketability of your issues and to maintain your financial standing.

Financial Standing

A number of factors lead us to conclude that you should be able to maintain your high financial standing in the years ahead. Your extraordinary fine lending record should continue to enhance investors' confidence in the Bank's securities. To be sure, the Bank's emphasis on helping to finance the developing countries may occasionally cause concern among some investors. Such adverse views, however, can be readily muted by the Bank through a series of dialogues with the investment community. The dialogues should elaborate on the unique role of the IBRD in international finance, its economic and financial achievements, and the capacity of its financial resources.

In spite of the excellent lending record of the Bank thus far, the high financial standing of the Bank would be reinforced if it would clarify for investors the impact of a large borrowing country going into default on the Bank's earnings and total financial capacity. This could be accomplished by the aforementioned dialogues with investors or through a formalized contingency plan.

On the liability and capital side of your balance sheet, the decline in your equity ratio should not be a matter of concern. This is because of the large call that can be made by the Bank on subscribing stockholders. It seems to us that the Bank should, however, strive to maintain a reasonable earnings performance, which would be in keeping with the overall policies and objectives of the Bank and serve as a measure of performance and assurance to investors. Recognizing the objectives of the Bank, the maintenance of a 5% return on equity should satisfy these requirements.

The Market Performance of the Bank's Issues

To judge the market performance of the Bank's issues in the U.S., we have prepared the accompanying table and two charts. The table shows the new issue yield on the Bank's bonds compared with the yield on new Aa utility bonds and long U.S. Governments. During the early postwar years, the new issue yield on the IBRD bonds exceeded the yield on new utility bonds most of the time. During the past decade, however, the reverse was generally true with the Bank being able to issue bonds at yields below those offered by Aa utilities. Your two recent note offerings came to market at yields of 22 to 25 basis points below those offered on utilities of comparable maturity. In contrast, there has been only one long Bank issue that was marketed at such a favorable coupon spread to the Bank. Comparisons with yields on U.S. Governments are not meaningful because there have been no long-term Government issues in recent years.

In the secondary market, these favorable yield spreads have not been maintained for the note issues. As shown in the accompanying chart, the yield on the note issue was in close alignment with that of the Telephone issue for most of the first nine months of 1971, then yielded as much as 48 basis points less than the Telephone issue in November, and moved back to a close alignment with the Telephone issue in early January 1972.

The yield on your outstanding long-term issues tend to be below those of seasoned Aa utility issues most of the time with the yield spread fluctuating within a band of about 25 basis points in favor of utilities to an occasional small spread in favor of the Bank issues.

Financing Strategy

Your financing strategy should be designed, of course, in such a way as to enable the Bank to facilitate its lending objectives. With this in mind, we feel that your financing program should provide for adequate flexibility to cope with unsettled credit market conditions. It should also facilitate the broadening of the ownership base of your debt securities and take advantage of the unique international position of the Bank. In keeping with these strategy objectives, we should like to offer the following suggestions.

Issuance of Short-Term Open Market Paper. The offering of this type of obligation would be an important complement to your current sources of funds and would also offer distinct advantages. When money is tight, it would be a much easier source of funds to tap in the U.S. than the long-term market, which might be officially closed to the Bank. Thus, it would provide an external financing vehicle instead of having to carry large internal liquidity for the purpose of financing the Bank during times of inaccessible credit markets. Short-term open market paper would also allow you additional leeway in the timing of your long-term financing. In addition, this type of financing is bound to lower your total financing costs. During the postwar years, short-term open market rates have only rarely equalled or exceeded long-term rates. Among the leading governmental institutions now issuing short-term paper are the Federal National Mortgage Association and the Export-Import Bank. In view of your financial strength, we estimate that the market could absorb a very substantial volume of your paper.

Private Placement. Periodically, there is a substantial availability of funds in the two to four-year range at institutional investors in the U.S. At such times, these funds could be quickly captured by the Bank through a private placement at virtually little concession to the publicly offered market. Among the institutional investors receptive to such a financing would be pension and retirement funds, special state funds, and bank trust departments.

Increasing the Role of Foreign Central Banks. In this connection, we suggest a three-dimensional approach. First, foreign central banks should be offered bank obligations with a wide range of maturities to capture the maximum of available funds from these institutions. Thus, foreign central banks which legally cannot commit funds long would help to finance the IBRD. In view of the fact that your experience shows an excellent rollover of maturing issues held by foreign central banks, it would seem highly unlikely that these institutions would become volatile investors by merely offering them tailor-made maturities. In the unlikely event of some increase in the volatility of their holdings, the fluctuations could be offset through the issuance of short-term open market paper.

Secondly, the large holdings of U.S. Governments by a number of important foreign central banks offer a financing opportunity to the IBRD, especially within the next year or so. This is because any lasting international currency agreement will have to include some provisions for either the formal or informal funding of at least part of the U.S. Government obligations held by these institutions. In a sense, the issuance of U.S. dollar-denominated IBRD bonds to the foreign official holders of dollars would facilitate the funding and would provide a yield higher than would be offered on a comparable maturity U.S. Government obligation.

Thirdly, foreign central banks should continue to be encouraged to purchase outstanding IBRD bonds. This activity provides a powerful support for the secondary market of your obligations which in turn encourages private investors to hold your issues.

Reduce the Non-Call Feature on New Long-Term Issues. We feel that the non-call provision of your long-term bond can be reduced from 12 1/2 to 10 years without any significant cost to you. It would provide you with additional flexibility to refund outstanding high coupon issues and thereby reduce financing costs. A ten-year non-call feature is not unusual in the United States. It is generally offered by industrial corporations while utilities hold to five years.

Regulatory Changes in U.S. That Would Strengthen IBRD Bonds. There are several bond issuers in the U.S., particularly the U.S. Government and its various agencies, that have very favorable regulatory treatment which is not now enjoyed by the IBRD. Because the United States strongly supports the IBRD, at least some of these regulations could be enlarged to also provide favorable treatment for the Bank. Currently, IBRD bonds are not eligible for collateral at the Federal Reserve for dealer repurchase agreements, for purchases by U.S. Government investment accounts, for purchase by national banks without regard to statutory limitations, for legal investment for Federally chartered savings and loan associations, and for qualifying assets for mutual savings banks that pay taxes according to the "Percentage of Income Method."

A European Unit of Account Issue. The enlargement of the Common Market reaffirms the increasing importance of the European capital markets. In light of this development and the restructuring of the international monetary system, a European Unit of Account issue might be another financing alternative for you. However, we want to delve into the suitability of this financing in greater detail before we render a definitive judgment.

We would be pleased to discuss our comments and suggestions with you at your convenience. In the meantime, your effort to keep us abreast of your plans is greatly appreciated and will help us to serve you as underwriter of your securities, which we value highly.

January 27, 1972

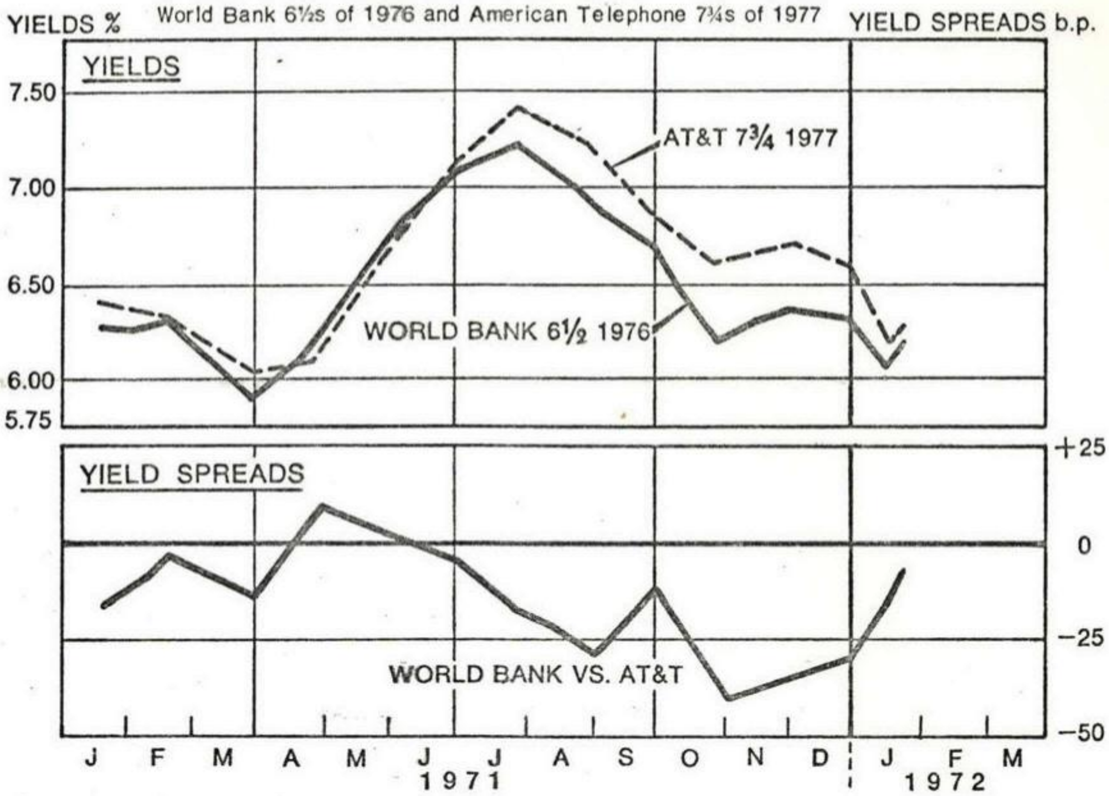
NEW MEDIUM AND LONG-TERM WORLD BANK BOND ISSUES

| Long Term | New Issues: | | Date Offered | World Bank Orig. Offering | New Aa Util. Def'd. Call | Long Govts. | Yield Spreads (b.p.) IB vs. Utils. | Utils. vs. Govts. | IB vs. Govts. |
|---|---|---|---|---|---|---|---|---|---|
| World Bank | 3 | 72-52 | 7/11/47 | 3.00 | 2.69* | 2.33* | +31 | + 36 | + 67 |
| | 3 | 76-56 | 2/28/51 | 3.00 | 2.90 | 2.44 | +10 | + 46 | + 56 |
| | 3 1/4 | 81-56 | 9/11/51 | 3.25 | 3.01* | 2.56* | +24 | + 45 | + 69 |
| | 3 3/8 | 75-57 | 5/14/52 | 3.47 | 3.15* | 2.58* | +32 | + 57 | + 89 |
| | 4 1/2 | 77-67 | 1/10/57 | 4.50 | 4.50* | 3.48* | 0 | +102 | +102 |
| | 4 1/4 | 78-67 | 4/18/57 | 4.40 | 4.29* | 3.31* | +11 | + 98 | +109 |
| | 4 3/4 | 80-67 | 10/15/57 | 4.75 | 4.78* | 3.63* | - 3 | +115 | +112 |
| | 4 1/4 | 79-68 | 1/ 7/58 | 4.29 | 3.89 | 3.20 | +40 | + 69 | +109 |
| | 4 1/2 | 73-68 | 11/18/58 | 4.50 | 4.40 | 3.82 | +10 | + 58 | + 68 |
| | 5 | 85-70 | 2/ 9/58 | 5.00 | 4.85 | 4.34 | +15 | + 51 | + 66 |
| | 4 1/2 | 82-72 | 1/24/62 | 4.50 | 4.50 | 4.11 | 0 | + 39 | + 39 |
| | 4 1/2 | 90-75 | 1/14/65 | 4.47 | 4.43 | 4.23 | + 4 | + 20 | + 24 |
| | 5 3/8 | 91-76 | 6/28/66 | 5.39 | 5.45 | 4.73 | - 6 | + 72 | + 66 |
| | 5 3/8 | 92-77 | 3/14/67 | 5.35 | 5.45 | 4.50 | -10 | + 95 | + 85 |
| | 5 7/8 | 93-77 | 8/22/67 | 5.95 | 6.17 | 5.12 | -22 | +105 | + 83 |
| | 6 1/2 | 94-80 | 3/21/68 | 6.54 | 6.63 | 5.58 | - 9 | +105 | + 96 |
| | 6 3/8 | 94-80 | 9/17/68 | 6.44 | 6.40 | 5.35 | + 4 | +105 | +109 |
| | 8 5/8 | 95-83 | 7/23/70 | 8.63 | 8.50 | 6.85 | +13 | +165 | +178 |
| | 8 1/8 | 96-84 | 8/11/71 | 8.13 | 8.15 | 6.34 | - 2 | +181 | +179 |
| Medium Term | | | | | | | | | |
| World Bank | 6 1/2 | 76 | 1/14/71 | 6.50 | 6.75 | 5.88 | -25 | + 87 | + 62 |
| | 6 3/8 | 77 | 1/ 4/72 | 6.375 | 6.60 | 5.39 | -22 | +121 | + 99 |

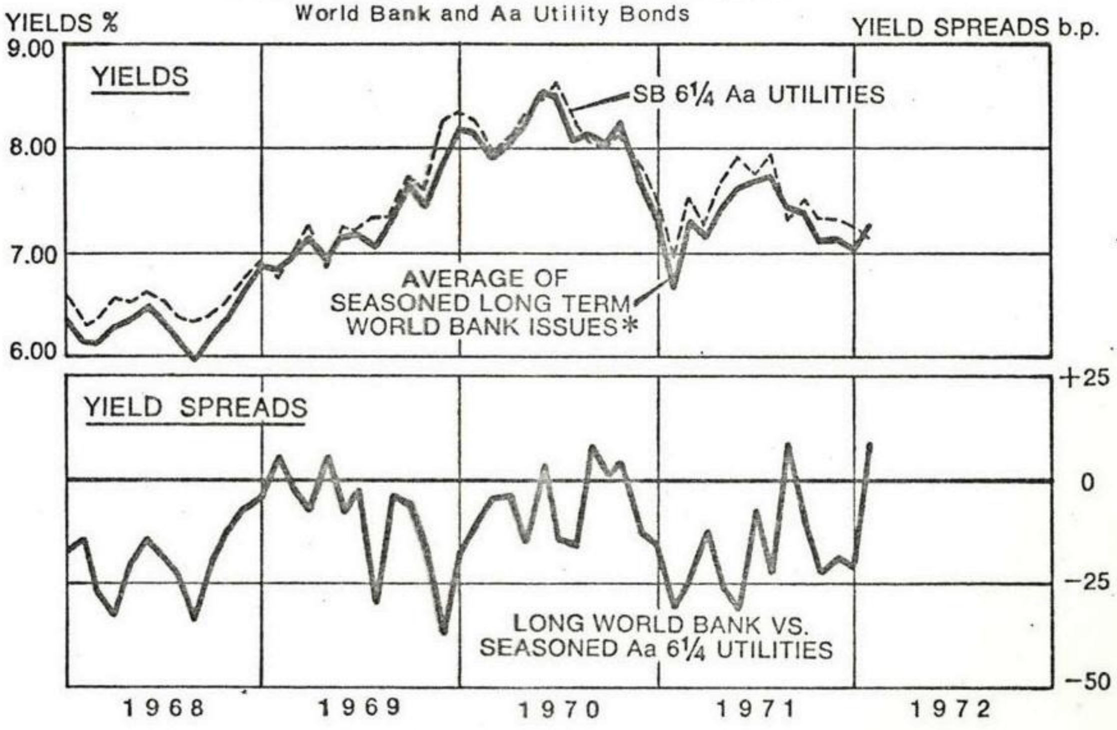
*First of the Month

Seasoned Medium and Long Term World Bank Issues compared with Seasoned High Grade Utility Bonds with comparable maturity

Seasoned Medium-Term Yields and Yield Spreads
World Bank 6½s of 1976 and American Telephone 7¾s of 1977




Seasoned Long-Term Yields and Yield Spreads
World Bank and Aa Utility Bonds




*Average of two of the more actively traded long World Bank issues-through late 1968, IB 5 3/8's '92 and the IB 5 7/8's '93 thereafter the IB 5 3/8's '92 and the IB 6 3/8's of '94.

CONFIDENTIAL

Memorandum to Mr. Robert S. McNamara

February 1, 1972

*MORGAN STANLEY & CO.*
*140 Broadway*
*New York, N. Y. 10005*



February 1, 1972

CONFIDENTIAL

MEMORANDUM TO: Mr. Robert S. McNamara

COMMENT ON MEMORANDUM:

"The Scale of IBRD Financial Operations FY74-78"

## I. Scope of the Assignment

You have asked us for our comments on a memorandum dated December 15, 1971 entitled "The Scale of IBRD Financial Operations FY74-78." We understand that this memorandum has been circulated to the Executive Directors of the Bank and that it is scheduled to be discussed at a meeting on February 8, 1972. You have requested that we address ourselves in particular to that portion of the memorandum which deals with the ability of the Bank to borrow its projected requirements in the capital markets of the United States.

We have been furnished with certain supporting material used in preparation of the memorandum and have been given the opportunity to question senior officers of the Bank on its content. In addition, we bring to this study our experience over the past 25 years in working continually to develop and broaden the market for Bank bonds, and our resulting exposure over this period to investor reactions. We have drawn extensively on this experience in analyzing the memorandum, and in so doing have permitted ourselves to comment on certain broader aspects of the problem of marketing Bank securities. These include the lending policies of the Bank as viewed by potential investors, its capital structure and the changing character of the primary and secondary markets for its bonds. We have also offered certain observations on the potential market for Bank bonds outside the United States.

We have made no attempt to make a qualitative analysis of the Bank's loan portfolio or of its lending policies. We do not question the Bank's competence to assess the creditworthiness of its borrowers, and we fully accept and concur with the judgments in this area contained in the memorandum. On the other hand, the Bank gained general acceptance for its securities largely on the basis of subjective judgments by investors that the Bank was being operated according to sound business principles. Subjective judgments of this nature will do much to determine the Bank's future success in raising funds. For this reason we have pointed out in this study certain areas of investor concern which we believe a realistic assessment of the future market requires us to recognize.

At your instructions we have made no assumptions as to the attitude of the U.S. Treasury Department in giving its permission for expanded borrowing by the Bank, and our views as to the feasibility of the program are necessarily based on the U.S. Treasury's full cooperation.

We have in our study gone beyond a mere assessment of the size of the market for Bank bonds in the traditional market framework. We have suggested the study of certain means of enlarging the existing market and possibly of penetrating segments of it which have not heretofore been important. Certain of these proposals go well beyond areas we have reviewed with the Bank in the past, and would require extended study of the feasibility and desirability of putting them into effect. However, as we have noted, the subject of how to broaden the Bank's market has been examined at length over a period of many years. To have the fullest assurance that that market can now be nearly doubled under all conditions requires, in our view, willingness to consider new approaches.

Finally, we think it goes without saying that the objective is not the mere achievement of the projected five-year borrowing target. We assume that the senior management of the Bank would like to accomplish this at the lowest practicable cost and furthermore would like to end the five-year period with the Bank in a posture of financial strength and with its financing flexibility intact for whatever course management may then choose to follow.

## II. Summary and Conclusions

1. We believe the 1974-1978 borrowing program, as projected, can be readily accomplished and that the U.S. capital markets will be able to absorb the increased level of Bank borrowing. Such a program can be accomplished within the existing market framework, although it will require that the Bank maintain a flexible approach toward the size, timing, maturity and other terms of its issues.

2. The Bank's capital requirements are of a magnitude that will require significantly increased support from present lenders as well as broadening of the market to attract new buyers. In addition, the types of investors who have purchased Bank bonds have changed over the years, and there has been some degree of concern about the Bank voiced among those currently constituting the

principal actual and potential market. In connection with the increased volume of borrowing we recommend that a new educational program be developed promptly which would be designed to give investors a fuller understanding of the Bank's operations, including the quality of its lending activities and the strength of its financial position. This program would involve both group meetings and published materials.

3. We think that the continued success of the borrowing program may call for consideration of additional capital subscriptions at some time prior to 1978. We do not believe that an increase in capital subscription is necessary now, but we recommend that this question be kept under review as the program develops.

4. We believe that it will be essential for the Bank to retain its triple A rating during this period. Toward this end, it is important to review regularly developments in the Bank's financial position with the rating agencies to be aware of their reactions.

5. Although a significant amount of work has been done in the past to broaden the market for Bank issues, we believe that additional improvements remain to be made. In our judgment the secondary markets for long-term Bank obligations are not as broad as those for corporates of similar size, and this has taken on added significance as institutions have become more liquidity conscious. We think the solution lies principally in obtaining a wider distribution of original purchasers, which should be a primary consideration in designing the educational program referred to above.

6. We believe that while the proposed program can be accomplished through the traditional means of publicly offered medium and long-term debt

issues, in order to obtain maximum market penetration under all conditions the Bank should be prepared to consider ways of tapping alternative sources of funds not heretofore used. These would include short-term debt, subordinated debt and Eurobonds.

## III. Historical Background

The procedures currently in use for marketing Bank bonds in the United States have evolved over an extended period of time. In the first few years after its formation the Bank experimented with a variety of techniques for selling its issues. These included (i) an offering directly by the Bank where it opened the books for subscription by dealers in the manner of U.S. Government issues, (ii) an offering to underwriters by means of competitive bidding and (iii) two issues offered through a sponsoring group of dealer-managers. These issues met with varying degrees of success. In May, 1952 the Bank sold an issue through a negotiated underwriting group managed by Morgan Stanley & Co. and The First Boston Corporation. This procedure has been used for public issues ever since, and to date the Morgan Stanley - First Boston underwriting group have sold 22 issues totalling $3.2 billion and varying in maturity from three to 26 years. In January, 1971 a new underwriting group for the purpose of marketing intermediate-term Bank notes was formed under the management of The First Boston Corporation, Morgan Stanley & Co. Incorporated and Salomon Brothers. This group to date has sold two issues totalling $450 million.

At the outset the Bank's marketing efforts encountered a certain degree of resistance from institutional investors. For a great many institutions Bank bonds were not legal investments under state laws, and for others their purchase was inhibited by governmental examining agencies. Among all types of investors there was a general lack of understanding of the Bank and a tendency to regard it either as a foreign institution or as a global agency for dispensing foreign aid.

In this environment the Bank and its managing underwriters launched a broad program aimed at developing and maximizing the institutional market. Extensive work was done with state authorities to change the laws and regulations so as to make Bank bonds legal investments. At the same time the managers conducted over several years a broad educational campaign, calling on hundreds of institutional investors, supplying them with studies and arranging visits by them to the offices of the Bank. At times the managers prepared educational booklets highlighting elements of the Bank's credit and furnished them to thousands of investors across the country. These educational activities were continued for many years, with much of the activity taking place between issues when there was not the time pressure of an issue at hand. On several occasions Morgan Stanley and First Boston made presentations before the Executive Directors of the Bank to acquaint them with developments in the marketing of Bank bonds. In our experience these educational efforts were highly productive and resulted in materially extending the market among investors whose initial reactions had been negative.

Various incentives were used during this period to stimulate sales of Bank issues. For many years the selling concession paid to underwriters and dealers on sales of Bank issues was maintained at 0.50% compared with approximately 0.375% for other high-grade issues. (It has recently been 0.40% where it is in line with that for other high-grade issues). The bonds were given a slightly longer period of call protection than that customary for comparable industrial issues. An extended delayed delivery option was provided, with a commitment fee paid in the interim. Occasionally a device such as a purchase fund was employed. In several issues portions of the issues were set aside to attract new buyers who had not purchased Bank bonds in the past. Particularly careful account was kept of the performance of members of the underwriting group, and their allotments in subsequent issues were adjusted to reflect their performance and thereby encourage maximum effort on succeeding issues.

It was natural that in the early years of the Bank's existence its obligations were marketed virtually entirely on the strength of its uncalled capital. More precisely, in order to overcome the disinclination of many investors in the United States toward securities with foreign connotations, the Bank's bonds were marketed by strongly emphasizing the uncalled subscription of the United States in relation to the Bank's total funded debt. Although the Bank never entered into a contractual requirement that the uncalled U.S. subscription would always exceed the funded debt (as did the Inter-American Development Bank), it gave what the market regarded as a clear signal to this effect when in 1959, at a time when the debt was approaching the U.S. subscription, the Bank's capital was more than doubled. The effect of this on the investment market was evidenced by the actions of the rating agencies which at that time raised the Bank's debt rating from double A to triple A.

As time passed and the Bank built up an operating record of unquestioned success, the managing underwriters endeavored to shift the emphasis to a more comprehensive evaluation as an operating financial institution. The educational efforts were directed toward convincing investors of the soundness of the Bank's lending policies, the quality of its portfolio, its record of earnings and the protection afforded by its reserves. It was recognized both by the Bank and by its underwriters that the U.S. subscription by itself would not be enough to market bonds on the best possible terms unless there was complete confidence among investors in the Bank as a sound and profitable financial institution. This image was largely achieved among the preponderance of professional investors who were reached by the educational campaigns. The uncalled U.S. subscription remained the paramount element of the credit, but knowledgeable investors regarded as highly remote the likelihood of an actual call being required.

On a number of occasions Morgan Stanley and First Boston were asked to study additional ways of raising funds. One example was the Horowitz Plan for using the U.S. capital market as a source of funds for IDA; another was a proposal for a standby credit from U.S. insurance companies to tide the Bank over periods when its liquidity might be impaired. The two firms were frequently consulted for opinions as to the market reaction to changes in the Bank's lending rate, new types of Bank loans, etc. Over a number of years both firms sent members of their professional staffs to do two-year tours of duty with the Bank, which did a great deal to further their understanding of its internal operations. In addition, several members of the staff of the Bank spent time in the offices of the two managers.

In summary, the market for the Bank's credit in the United States was developed by the joint efforts of the Bank and its managing underwriters, working closely together to promote knowledge and understanding among the investment community. These efforts were continued intensively until the Bank's securities had become legal investments virtually everywhere, its credit standing had been firmly established and the market had been expanded to a point where it was readily able to absorb the volume of issues which the Bank was offering.

## IV. Recent Developments

In recent years a number of developments have taken place which have been widely noticed by investors and commented on in the financial press. While many of these developments are natural products of the Bank's growth, and indeed many of them are positive elements of strength in the Bank, it would be a mistake to overlook the fact that there has been a certain degree of misunderstanding and apprehension about them among some segments of the investment community. The favorable developments and the arguments in support of the measures taken receive much less exposure.

Beginning in the late ~~mid~~-1960's the Bank began an escalation of its operations at a rate markedly more rapid than that prior thereto. The dollar amount of loans granted, which had been virtually flat in the seven fiscal years ended 1968, rose from $847 million in that year to $1,896 million in fiscal 1971. Gross borrowings, which had averaged about $275 million in the five fiscal years ended 1966, rose to $1,386 million in fiscal 1971. The staff of the Bank in the past five years has doubled.

Roughly coincident with this stepped-up growth the Bank has entered or expanded a number of new fields of lending. These include education, water supply, population control, tourism and rehabilitation. The Bank has indicated that in appropriate circumstances it is prepared to make both non-project loans and loans for local expenditures. Loans have been made in an expanded list of newer and smaller countries, while some of the Bank's larger borrowers have encountered serious economic or political difficulties. The arrangements made in 1967 with respect to India received wide notice among investors because of the description thereof in Bank prospectuses.

In 1964 the Bank inaugurated a policy of making grants out of its net income to IDA, and to date such grants total close to $600 million. The legal status of IDA is not well understood by investors, and it is frequently referred to in the press and elsewhere as the "soft loan window" of the Bank. This confusion persists among investors despite efforts to clarify the relationship in the prospectus.

The foregoing are factors which have been interpreted by significant numbers of investors as in one way or another negative in their effect on the credit of the Bank. These reactions will be discussed at greater length later in this memorandum. In and of themselves these factors would not be serious impediments to the Bank's marketing operations, and there are many counter-arguments and positive elements of credit strength which can be and have been used to answer them. However, it is particularly significant that these developments have come to attention at the very time the Bank's debt has grown to exceed the U.S. uncalled subscription. Although again there are strong positive arguments why this should not be regarded as detrimental, it is apparent that, taken together with the factors described above, the effect on investors is not beneficial. In this environment, we believe that without an effort to counter these reactions the announcement of a five-year program such as that contemplated in the Bank's memorandum could have a measurable impact on the market.

The foregoing leads us to the opinion that the Bank and its managing underwriters should without delay commence the study and organization of a new educational program directed toward existing and potential investors. Our suggestions as to certain of the elements of such a program are set forth later in this memorandum.

## V. Capacity of the U.S. Market

The Bank's memorandum contemplates the following borrowing program in the United States over the five-year period indicated:

($ in millions)

| | Fiscal Years | 1974 | 1975 | 1976 | 1977 | 1978 |
|---|---|---|---|---|---|---|
| 5 Years | Gross | $250 | $250 | $450 | $450 | $450 |
| | Retirement | - | - | 200 | 200 | 200 |
| | Net | $250 | $250 | $250 | $250 | $250 |
| 25 Years | Gross | $400 | $500 | $600 | $700 | $700 |
| | Retirement | 87 | 63 | 65 | 74 | 96 |
| | Net | $313 | $437 | $535 | $626 | $604 |
| Combined | Gross Total | $650 | $750 | $1,050 | $1,150 | $1,150 |

This program would substantially more than double the current level of Bank borrowing in this country. The central question posed to us is whether or not the Bank can borrow these amounts on reasonable terms in the U.S. market.

We think it can. We do not regard the projected overall size of the U.S. market as in any way a limiting factor. There are, however, other considerations to which our basic conclusion is subject. This section will deal with the relationship of the Bank's program to the total U.S. market. The following section deals with the factors which in our opinion will influence the market for Bank bonds, and with our suggestions and recommendations for maximizing that market.

Exhibit I shows the Bank's projected sources and applications of funds in greater detail. Exhibit II relates the volume of Bank financing over the past decade to the total volume of public financing, the volume of U.S. Government agency financing and the volume of financing by the Bell System, the largest private issuer in the U.S. market.

Clearly the feasibility of the Bank's proposed borrowings from the U.S. capital market in fiscal 1974-1978 will be affected by the overall size of the market in which this borrowing would take place. The Bank memorandum considers this aspect of the feasibility of its proposed five-year plan, and the supporting memoranda offer further background material. These memoranda conclude that the likely size and composition of the U.S. capital market in 1974-1978 will be such that Bank borrowing, even at the expanded levels proposed, will continue to constitute only a small percentage of total market borrowing.

We agree with this conclusion. Indeed, we think that under any reasonable forecast of the next decade's development of the U.S. capital market, Bank borrowing at the proposed levels would constitute but a small fraction of total market borrowing; hence the feasibility of the proposed borrowing is not likely to be affected by the accuracy of forecasts of the size of the total U.S. market. It is necessary to look elsewhere for the factors that will bear on the size of the market for the Bank's securities during this period.

A more detailed analysis of the relationship between the Bank's program and the prospective size of the total U.S. market is attached hereto as Appendix I.

## VI. Marketing Considerations

We have indicated that we do not consider the overall size of the U.S. market as limiting upon the Bank's projected borrowing program. There are, however, many factors which to a greater or lesser degree will have a bearing, both upon the feasibility of the program and upon the degree of ease and success with which it is carried out. The more important of these factors are discussed below.

### Types and Attitudes of Purchasers

As the Bank has recognized in its memorandum, the types of investors who have purchased its long-term bonds over the years have changed. Exhibit III is a record of the principal categories of purchasers over the past 12 years. As is evident, the most significant shift has been away from insurance companies and toward state and municipal pension funds. This shift, of course, is not unique to Bank obligations since it reflects broad trends within the investing policies of institutions, primarily the following: (i) a reorientation of the investment policies of insurance companies away from high-quality, low-yielding public offerings toward higher-yielding investments normally offered in private placements, and (ii) the extremely rapid growth of the public pension funds and their preference or legal requirement for publicly offered, rated issues.

In analyzing the potential for substantially increasing the market for Bank bonds, we have reviewed our records of the major potential purchasers with particular focus on the state and municipal pension funds and commercial banks. For public pension funds, many of whom are limited in the amount that can be invested in any one organization, we have related current holdings of

Bank issues to current investment limitations. For other major purchasers who do not operate under such specific legal limitations, we have reviewed our records of Bank holdings, where known, and related them to each institution's general attitude toward additional investment in Bank issues.

Attached as Exhibit IV is a summary of Morgan Stanley & Co.'s records regarding the purchasing policies and attitudes of the principal public pension funds toward the Bank. This summary includes for each pension fund where available legality of Bank bond holdings, current holdings of Bank bonds, limitation on investments in any one obligor, current posture toward purchasing Bank bonds and any comments helpful in explaining such posture. This information is not intended to be definitive since it has been prepared from records and general information rather than in-depth interviews with each of the subject funds. While a definitive study could be undertaken at a later date of public pension funds and other major purchasers, the information available leads to several observations with regard to marketing future long-term Bank issues.

Exhibit IV indicates that, as mentioned earlier in this memorandum, Bank bonds now qualify as legal holdings for most state pension funds. However, the summary indicates that, in spite of the legal status, there are many public pension funds which are not purchasing Bank bonds. The reasons given for avoiding commitments in Bank securities are diverse, but a significant portion relates to the views of their respective investment officers and investment committees as to the relative investment appeal of Bank securities.

It should be recognized that the administrators of these funds are state and municipal employees who have smaller staffs and are generally less experienced in investment analysis than other professional money managers. As suggested earlier, many of their views reflect a misunderstanding or confusion regarding the Bank and its policies. A number of potential purchasers have attributed the lending policies of IDA to the Bank and are critical of what they see as an increasing reliance on soft loans. In addition, increased lending for projects of a social nature has been viewed as a departure from what they had thought of as the Bank's traditional policy of lending to profitable, self-liquidating projects. Unfavorable U.S. press comment regarding loans for tourism and loans to countries which are not pro-U.S. has also caused some pension funds in practice to avoid investments in Bank issues. In our opinion a direct rebuttal by the Bank to many of these concepts could result in the conversion of several funds to active purchasers of Bank issues. Rebuttals of this type are usually undertaken in connection with a sales effort for a specific offering and are not always viewed by the fund administrators as a dispassionate analysis of the Bank and its operations. Hence our preference for the type of educational campaign discussed later in this memorandum.

There is even some concern among fund administrators as to the possibility of a downgrading of Bank bonds to double A. If this should become widespread, it could result in a liquidation of holdings of Bank bonds in order to avoid the capital loss which would result from a downgrading. Such portfolio liquidation would place increased pressure on the secondary market for Bank issues, resulting in the need for higher yields on new issues. While we are well aware of the positive attitude taken toward the Bank by the rating agencies, it will be important to take steps to dispel the concern of some segments of the investment community that the Bank's credit rating might be downgraded.

We do not mean to imply that investor concern is entirely limited to the less sophisticated fund administrators. There is also some element of concern among more sophisticated institutional investors who need to be assured that the Bank's securities will be as sound in the future as they are today as the Bank expands the scope of its operations at an accelerating rate.

We recount these views in order to acquaint you with attitudes which, while of relatively minor importance at past levels of Bank borrowing, clearly must be confronted if the Bank is to double its borrowing in the U.S. market at no yield concession from its current relative position.

Educational Campaign

We believe that any negative attitudes on the part of any investor toward the Bank must be corrected. In our view, the new borrowing program will require a renewed educational campaign, directed toward the new types of actual and potential investors in Bank bonds, securities dealers and members of the financial press. We think that such a program must be carefully designed and carried out with the full commitment of the senior officers of the Bank. The essential elements of such a program would involve bringing the key investment officers of important financial institutions to Washington for in-depth briefings, extending for at least one and possibly two full days. The President and other senior Bank officials would meet with small groups of these investors and describe the Bank's philosophy and operations. The emphasis would be laid on the continued soundness of the Bank's operating procedures and on the various elements of strength in its financial situation. We recognize that such efforts would take a great deal of the time of the Bank's executive officers. Such meetings would, however, enable potential investors to be exposed to the strength and depth of the Bank's management.

We have seen this type of program work in the past and we believe it should constitute an important part of the Bank's marketing operations in the coming five years.

The factors that would be stressed in this program would include an examination of the primary aspects of the Bank's credit position such as those set forth in the Fact Sheet distributed with the last note issue (attached hereto as Appendix II), together with others that could be added to the list. The program would, however, also highlight the type of analysis undertaken by the Bank in assessing the creditworthiness of borrowing countries, appraising individual projects and supervising existing loans. We know that the Bank can make highly effective presentations of this nature, and we are convinced that the effect on the investment community will be extremely beneficial. The ultimate aim, of course, will be to convince investors that the Bank is dedicated to the retention of the highest credit standing and will continue to conduct its affairs with this as a guiding principle.

There are other educational activities that should be explored. These would include meetings with potential investors and securities dealers in other cities, the use of films, the publication of brochures highlighting the elements of strength in the Bank's credit position, and possibly visits by investors directly to the sites of important Bank projects. Techniques such as these are used frequently in financing privately-owned projects. We used all of the foregoing, for example, in raising funds for the Churchill Falls hydroelectric project in Canada, which is the world's largest privately-financed power project. Such methods should prove even more valuable in aiding financing of the magnitude contemplated by the Bank.

We have one suggestion not directly related to educational activities but which we believe would be most helpful to marketing efforts. We have alluded to the confusion that exists in the minds of many investors between the Bank and IDA. We think that this confusion might be better clarified by the treatment of IDA in the Bank's Annual Report, where in speaking of the activities of the "World Bank Group" the operations of the Bank and IDA are aggregated and it is sometimes not clear to which entity reference is being made. We appreciate that the Bank has reasons for this presentation, but we think the matter is important enough at least to raise consideration of the possibility of publishing a separate Bank report for the financial community.

Capital Increase

We have indicated that we believe an educational campaign to be of the highest priority. We must recognize, however, that there are limits to what can be accomplished by such a program. In the last analysis the Bank will have to depend on a far larger number of investors than can be brought to Washington for comprehensive indoctrination. Therefore, we think it may ultimately be necessary for the Bank to effect a renewed capital increase. Whether or not it will be necessary to restore full cover of funded debt by the uncalled U.S. subscription is a question we think it is too early to answer. The Bank's debt has only recently penetrated this level and we would prefer to await some experience with the expanded borrowing program. However, we would point out that although one may propound the strengths of leading world currencies and the protection afforded by the uncalled subscriptions of the Group of 10, pension fund buyers in many parts of the country have only a limited understanding of foreign currencies and indeed probably an ingrained suspicion of them. It is clear that there is at least some body of investors who would remain outside the market for Bank bonds unless the U.S. cover were restored.

We do not think a capital increase of any magnitude is required immediately, but we believe that the matter should be kept under continual review and that before the end of the period covered by the Bank's memorandum, it may be necessary to take the first steps to implement an increase.

Exhibit V shows the historical record and future projections of the relationship between the Bank's funded debt and its capital.

Rating

One of the key factors in maintaining maximum access to the U.S. market at optimum interest costs is retention of the Bank's triple A credit rating from the major rating agencies. In recent years of massive corporate borrowing and increasingly higher interest rates, we have begun to see ratings reduced in numbers not seen since the 1930's. In order to maximize the dimensions of its market and to keep borrowing costs at the lowest level, it is essential that the Bank continue to be rated in the highest classification. Toward this end we think that the Bank and its managing underwriters must engage in a continuing dialogue with the agencies, designed to identify at an early stage any development which the agencies regard as troublesome. The Bank must never permit its financial condition to reach a point where there is any real room for doubt as to the agencies' reactions. It is possible, for example, that entirely aside from its desirability as an attraction to investors, a capital increase by the Bank may in due course become a requirement of the rating agencies. This might occur in particular if the program for years subsequent to 1978 were to call for continued increases in borrowing.

Secondary Market

Although a significant amount of work has been done over the years to broaden the market for Bank bonds, there is considerable evidence that the secondary markets for long-term Bank obligations are not as broad as those for corporate obligations of similar size. In our judgment the market remains relatively thin, being characterized by a limited number of market makers, relatively wide spreads between bid and asked prices and the inability to absorb sizeable offerings without material price changes. These aspects have been commented on by many investors and potential investors in Bank bonds. For many investors, particularly those who manage their bond portfolios aggressively, increased breadth in the secondary market would encourage them to be more active purchasers in the new issue market. The significance of this fact will undoubtedly increase in the future since we believe that the aggressive management of bond portfolios will continue to develop and will become a much more important factor in asset management as a whole.

Some improvement in secondary markets can be expected with the increasing size and frequency of Bank issues which will come as part of the new borrowing program. We think also that a change in the sinking fund would be helpful. Sinking fund payments for Bank issues have in the past started in the year following expiration of the non-call period. This was so designed in order to protect the integrity of the non-call period and thus gain the full market benefit of the provision. However, purchases for sinking funds have been an important factor in the secondary market for those issues where the sinking fund is operative, and we believe that the secondary market would be improved if the sinking fund were to begin earlier. We would suggest when designing future issues that consideration be given to beginning the sinking fund in the fifth to seventh year. There is sufficient precedent for such a sinking fund pattern in the corporate debt market to conclude that this should have no impact on the offering yield. An earlier commencement of sinking fund payments would not require a significant shortening of the average life of an issue, since an increasing or "stepped up" sinking fund schedule could be designed to yield an average life of 21 to 22 years, similar to that of recent long-term Bank issues.

The essential ingredient to an improvement in marketability, however, is a wider mix of original purchasers. High grade industrial issues of the same or even smaller size have noticeably better secondary markets than Bank issues because of the more complete representation of types and sizes of initial purchasers. These include a wide variety of small institutions who purchase only limited quantities of a given issue, and, in certain market circumstances, individuals. The trading activities and differing objectives of such investors lead to frequent buy and sell inquiries in the secondary market and hence to a better market.

Bank bonds tend to be purchased in large quantities by relatively large investors. This comes about essentially for two reasons: (i) the Bank's marketing efforts to date have been successful without the necessity of cultivating the smaller purchaser, and (ii) the Bank is a more complex and less easily understood entity than the typical industrial corporation. In contrast, for example, many small institutions and individuals purchase Bell System obligations or General Motors Acceptance Corporation debentures without any analysis, relying solely on the generally accepted high quality of the issues.

In our view the solution of this problem comes once again to education. We believe that the small institution can be reached with a program of the type we have described, although regional meetings rather than trips to Washington would be a more appropriate format. We believe that this effort should be made, and that it would yield tangible results in a better mix of original purchasers and a consequently better secondary market.

Terms of Long-term Issues

With a borrowing program of the magnitude now contemplated, it will be increasingly important for the Bank to maintain complete flexibility as to size, timing and maturity of its issues. While it would normally be desirable to alternate long and medium-term issues, there may well be occasions when this sequence should be varied. Ideally, the Bank should be able to move on short notice and mount issues of whatever the optimum size the market will absorb. (Were it not for the problem of Treasury approval the Bank would have a distinct advantage over corporate issuers in its ability to move quickly because of the absence of S.E.C. registration requirements.)

Morgan Stanley and First Boston have recently furnished the Bank with a memorandum on their recommendations as to terms of long-term bond issues. A copy of this memorandum is attached hereto as Appendix III. While these views were presented before we had knowledge of the Bank's expanded borrowing program, we believe that, with the possible exception of the change in sinking fund mentioned above, they would be appropriate for a long-term issue offered today. However, we reiterate that the expanded program will require flexibility and that alterations in these terms may well be indicated in future issues.

Medium-term Issues

The use of issues with a five-year maturity as an integral part of the Bank's overall financing program is a recent development started in January, 1971. The Bank's medium-term issues have attracted institutional investor interest similar to that evidenced for high-grade, corporate issues with maturities of 5 to 7-1/2 years offered during the same period. Such groups have included, among others, commercial banks for trust and portfolio accounts, savings banks, and mutual funds and other equity-oriented investors seeking a temporary income-producing haven for equity funds. In the case of Bank issues, commercial banks have accounted for a larger than normal percentage. Despite the active participation by commercial and savings banks in these two offerings, however, it is clear that the Bank is not competing for the largest pool of medium-term funds held by these banks, i.e. those funds invested in U.S. Government and agency securities.

FR Bell.

As you are aware, federal legislation would be required to make Bank medium-term notes eligible for many of the important uses made of agency securities. Such uses would include, among others, use as collateral for Federal Reserve discounts and advances, use as collateral for Federal Reserve dealer repurchase agreements, purchase by the Federal Reserve for open market operations and purchase by U.S. Government investment accounts. We have not inquired into the feasibility of obtaining the necessary legislation required to achieve the above, although we believe this should be studied. It is apparent, however, that increasing the similarity of Bank issues to those of U.S. agencies would both increase the size of the potential market for the issues and result in offering yields closer to those for agencies.

We believe that even if all the impediments were removed it is unlikely that Bank securities would be marketable at the same yield as those of agencies, since among other things they would continue to lack the liquidity of agency issues. The importance of liquidity can be gauged by the fact that actively traded high-grade, medium-term corporate notes sell at yields comparable to those of medium-term agency issues. For example, we recently placed $125 million General Electric Company 7-1/2 year notes at a yield lower than some of the outstanding agency issues of comparable maturity. Nevertheless, we think the effort to achieve a legal status comparable to agency issues should be made and that the result will be beneficial.

Savings banks, commercial banks and other purchasers of short-term securities place high value on liquidity. Receptivity of these institutions to Bank issues would be helped if their liquidity in the secondary market could be improved. In order to increase the liquidity of Bank medium-term issues and make greater use of the medium-term market, we would suggest that the Bank vary its pattern and consider offering medium-term notes with original maturities in the range of 5 to 8 years. As the market develops further, issues of slightly longer initial maturities, such as up to 10 years, could also be considered. Such original issues would be designed to take advantage of the yield curve at the time of offering, seeking to extend the term when little or no increased yield is required or to obtain an interest cost saving when short-term rates are relatively low.

From time to time, when appropriate, we think that the Bank might utilize the technique of reopening original issues as is done with U.S. Government issues. In reopening an issue, the Bank would offer an additional principal amount of an outstanding issue whose coupon is close to the then current new issue yield. The newly issued portion of a particular maturity would be sold at a modest price premium or discount from the bonds outstanding, depending upon market conditions at the time of offering. By careful use of the reopening technique, the Bank could have larger principal amounts of a particular issue outstanding without incurring the yield premium that would be demanded by the market if the entire issue were done at one time. The larger amounts of particular maturities outstanding would make the issue attractive to more market makers and improve the breadth of the secondary market.

To further tap the medium-term market for the Bank and to further encourage savings banks, commercial banks and other investors in U.S. agencies to consider the Bank as a viable investment alternative to U.S. agencies, we would suggest that consideration be given to the issuance of notes with original maturities of from 2 to 5 years. As a result of the increasing importance of commercial banks, including country banks, and other buyers in markets of this shorter maturity, we believe that the use of this market may be merited, although it should be recognized that agency eligibility is of greater importance to bank buyers of these maturities.

Short-term Borrowing

In examining all feasible forms of finance, we would not rule out limited recourse to commercial bank borrowing and commercial paper. In general, we consider that one of the basic elements of strength in the Bank's financial structure as compared with many other financial institutions is its lack of dependence on fluctuating short-term money rates. Nevertheless, we think there may be times when the Bank's liquidity position could appropriately be sustained by use of short-term funds, and we think that the larger the cash flow of the Bank becomes, the more the use of such techniques will be justified. If the Bank does contemplate this possibility in the future, there may be some advantage to beginning on a moderate level early in order to establish the market.

New Sources of Funds

Subject to the considerations we have mentioned, we believe that the Bank can obtain the funds it needs from the traditional sources of publicly offered medium and long-term debt issues. However, as Bank borrowing levels continue to grow, we think the Bank and its investment bankers should be aware of other sources and be prepared to utilize them if circumstances should so indicate.

There are three major identifiable purchasers of long-term debt that have not participated in offerings by the Bank in the last several years. These categories of purchasers include (i) the major insurance companies, (ii) the broad public market of individuals and (iii) the straight debt buyers (other than major insurance companies) who seek a lower quality of credit in search of higher yield.

The willingness of the first of these categories, the major life and casualty companies, to purchase triple A indebtedness at a yield differential from the public market is demonstrated by the recent private placement which we arranged for American Telephone and Telegraph Company of $1 billion of fixed income securities consisting of $375 million principal amount of 7.75% Notes due January 15, 1997 and $625 million of Preferred Shares with a dividend rate of 7.75%. While the major insurance companies were attracted to the AT&T offering in part by the preferred stock which gives them the benefit of the favorable intercorporate tax on dividends, a Bank issue of debt alone could be done with this segment of the market at a yield differential dependent on markets at the time of offering and on the size of the offering. In the AT&T offering, which is the largest private placement ever made, the Company received an immediate commitment for $1 billion from a group of investors most of whom have not purchased high grade securities since the mid-1950's, at a yield level which, while higher than the public market rate for an issue of normal size, was closer to that rate than this group of buyers had been willing to commit for many years. Because of the Bank's ability to finance its current

U.S. borrowing needs in the public market, a private placement on the scale of AT&T would not appear advisable. However, one or more private placements of smaller size and perhaps, therefore, less yield concession could be used by the Bank to tap this segment of the market which recently has been unavailable to it.

The private placement market with major insurance companies could be used by the Bank to borrow on a subordinated basis. Certain corporate borrowers, such as General Motors Acceptance Corporation, pursue an active program of offering senior debt publicly and subordinated debt privately. Although the subordinated debt carries a somewhat higher interest rate, it makes available an important segment of the market that would not be available otherwise. A collateral benefit for the Bank would be that the placement of subordinated indebtedness with the more sophisticated segments of the institutional market should have a favorable impact upon those public pension funds which are concerned with the credit of the Bank's senior debt.

The use of subordinated debt, in addition to requiring a somewhat higher interest rate than the senior obligations, would raise a number of legal questions. Nevertheless it would constitute a new implement for the raising of funds for use in a period when all available means may be required.

The second major classification of investors which have not been important purchasers of Bank bonds is individuals. Individuals are not normally attracted to the bond market in significant numbers but do become a large factor at times of extremely high interest rates such as have occurred on occasion in recent years. During these periods individuals have been significant buyers of Bell System and other high-grade bonds. They have not invested to the same extent in Bank obligations because the Bank is not as well known or as well understood. Furthermore, to many individual investors, the international character of the Bank is not a positive element. At such times as individuals are a factor in the market, therefore, we would advise extension of the educational program so as to reach them, primarily through members of the underwriting syndicate and dealers. An example of an educational program directed toward attracting purchases from individuals as well as institutions was the one which we organized in 1970 for the marketing of the $1.6 billion issue of AT&T debentures with warrants. This consisted of meetings in 16 cities at which slide presentations and other visual material were used, and proved to be an effective way of influencing individual investors.

For the third category, those straight debt buyers (other than major insurance companies) who seek a higher yield and are willing to accept a lower quality of credit, the Bank is not an attractive investment alternative. Several of the large state and municipal pension funds are included in this category. While not active prospects at this time, the policies of many of these investors are subject to change with new Board members, changes in the market, changes in portfolio advisors and other factors. Several of these investors could well become significant purchasers of Bank issues in the future. In addition, as we have noted, a significant and growing factor in fixed income portfolio management is the trading of the portfolio. As this practice grows, more managers will focus increasingly on the marketability of their portfolios. Marketability will be more important than the higher initial yields obtainable on bonds of lower credit rating or limited liquidity. Increased trading of bond accounts will induce even this category of investors to keep a portion of their portfolio in large high-grade issues which are known to have good secondary markets.

Another potential source which we believe may become available shortly is the fixed rate term bank loan. Such loans have been made by banks in previous times of low money rates and slack loan demand. We see indications that they may become available again on terms which we would consider attractive. There are a number of other possibilities which the Bank might wish to consider as means of maximizing its resources. One of the most promising, in our view, would be the use of its guarantee power, either in connection with portfolio sales or with new loans. We think that securities could be fashioned which would be easily salable and would replenish or conserve the Bank's cash resources. We have considered certain other, less orthodox, possibilities which we will be glad to discuss with you if you should wish.

## VII. The Eurobond Market

At the time we were given the assignment of reviewing the Bank's potential market in the United States, we were invited to the extent we felt competent to comment on the conclusions of the Bank's memorandum as they related to other markets. Our affiliate, Morgan & Cie International S.A., is one of the leading firms in the international capital market and has managed the largest volume of Eurobond issues denominated in U.S. dollars. We have extensive experience in seeking funds in international markets for major borrowers wishing to maximize their use of all currencies available.

The Bank memorandum concludes that the Eurobond market is unlikely to be an important source of available capital for the Bank because (i) the size of issues is small and (ii) the issues might divert funds from Bank issues placed in national markets so that the volume of funds available is not actually increased. We believe that neither of these conclusions necessarily prevails today and that the Eurobond market has become a very important source of funds which is not being reached through other channels.

In the past 18 months, the dollar Eurobond market has been able to absorb a number of large issues and borrowers have been able to come back to the market with increasing frequency. In 1971, for example, a finance subsidiary of Standard Oil of New Jersey offered within an eight-month period a total of $200 million of bonds in two offerings of $100 million each, divided in each case equally between medium and long maturities. Another example is Royal Dutch Shell, whose finance subsidiary offered a $60 million long-term issue in November, 1971 which was followed eight weeks later by a $70 million long-term issue. As the recent currency settlement is formalized, we would hope the relative strength of the dollar would increase, enabling issuers to make even greater use of this market.

The Eurobond market includes public, international issues denominated in a number of European currencies, units of account, European currency units and U.S. dollars. Undoubtedly, when an international Eurobond issue is denominated in a national currency other than the dollar, such an issue has some affect on the issuer's ability to borrow within that nation's domestic market, particularly since in the case of most currencies the national bank carefully regulates both domestic and international issues denominated in its respective currency. We have seen little evidence, however, that the use of one market diverts funds which would have been available for the same borrower in another market, if the overall financing program is carefully managed. Royal Dutch Shell is an example of a borrower which used many of these markets during the last year, raising at least the equivalent of $380 million. The $60 million

Eurobond issue by Royal Dutch mentioned above was announced on the offering day of a Swiss Franc 80 million public issue for the same borrower and no important adverse affect was apparent in the reception for either issue. Furthermore, Swiss demand for the $70 million Eurobond issue offered eight weeks later was proportionally the same as for the earlier Eurobond issue. Dutch demand for the $70 million issue was proportionally higher than for the earlier $60 million issue notwithstanding a Guilder 200 million private placement arranged in Holland immediately before the announcement of the later issue. Another important international borrower has been Gulf Oil Company, which for several years has borrowed regularly in all of the leading markets while successfully offering several dollar Eurobond issues, including three in the last two years totalling $110 million. Perhaps the best example of a borrower using all markets is the European Investment Bank, which raised the equivalent of $376 million in 1971 in 20 separate offerings, of which a total of $50 million were in the form of publicly offered dollar Eurobonds. This borrower is currently offering a $50 million long-term issue in the international dollar market. Based on our experience, it is our view that conditions within a given market, particularly those arising from shifting currency preferences, are more determinative of the amount that can be raised and the terms of the offering than competing offerings by the same borrower in another market.

The Eurobond market has, for the Bank, the added advantage that it is subject to no governmental controls, and hence would presumably be available, subject to market conditions, at short notice and at times when the permission of national governments might not be forthcoming. By the same token, Eurobond issues denominated in U.S. dollars presumably would not reduce the existing commitment of any government to contribute economic assistance to the under-developed countries. The Bank would, of course, need the permission of the U.S. Government to do a Eurobond issue in dollars.

The primary drawback to a Bank Eurodollar issue would be the likelihood of the bonds flowing into the United States in the secondary market. For the past few years interest rates in the Eurodollar market have been materially higher than in the United States. Under these conditions it could be expected that dollar-denominated issues would return to the United States. At present, however, the differential is less than it has been for some years, and there may come a time when the differential disappears altogether.

If a Bank Eurodollar issue were considered likely to return to the United States in substantial amounts, we would expect objections from the Treasury and we would also regard it as injurious to the market for Bank bonds in this country. U.S. corporate issues in the Eurodollar market have been prevented from flowing into this country by designing them so as to subject purchasers to the U.S. Interest Equalization Tax. Although we have not consulted counsel on the matter, we believe that if the Bank did not object on grounds of policy, it would be possible to structure a Bank issue so as to be subject to the Interest Equalization Tax and thus to be insulated from return to this country. There may be other means of accomplishing the same goal, and we would be pleased to explore the matter with you.

In conclusion, we believe that given continued favorable conditions, the Bank could reasonably expect to raise annually up to $200 million in medium to long-term funds in the dollar Eurobond market. In our opinion these funds would be forthcoming largely from sources not presently being tapped by the Bank.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

List of Exhibits

EXHIBIT I

# THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

## Projected Sources and Applications of Funds as of the Years Ending June 30, 1972-78

(U.S. $ Millions)

| | 1972 | | 1973 | | 1974 | | 1975 | | 1976 | | 1977 | | 1978 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Sources: | | | | | | | | | | | | | | |
| Net Income | $ 188 | 9.3% | $ 188 | 8.2% | $ 207 | 8.0% | $ 227 | 7.7% | $ 242 | 7.3% | $ 260 | 7.3% | $ 269 | 6.6% |
| Capital Repayments | 80 | 4.0 | 51 | 2.2 | 45 | 1.7 | 4 | .1 | - | - | - | - | - | - |
| Loan Repayments | 383 | 18.9 | 437 | 19.0 | 475 | 18.4 | 553 | 18.4 | 608 | 18.4 | 679 | 19.1 | 787 | 19.3 |
| Borrowings | 1,303 | 64.4 | 1,493 | 64.9 | 1,726 | 66.6 | 2,082 | 69.4 | 2,278 | 69.1 | 2,418 | 67.9 | 2,823 | 69.1 |
| Other (1) | 68 | 3.4 | 130 | 5.7 | 138 | 5.3 | 133 | 4.4 | 172 | 5.2 | 203 | 5.7 | 208 | 5.0 |
| Total Sources | $ 2,022 | 100.0% | $ 2,299 | 100.0% | $ 2,591 | 100.0% | $ 2,999 | 100.0% | $ 3,300 | 100.0% | $ 3,560 | 100.0% | $ 4,087 | 100.0% |
| Applications: | | | | | | | | | | | | | | |
| Transfers to IDA | $ 110 | 5.4% | $ 100 | 4.3% | $ 100 | 3.9% | $ 100 | 3.3% | $ 100 | 3.0% | $ 100 | 2.8% | $ 100 | 2.4% |
| Disbursement on Loans | 1,210 | 59.9 | 1,402 | 61.0 | 1,612 | 62.2 | 1,825 | 60.9 | 1,980 | 60.0 | 2,229 | 62.6 | 2,478 | 60.6 |
| Debt Repayment | 606 | 30.0 | 733 | 31.9 | 721 | 27.8 | 810 | 27.0 | 1,041 | 31.5 | 1,012 | 28.4 | 1,124 | 27.5 |
| Increases in Liquidity | 96 | 4.7 | 64 | 2.8 | 158 | 6.1 | 264 | 8.8 | 179 | 5.5 | 219 | 6.2 | 385 | 9.5 |
| Total Applications | $ 2,022 | 100.0% | $ 2,299 | 100.0% | $ 2,591 | 100.0% | $ 2,999 | 100.0% | $ 3,300 | 100.0% | $ 3,560 | 100.0% | $ 4,087 | 100.0% |

NOTE: (1) Primarily delays in cash payments to IDA over amount set aside for such transfer.

EXHIBIT II

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Long-Term IBRD Financing Related to Total Public Financing,
U.S. Government Agency Financing and Bell System Financing for Calendar Years 1962-71
(U.S. $ Millions)

| | Total Public Financing (1) | | | U.S. Government Agency Financing (1) (4) | | | Bell System Financing | | | Long-Term IBRD Financing (2) | | | Long-Term IBRD Financing as a Percentage of Total Public Financing | | | Long-Term IBRD Financing as a Percentage of U.S. Government Agency Financing | | | Long-Term IBRD Financing as a Percentage of Bell System Financing | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Year | Debt | Equity | Total | Debt | Equity | Total | Debt | Equity | Total | Debt | Equity | Total | Debt | Equity | Total | Debt | Equity | Total | Debt | Equity | Total |
| 1962 | $ 4,440 | $ 1,736 | $ 6,176 | $ 1,188 | - | $ 1,188 | $ 955 | $ 332 | $ 1,287 | $ 100 | - | $ 100 | 2.3% | - | 1.6% | 8.4% | - | 8.4% | 10.5% | - | 7.8% |
| 1963 | 4,713 | 1,354 | 6,067 | 1,168 | - | 1,168 | 700 | 401 | 1,101 | - | - | - | - | - | - | - | - | - | - | - | - |
| 1964 | 3,623 | 3,091 | 6,714 | 1,205 | - | 1,205 | 230 | 1,621 | 1,851 | - | - | - | - | - | - | - | - | - | - | - | - |
| 1965 | 5,570 | 2,272 | 7,842 | 2,731 | - | 2,731 | 357 | 462 | 819 | 200 | - | 200 | 3.6 | - | 2.6 | 7.3 | - | 7.3 | 56.0 | - | 24.4 |
| 1966 | 8,018 | 2,513 | 10,531 | 6,806 | - | 6,806 | 1,270 | 308 | 1,578 | 175 | - | 175 | 2.2 | - | 1.7 | 2.6 | - | 2.6 | 13.8 | - | 11.1 |
| 1967 | 14,990 | 2,844 | 17,834 | 8,180 | - | 8,180 | 1,325 | 225 | 1,550 | 400 | - | 400 | 2.7 | - | 2.2 | 4.9 | - | 4.9 | 30.2 | - | 25.8 |
| 1968 | 10,732 | 4,583 | 15,315 | 7,666 | - | 7,666 | 1,160 | 51 | 1,211 | 400 | - | 400 | 3.7 | - | 2.6 | 5.2 | - | 5.2 | 34.5 | - | 33.0 |
| 1969 | 12,734 | 8,396 | 21,130 | 8,617 | - | 8,617 | 1,315 | 26 | 1,341 | - | - | - | - | - | - | - | - | - | - | - | - |
| 1970 | 25,384 | 8,680 | 34,064 | 16,180 | - | 16,180 | 4,239 | 2 | 4,241 | 200 | - | 200 | 0.8 | - | 0.6 | 1.2 | - | 1.2 | 4.7 | - | 4.7 |
| 1971 | 24,770(3) | 13,109(3) | 37,879 (3) | 14,459(3) | - | 14,459(3) | 3,180 | 1,418 | 4,598 | 175 | - | 175 | 0.7 | - | 1.5 | 1.2 | - | 1.2 | 5.5 | - | 3.8 |
| Total | $114,974 | $48,578 | $163,552 | $68,200 | - | $68,200 | $14,731 | $4,846 | $19,577 | $1,650 | - | $1,650 | 1.4% | - | 1.0% | 2.4% | - | 2.4% | 11.2% | - | 8.4% |

NOTES: (1) Source: Federal Reserve Bulletins of September 1969 and December 1971.

(2) There were no IBRD issues in 1963, 1964 and 1969.

(3) Last three months of 1971 based on estimates from the Federal Reserve.

(4) Issues not guaranteed.

EXHIBIT III

## INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

### Analysis of Distribution of Selected Public Offerings Managed by Morgan Stanley & Co. Incorporated and The First Boston Corporation

(Foreign Sales in Parenthesis)
(U.S. $ Millions)

| Issue | 25 Year 5% due 2/15/85 $125,000,000 | | | 20 Year 4 1/2% due 2/1/82 $100,000,000 | | | 25 Year 4 1/2% due 2/1/91 $200,000,000 | | | 25 Year 5 3/8% due 7/1/91 $175,000,000 | | | 25 Year 5 3/8% due 4/1/92 $250,000,000 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Date | February 8, 1960 | | | January 24, 1962 | | | January 14, 1965 | | | June 28, 1966 | | | March 14, 1967 | | |
| Manager Running the Books | MS&Co. | | | FOB | | | MS&Co. | | | FOB | | | MS&Co. | | |
| | Amount | | % | Amount | | % | Amount | | % | Amount | | % | Amount | | % |
| Insurance Companies: | | | | | | | | | | | | | | | |
| Life | $ 29,403 | ($4,709) | 23.36% | $ 12,800 | ($5,545) | 12.52% | $ 18,075 | ($9,745) | 9.04% | $ 39,448 | ($13,315) | 22.42% | $ 47,255 | ($4,925) | 18.52% |
| Fire and Casualty | 1,285 | ( 110) | 1.02 | 1,630 | ( 885) | 1.59 | 3,470 | ( 415) | 1.74 | 6,535 | ( 525) | 3.71 | 6,665 | ( 485) | 2.61 |
| Fraternal, Charitable, Educational and Institutional | 9,168 | ( 55) | 7.28 | 4,710 | | 4.61 | 14,553 | ( 225) | 7.28 | 10,966 | ( 575) | 6.23 | 19,169 | | 7.51 |
| Savings Banks | 8,785 | | 6.98 | 5,424 | ( 1,550) | 5.30 | 7,645 | ( 20) | 3.82 | 4,703 | | 2.67 | 50,590 | | 19.83 |
| Banks for own Account or the Account of Others | 42,576 | ( 5,707) | 33.83 | 26,800 | (13,077) | 26.21 | 77,487 | ( 8,015) | 38.74 | 59,902 | ( 5,802) | 34.05 | 40,818 | ( 4,715) | 16.00 |
| Pension Funds | 17,142 | ( 270) | 13.62 | 26,753 | ( 255) | 26.16 | 63,155 | | 31.58 | 47,043 | | 26.74 | 64,881 | ( 385) | 25.44 |
| Corporations | 1,326 | ( 222) | 1.05 | 2,956 | ( 880) | 2.89 | 3,830 | ( 390) | 1.91 | 1,260 | | .72 | 5,337 | ( 1,000) | 2.09 |
| Investment Trusts | 7,891 | ( 170) | 6.27 | 9,840 | ( 30) | 9.62 | 4,945 | | 2.47 | 3,582 | | 2.04 | 6,925 | | 2.71 |
| Individuals | 5,947 | ( 548) | 4.73 | 2,662 | ( 195) | 2.60 | 4,930 | ( 160) | 2.46 | 1,097 | ( 125) | .62 | 5,273 | ( 55) | 2.07 |
| Dealers | 2,337 | ( 115) | 1.86 | 8,694 | ( 1,055) | 8.50 | 1,910 | ( 75) | .96 | 1,412 | | .80 | 8,215 | | 3.22 |
| | $125,860 | ($11,906) | 100.00% | $102,269 | ($23,472) | 100.00% | $200,000 | ($19,045) | 100.00% | $175,948 | ($20,342) | 100.00% | $255,128 | ($11,565) | 100.00% |
| | | ( 9.46%) | | | (22.95%) | | | ( 9.52%) | | | ( 11.56%) | | | ( 4.53%) | |

| Issue | 26 Year 5 7/8% due 9/1/73 $150,000,000 | | | 26 Year 6 1/2% due 3/15/94 $150,000,000 | | | 26 Year 6 3/8% due 10/1/94 $250,000,000 | | | 25 Year 8 5/8% due 8/1/95 $200,000,000 | | | 25 Year 8 1/8% due 8/1/96 $175,000,000 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Date | August 22, 1967 | | | March 21, 1968 | | | September 17, 1968 | | | July 23, 1970 | | | August 11, 1971 | | |
| Manager Running the Books | FOB | | | MS&Co. | | | FOB | | | MS&Co. | | | FOB | | |
| | Amount | | % | Amount | | % | Amount | | % | Amount | | % | Amount | | % |
| Insurance Companies: | | | | | | | | | | | | | | | |
| Life | $ 31,000 | ($ 500) | 20.66% | $ 19,015 | ($2,375) | 12.43% | $ 27,830 | ($2,535) | 11.01% | $ 18,570 | ($4,015) | 9.25% | $ 18,782 | | 10.49% |
| Fire and Casualty | 4,739 | ( 300) | 3.16 | 300 | ( 25) | .20 | 8,030 | ( 690) | 3.18 | 5,095 | | 2.54 | 3,230 | | 1.80 |
| Fraternal, Charitable, Educational and Institutional | 3,625 | ( 70) | 2.42 | 11,067 | | 7.23 | 16,913 | | 6.69 | 18,298 | | 9.12 | 11,915 | | 6.65 |
| Savings Banks | 21,395 | ( 500) | 14.26 | 39,960 | ( 25) | 26.12 | 43,007 | | 17.01 | 8,450 | ( 480) | 4.21 | 13,685 | | 7.64 |
| Banks for own Account or the Account of Others | 20,936 | ( 7,125) | 13.96 | 27,178 | ( 6,095) | 17.77 | 54,712 | ( 8,315) | 21.64 | 43,251 | ( 3,775) | 21.55 | 33,300 | | 18.60 |
| Pension Funds | 55,840 | ( 850) | 37.23 | 42,297 | ( 190) | 27.65 | 75,655 | ( 100) | 29.91 | 71,525 | ( 450) | 35.64 | 52,837 | | 29.51 |
| Corporations | 3,027 | | 2.02 | 2,385 | | 1.56 | 3,494 | | 1.38 | 4,749 | ( 1,000) | 2.37 | 7,345 | | 4.10 |
| Investment Trusts | 1,880 | | 1.25 | 3,890 | ( 125) | 2.54 | 11,360 | | 4.49 | 21,197 | ( 100) | 10.56 | 14,195 | | 7.93 |
| Individuals | 3,152 | | 2.10 | 2,424 | ( 50) | 1.58 | 7,713 | ( 160) | 3.05 | 6,145 | ( 105) | 3.06 | 11,940 | | 6.67 |
| Dealers | 4,406 | ( 800) | 2.94 | 4,470 | ( 25) | 2.92 | 4,142 | ( 385) | 1.64 | 3,390 | ( 200) | 1.69 | 11,842 | | 6.61 |
| | $150,000 | ($10,145) | 100.00% | $152,986 | ($8,910) | 100.00% | $252,856 | ($12,185) | 100.00% | $200,670 | ($10,125) | 100.00% | $179,071 | ($ 815)(1) | 100.00% |
| | | ( 6.76%) | | | ( 5.82%) | | | ( 4.82%) | | | ( 5.05%) | | | (0.46%) | |

NOTES: (1) Breakdown of foreign sales unavailable.

# STATUS OF CERTAIN STATE AND MUNICIPAL PENSION FUNDS WITH REGARD TO PURCHASE OF INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT BONDS AND NOTES

## SUMMARY*

### IBRD Bonds and Notes Not Legal

Texas Employees (300)
Texas Teachers (1,513)

### IBRD Bonds and Notes Legal but Never Purchased

Baltimore (City of) (377)
Boston (City of) (115)
Delaware (-)
Detroit (City of) (509)
Florida (2,936)
Illinois Municipal Employees (294)
Indiana Employees (235)
Kentucky Employees (140)
Louisiana Employees (310)
Louisiana Teachers (688)
Milwaukee (City of) (182)
Minnesota (741)
Missouri Teachers (410)
Ohio Industrial Commission (-)
Ohio Teachers (2,000)
Oregon (450)

### IBRD Bonds and Notes Legal but Not Willing to Purchase Currently

Alabama (431)
Georgia (721)
Idaho (69)
Los Angeles City Employees (290)
Massachusetts (481)
Michigan (998)
New Hampshire (137)
New York (City of) (5,673)
San Francisco (City of) (427)
South Carolina (466)
Tennessee (394)

### IBRD Bonds and Notes Legal and Willing to Purchase

Alaska (63)
Arizona (400)
Arkansas (169)
California (6,500)
Chicago Firemen (108)
Chicago Municipal Employees (270)
Chicago Park Employees (82)
Chicago Police (115)
Chicago Teachers (183)
Colorado (510)
Connecticut (1,032)
Department of Water & Power-L.A.(285)
Illinois State Teachers (750)
Indiana Teachers (176)
Iowa (400)
Kentucky Teachers (310)
Los Angeles County Employees (1,000)
Los Angeles Fire and Police (165)
Maine (180)
Maryland (594)
Montana (123)
Nebraska (40)
New Jersey (3,057)
New York Employees (4,500)
New York Teachers (3,200)
North Carolina (961)
Ohio Public Employees (1,400)
Pennsylvania (840)
Utah (168)
Vermont (81)
Virginia (591)
Washington (780)
West Virginia (398)
Wisconsin (1,722)

* Figures in parentheses indicate most recent statistics on amount of invested funds (in millions of dollars).

Status Could be Clarified Only by Direct Interview

Hawaii (400)
Kansas (140)
Mississippi (210)
Nevada (129)
New Mexico (227)
North Dakota (-)
Oklahoma (208)
Rhode Island (143)
South Dakota (25)
Wyoming (60)

January 31, 1972

STATUS OF CERTAIN STATE AND MUNICIPAL PENSION FUNDS
WITH REGARD TO PURCHASE OF
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
BONDS AND NOTES

| | |
|---|---|
| Alabama | Legal, has purchased in past but not presently due to foreign flavor. No percentage of assets limitation on investments in one organization. |
| Alaska | Legal. Purchase decision up to advisors. Feel IBRD bonds are consistent with portfolio objective. |
| Arizona | Legal, have and continue to purchase. Future purchasing up to advisors. No percentage of assets limitation on investments in one organization. |
| Arkansas | Thinks illegal, but not tested. Advisor has never recommended purchase. |
| California | Legal, have and continue to purchase. Limit of 5% of total assets in one name. |
| Colorado | Legal, have and continue to purchase. |
| Connecticut | Legal, have and continue to purchase. Current holdings approximately $7 million. No percentage of asset limitation on investments in one organization. |
| Delaware | Presumed legal. Never purchased. |

Florida — Legal, have not purchased. Required to keep 50% of assets in government bonds. Invests remaining 50% in higher yielding, lower quality (A) corporate bonds. Feels credit is low for yield levels at which bonds are sold. IBRD bonds would become more attractive if they could be used to satisfy government holding requirement.

Georgia — Legal, have purchased in past but not currently due to policy of buying local issues and mortgages. Commented on lack of marketability.

Hawaii — Legal.

Idaho — Legal, have not purchased recently. Will purchase only if 25 basis points cheaper than telephone issues due to poor marketability.

Illinois — State Teachers - Legal, has not purchased recently as yield has been too low in comparison to alternative fixed income obligations which could be used in the portfolio.

Municipal Employees - Legal, have not purchased.

Indiana — Employees - Legal but have never purchased because of marketability and name.

Teachers - Legal but have never purchased because of marketability. However, this is changing and may purchase modest amount in future.

Iowa — Legal, have and continue to purchase. Current holdings approximately $4 million, could be near upper limit.

| | |
|---|---|
| Kansas | Legal |
| Kentucky | Employees - Legal, have not purchased.<br>Teachers - Legal, have and continue to purchase. Current holdings approximately $6.2 million. |
| Louisiana | Employees - Legal, have not purchased.<br>Teachers - Legal, have not purchased. |
| Maine | Legal, have purchased. Future purchasing up to advisors. |
| Maryland | Legal, have purchased but not recently because of rate. Can invest up to $5 million in one organization. |
| Massachusetts | Legal, have purchased. No limitation on assets invested in any one organization. Hold $2 to 4 million. Not currently buying, member of Board resistant. |
| Michigan | Legal. Will not purchase as Fund does not consider IBRD to be Aaa credit, feels that it does not trade like a Aaa, prefers domestic credit and feels that soft loans have definitely altered the strength of this credit. |
| Minnesota | Legal, have not purchased because of resistance by Board. |
| Mississippi | |

Missouri — Legal, have not purchased. Invest mainly in higher quality private placements whose yields are higher than IBRD. If entered high grade public market would consider IBRD bonds at attractive yields only. Concerned about marketability of IBRD bonds.

Montana — Legal, have and continue to purchase.

Nebraska — Legal, will purchase.

Nevada

New Hampshire — Legal, have purchased. No limitation on assets invested in any one organization. Hold $1,450,000. Not currently buying because of policy to invest in 7 to 10 year maturities.

New Jersey — Legal, have purchased. Hold $20 million which could be more than doubled before reaching statutory limitation. Prefer not to buy new issues but purchase in after market. Consider new issues to be priced with Aaa telephones while aftermarket yield are those of A electrical utility issues.

New Mexico

New York

Employees - Legal, have purchased. Currently own $42 million with limit of 2 1/2% of assets in Aaa credit (approx. $125 million). Intend to limit purchases in future to avoid getting too much of name.

Teachers - Legal, have and continue to purchase. Current holdings $46.5 million. Can put up to 5% of assets in investments of one organization (approx. $150 million).

North Carolina

Legal, have purchased. Will continue to purchase primarily in secondary market. Do not have percentage of assets limitation on investments in one organization.

North Dakota

Ohio

Public Employees - Legal, have purchased. Will continue to consider for purchase. Currently own $5 million.

Industrial Commission - Legal, have not purchased.

Teachers - Legal, have not purchased. Prefer lower quality, higher yielding issues or pure domestic high grade corporates.

Oklahoma

Legal.

Oregon

Legal, have not purchased. Not currently buying Aaa quality but would consider IBRD if policy changed to one of buying higher quality issues. No limit on lending to any one borrower.

| | |
|---|---|
| Pennsylvania | Legal, have and continue to purchase. Can put up to 2% of assets in investments of one organization (approx. $17 million). Current holdings close to that limit. |
| Rhode Island | Legal, have purchased. Current holdings between $1 and $2 million. |
| South Carolina | Legal, have purchased but have encountered some resistance to further commitments in IBRD Bonds on the part of certain committee members. Current holdings $1.2 million. No percentage of asset limitation on investments in one organization. |
| South Dakota | |
| Tennessee | Legal, have purchased but not presently due to loan policies. Would be sellers. |
| Texas | Employees and Teachers - Not legal. |
| Utah | Legal, have and continue to purchase. Current holdings over $2 million. Can put up to 2% of assets in investments in one organization (approx. $3.5 million). |
| Vermont | Legal. No current holdings. Would buy if priced right. |

| | |
|---|---|
| Virginia | Legal, have and continue to purchase. |
| Washington | Legal, have and continue to purchase. Current holdings $26 million. |
| West Virginia | Legal, have and continue to purchase. Limit of investment in any one corporation to 5% of assets (approx. $20 million). Hold $17 million but do not apply limit to "agencies" such as IBRD. Has expressed disappointment with lack of good marketability. |
| Wisconsin | Legal, have purchased. Statute limits investments in international organization to 2% of assets. Up against that limitation currently. Own $10 million currently. |
| Wyoming | |

MUNICIPALITIES

| | |
|---|---|
| Baltimore (City of) | Legal, but have not purchased. |
| Chicago Municipal Employees | Legal, have and continue to purchase. Currently own $4.5 million. Can put up to 5% of assets in investments of one organization (approx. $ 14 million). |

| | |
|---|---|
| Dept. of Water & Power - L.A. | Legal. Investment decisions up to advisor and dependent on price. |
| Detroit (City of) | Legal, have purchased recently. Future purchases could be limited as Fund is approaching self-imposed limit of 5% of assets invested in one name. |
| Los Angeles City Employees | Legal, have purchased. Currently own approximately $6 million. Will not purchase now unless they move to higher quality and would consider IBRD bonds at appropriate discount from Aaa industrials. No limitation on assets invested in one organization. |
| Los Angeles County Employees | Legal, have and continue to purchase. |
| New York (City of) | Legal, have purchased. Not currently purchasing because of desire for higher yields which accompany private placements and lower quality issues. |
| San Francisco (City of) | Legal, have purchased. Current holdings of $3.8 million. Limitation of 3% of assets invested in one organization (approx. $16 million). Currently purchasing equities only. |

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Actual and Pro Forma Statistics Using IBRD's Projections

Actual Figures as of the End of Fiscal Years Ending June 30

| | 1961 | | 1962 | | 1963 | | 1964 | | 1965 | | 1966 | | 1967 | | 1968 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Capitalization | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Total Funded Debt | $2,228(1) | 46.0% | $2,521(2) | 47.8% | $2,519 | 46.5% | $2,492 | 44.9% | $2,724 | 46.0% | $2,806(3) | 45.6% | $3,075 | 46.9% | $3,290 | 47.6% |
| Capital Stock and Reserves | 2,617 | 54.0 | 2,749 | 52.2 | 2,894 | 53.5 | 3,063 | 54.1 | 3,200 | 54.0 | 3,344 | 54.4 | 3,480 | 53.1 | 3,623 | 52.4 |
| | $4,845 | 100.0% | $5,270 | 100.0% | $5,413 | 100.0% | $5,555 | 100.0% | $5,924 | 100.0% | $6,150 | 100.0% | $6,555 | 100.0% | $6,913 | 100.0% |
| Total Subscription of Member Governments | $20,093 | | $20,485 | | $20,730 | | $21,186 | | $21,669 | | $22,426 | | $22,850 | | $22,942 | |
| Total Funded Debt as % of Total Subscription of Member Governments | 11.1% | | 12.3% | | 12.2% | | 11.8% | | 12.6% | | 12.5% | | 13.5% | | 14.3% | |
| Coverage of Interest:(4) | | | | | | | | | | | | | | | | |
| Actual | 1.69 | | 1.67 | | 1.79 | | 1.95 | | 2.27 | | 2.22 | | 2.30 | | 2.10 | |
| Pro Forma | - | | - | | - | | - | | - | | - | | - | | - | |
| U.S. Subscription Subject to Call | $5,715 | | $5,715 | | $5,715 | | $5,715 | | $5,715 | | $5,715 | | $5,715 | | $5,715 | |
| Total Funded Debt as % of U.S. Subscription Subject to Call | 39.0% | | 44.1% | | 44.1% | | 43.6% | | 47.7% | | 49.1% | | 53.8% | | 57.6% | |
| Debt Payable in U.S. Dollars | $1,699 | | $1,900 | | $1,899 | | $1,885 | | $1,996 | | $2,071 | | $2,308 | | $2,447 | |
| as % of U.S. Subscription Subject to Call | 29.7% | | 33.2% | | 33.2% | | 33.0% | | 34.9% | | 36.2% | | 40.4% | | 42.8% | |
| Group of Ten Subscription Subject to Call | $12,623 | | $12,623 | | $12,623 | | $12,623 | | $12,899 | | $13,238 | | $13,276 | | $13,276 | |
| Total Funded Debt as % of Group of Ten Subscription Subject to Call | 17.7% | | 20.0% | | 20.0% | | 19.7% | | 21.1% | | 21.2% | | 23.2% | | 24.8% | |

Pro Forma Projections as of the End of Fiscal Years Ending June 30

| | 1969 | | 1970 | | 1971 | | 1972 | | 1973 | | 1974 | | 1975 | | 1976 | | 1977 | | 1978 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Capitalization | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Total Funded Debt | $4,081 | 52.2% | $4,568 | 54.2% | $5,424 | 57.3% | $ 6,138 | 59.0% | $ 6,898 | 61.3% | $ 7,903 | 63.9% | $ 9,175 | 66.6% | $10,412 | 68.7% | $11,818 | 70.7% | $13,517 | 72.7% |
| Capital Stock and Reserves | 3,733 | 47.8 | 3,858 | 45.8 | 4,043 | 42.7 | 4,264 | 41.0 | 4,364 | 38.7 | 4,471 | 36.1 | 4,598 | 33.4 | 4,740 | 31.3 | 4,899 | 29.3 | 5,069 | 27.3 |
| | $7,814 | 100.0% | $8,426 | 100.0% | $9,467 | 100.0% | $10,402 | 100.0% | $11,262 | 100.0% | $12,374 | 100.0% | $13,773 | 100.0% | $15,152 | 100.0% | $16,717 | 100.0% | $18,586 | 100.0% |
| Total Subscription of Member Governments | $23,036 | | $23,159 | | $23,871 | | $25,300 | | $25,420 | | $25,420 | | $25,420 | | $25,420 | | $25,420 | | $25,420 | |
| Total Funded Debt as % of Total Subscription of Member Governments | 17.7% | | 19.7% | | 22.7% | | 24.3% | | 27.1% | | 31.1% | | 36.1% | | 41.0% | | 46.5% | | 53.2% | |
| Coverage of Interest:(4) | | | | | | | | | | | | | | | | | | | | |
| Actual | 1.87 | | 1.87 | | 1.68 | | - | | - | | - | | - | | - | | - | | - | |
| Pro Forma | - | | - | | - | | 1.51 | | 1.45 | | 1.43 | | 1.41 | | 1.39 | | 1.38 | | 1.37 | |
| U.S. Subscription Subject to Call | $5,715 | | $5,715 | | $5,715 | | $5,715 | | $5,715 | | $5,715 | | $5,715 | | $5,715 | | $5,715 | | $5,715 | |
| Total Funded Debt as % of U.S. Subscription Subject to Call | 71.4% | | 79.9% | | 94.9% | | 107.4% | | 120.7% | | 138.3% | | 160.5% | | 182.2% | | 206.8% | | 236.5% | |
| Debt Payable in U.S. Dollars | $2,770 | | $2,877 | | $3,230 | | $3,605 | | $4,155 | | $4,805 | | $5,555 | | $6,605 | | $7,755 | | $8,905 | |
| as % of U.S. Subscription Subject to Call | 48.5% | | 50.3% | | 56.5% | | 63.1% | | 72.7% | | 84.1% | | 97.2% | | 115.6% | | 135.7% | | 155.8% | |
| Group of Ten Subscription Subject to Call | $13,276 | | $13,276 | | $13,710 | | $13,710 | | $13,710 | | $13,710 | | $13,710 | | $13,710 | | $13,710 | | $13,710 | |
| Total Funded Debt as % of Group of Ten Subscription Subject to Call | 30.7% | | 34.4% | | 39.6% | | 44.8% | | 50.3% | | 57.6% | | 66.9% | | 75.9% | | 86.2% | | 98.6% | |

NOTES: (1) Excludes obligations for repurchase of shares of Cuba and Dominican Republic in amount of $796,006.
(2) Excludes obligations for repurchase of shares of Cuba in amount of $711,660.
(3) Excludes obligations for repurchase of shares of Indonesia in amount of $3,164,200.
(4) Coverage of interest consists of net income to which has been added interest on borrowings, bond issuance and other financial expenses and discounts on sale of loans.

## RELATIONSHIP OF IBRD BORROWING PROGRAM TO TOTAL U.S. MARKET

One factor which could influence the feasibility of the Bank's proposed borrowings from the U. S. capital market in fiscal 1974-1978 is the overall size of the market in which this borrowing would take place. Consequently, it is necessary to compare the proposed growth in the Bank's requirements from this market with the likely gowth of the market itself. Any discrepancy between the two growth patterns which would render the Bank's proposed requirements a very large percentage of the market's overall supply of funds could imply the emergence of serious difficulty in achieving the Bank's borrowings targets.

The Bank memorandum considers this aspect of the feasibility of the proposed five-year plan, and the supporting memoranda offer further background material. In summary, these memoranda conclude that the likely size and composition of the U. S. capital market in 1974-1978 will be such that Bank borrowing, even at the expanded levels proposed, will continue to constitute only a small percentage of total market borrowing.

This conclusion seems to us to be essentially correct. Indeed, from the standpoint of the operational implications of U. S. capital market size for the feasibility of the proposed Bank borrowings program, an even stronger conclusion seems warranted: Specifically, <u>any</u> reasonable forecast of the next decade's development of the U. S. capital market is likely to imply that Bank borrowing at the proposed levels would constitute but a small fraction of total market borrowing; hence the feasibility of the proposed borrowing is not likely to be affected by the accuracy of one's forecast of the total U. S. market.

The entire range of forecasts of the size and composition of the overall market, following from any of a number of reasonable sets of relevant assumptions, leads to the uniform conclusion that Bank borrowing in the proposed amounts would not comprise so large a demand on the available supply of funds as to render the borrowing program infeasible.

Gross National Product. Many assumptions are necessary to generate a forecast of the development of the U.S. capital market. The initial basis of such a financial projection must be an overview of the corresponding development of the nonfinancial aspects of the economy, and the Bank memoranda assume an annual growth in the U. S. gross national product of 7% from the 1969 base. The 7% figure seems to be a conservative estimate, consistent with real growth of no greater than the economy's long-term potential of slightly over four percent, as well as substantial progress in reducing price inflation from the rate familiar in recent years. The National Planning Association, in perhaps the most widely circulated forecast of the U. S. economy in the 1970's, has projected an annual GNP growth of 8% in the 1970-1975 period and (largely because of slower price inflation in the second half of the decade) 7% in the 1975-1980 period. Estimates in the 7-8% range are also consistent with the output of the major computerized macroeconometric models such as the Wharton Model and the Federal Reserve Board-Massachusetts Institute of Technology Model. Although the proper assumption about GNP growth clearly depends in turn on partially political assumptions about progress in combatting price inflation, the Bank memoranda's 7% figure appears to lie toward the conservative end of a 6 1/2%-8 1/2% most probable range.

Nonfinancial Corporate Bond Volume. One of the Bank's background memoranda makes the assumption that the ratio of nonfinancial enterprises' gross debt issues to gross national product will fall from 2.6% in 1970, a high ratio by historical standards, to 1.6%. This assumption, applied to the assumed 7% GNP growth path, yields $26.5 billion of gross bond issues by nonfinancial enterprises in 1978; the proposed Bank issues of $1,150 million in that year would comprise only 4.3% of this total. This calculation of gross nonfinancial corporate bond volume appears to be on the conservative side. Given the rapidly increasing amounts of corporate bond maturities throughout the coming decade (electric utility companies, for example, will have over $7 billion of bonds maturing during the 1970's as opposed to less than $2 billion in the 60's), the volume of gross offerings throughout these years is likely to be substantially in excess of the Bank memoranda's projections. In 1971, for example, gross nonfinancial corporate bond volume totaled approximately $25 billion (2.4% of GNP), rather than $16.5 billion as forecast using the 1.6% assumption.

Total Corporate Bond Volume. Nevertheless, it seems inappropriate, for the purpose of considering the feasibility of the proposed Bank borrowing program, to focus attention on only that portion of gross corporate bond volume which is issued by nonfinancial enterprises. In recent years, private financial institutions such as commercial banks and finance companies have consistently issued a volume of bonds equal to about 15% of the volume issued by nonfinancial enterprises; in 1971 this fraction was even greater. Taking account of these factors means increasing the Bank memoranda's more limited corporate bond volume projection by approximately 15%. Specifically, the Bank memoranda's projection of $26.5 billion (1.6% of GNP) for nonfinancial enterprises alone in 1978 implies a corresponding projection of $30.5 billion (1.8% of GNP) for the total corporate bond market; the proposed

Bank issues of $1,150 million would comprise only 3.8% of this total. To whatever extent the Bank memoranda's projection for bond issues by nonfinancial enterprises may be on the conservative side, as suggested above, the corresponding projection of total corporate bond volume would also be conservative.

Reasonable Range of Estimates. More importantly, however, even if the Bank memoranda's projections of nonfinancial enterprises' gross bond volume and the corresponding total corporate bond volume are too large -- rather than too conservative, as seems to be the case -- it is difficult to suppose that the actual market size during 1974-1978 will be so small as to render the proposed amounts of Bank borrowing very large by comparison. Even if nonfinancial enterprises' gross bond offerings decline to an extreme low of 1.1% of GNP (fully .5% lower than the 1.6% used in the Bank memoranda and lower than any year in the past decade) and total corporate bond offerings decline accordingly to 1.3% of GNP, the total market size implied by the assumed 7% per annum GNP growth would still be $22 billion in 1978; the Bank's $1,150 million of borrowing in that year would be only slightly more than 5% of this total. Combining two relatively extreme assumptions, a 1.3% ratio of total corporate bond offerings to GNP and only 6 1/2% per annum growth of GNP itself, implies a total corporate bond volume in 1978 of $21 billion; again the proposed Bank borrowing in that year would be less than 5 1/2% of the market's total supply of funds.

The following table repeats this analysis of 1978, the final year of the Bank's five-year borrowing plan, for a set of assumptions about GNP growth and the ratio of total corporate gross bond offerings to GNP. The table shows the implied size of the corporate bond market in 1978 and, in parentheses, the fraction of that total which the Bank's $1,150 would constitute, for each pair of assumptions about these two basic parameters. The analysis assumes four different values of the annual rate of growth of GNP ranging between 6 1/2% and 8%, in comparison with the 7% assumed in the Bank memoranda. In addition, it assumes seven different values of the ratio of total corporate bond volume to GNP ranging from 1.2% to 2.4%, in comparison with the 1.8% ratio for total corporate volume implied by the Bank memoranda's assumption of a 1.6% ratio for issues of nonfinancial enterprises alone.

Total Corporate Bond Volume in 1978
(and Proposed Bank %)

(billions)

| Ratio of Total Corporate Bond Volume to GNP | Annual Growth Rate of GNP, 1971 - 1978 | | | |
|---|---|---|---|---|
| | 6 1/2% | 7% | 7 1/2% | 8% |
| 1.2% | $19.3 (5.96%) | $20.1 (5.72%) | $20.8 (5.53%) | $21.6 (5.32%) |
| 1.4% | $22.6 (5.09%) | $23.4 (4.91%) | $24.3 (4.73%) | $25.2 (4.56%) |
| 1.6% | $25.8 (4.46%) | $26.8 (4.29%) | $27.8 (4.14%) | $28.8 (3.99%) |
| 1.8% | $29.0 (3.97%) | $30.1 (3.82%) | $31.3 (3.67%) | $32.5 (3.54%) |
| 2.0% | $32.2 (3.57%) | $33.5 (3.43%) | $34.7 (3.31%) | $36.1 (3.19%) |
| 2.2% | $35.5 (3.24%) | $36.8 (3.13%) | $38.2 (3.01%) | $39.7 (2.90%) |
| 2.4% | $38.7 (2.97%) | $40.2 (2.86%) | $41.7 (2.76%) | $43.3 (2.66%) |

Conclusion. As the percentage figures shown in this table indicate, even under the broadest range of assumptions about growth of the U.S. economy in general and the corporate bond market in particular, Bank borrowing at the levels proposed for fiscal 1974-1978 will continue to constitute only a small percentage of the market's total supply of funds. As judged against this criterion, therefore, this proposed borrowing is a feasible undertaking, and the size of the market for Bank bonds during the period covered will not be affected to any appreciable extent by the rate of growth of the U. S. capital market as a whole. One must look elsewhere for the factors that will influence the Bank's market during this period.

December 23, 1971

**INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT**

**Fact Sheet**

**This memorandum is solely for the information of the several Underwriters of the proposed offering of the Bank's Five Year Notes of 1972. It is not to be distributed to others and is not an offer to sell or a solicitation of an offer to buy such Notes or any other securities of the Bank. The offering of such Notes is made only by the Prospectus, copies of which in preliminary form have been distributed.**

1. U. S. dollar debt following this issue will be \$3.6 billion. The uncalled U. S. subscription is \$5.7 billion, or 1.6 times the dollar debt. Of such dollar debt, \$809 million is owed to the Central Banks of member countries.

2. Total funded debt will be \$6.2 billion. The uncalled subscriptions of the Group of 10 countries is \$13.7 billion, or 2.2 times the total debt.

3. Approximately \$1.9 billion, or ⅓ of the Bank's total funded debt, is owed to Central Banks of member countries.

4. The Bank's lending rate is currently 7¼%. The average cost of all debt is 6.3%. The average cost of all funds (inclusive of capital and reserves) is 3.9%.

5. As of November 30, 1971, the Bank's liquid assets amounted to \$2.7 billion, or 47% of total funded debt then outstanding. The Bank's cash position has doubled since 1967.

6. The Bank's reserves total about \$1.6 billion, which includes a supplementary reserve against losses on loans amounting to \$1.3 billion. This amount is more than twice the largest amount of loans disbursed and outstanding to any single country.

7. Total equity including reserves is \$4.0 billion and the ratio of debt to total capitalization (debt plus equity) is 60% as of November 30, 1971.

8. The Bank has had aggregate net income of \$935 million over the past 5 years.

9. Administrative expenses in fiscal 1971 amounted to \$56 million, or less than 10% of gross income.

10. The Bank's liquidity position of \$2.7 billion permits it to conduct its operations involving disbursements currently running in excess of \$1 billion per year without the need to seek recourse to short-term commercial lines of credit.

11. The Bank has a 25-year record of successful and profitable operations. All loans are either made to, or guaranteed by, member governments. Loans are made only to productive projects which have been thoroughly appraised by the Bank's staff. IDA, a separate institution, strengthens the Bank by providing resources to member countries on lenient terms which aid in their development.

January 13, 1972

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Recommendations of Morgan Stanley & Co. Incorporated
and The First Boston Corporation
as to Terms of Long-Term Bond Issues

The following is a summary of the views given to the Bank by Morgan Stanley & Co. Incorporated and The First Boston Corporation at a meeting in Washington on November 15, 1971.

Maturity

Under present market conditions we believe that any maturity between 20 and 30 years is appropriate and that the exact maturity should be determined at the time of each issue in the light of the then market and the Bank's existing maturity schedule. Issues of as long as 40 years could be sold but such a maturity would materially narrow the market.

Period of Call Protection

As long as the Bank proposes to raise the maximum amount of new money each year that it can, the ability to refund existing issues is more or less academic and it is questionable whether the Bank is giving away much by offering a somewhat longer period of call protection than is customary with high-grade industrials. It is hard to measure the market value of the extra 2½ years, although clearly it is worth more in periods of high interest rates than when rates are lower. It has been of material value in the past and may well be in the future, and it would certainly not be a marketing plus to reduce it now. On the other hand if the Bank wishes to reduce the call protection to 10 years, we believe that under today's market conditions issues could be sold on terms close to those of an issue with 12½ years of call protection. We would strongly recommend against a shorter period than 10 years, and we believe that if it were reduced to 5 years it would require an increase in offering yield of at least 25 basis points.

The foregoing is based on market conditions as they now exist. If a shorter period of call protection were to come into general use among high-grade industrials, it would be appropriate to shorten that of the Bank as well. While we would think it generally advantageous to retain some differential over the call period on corporate bonds, it is conceivable that there might be circumstances in connection with a move to a new corporate level under which the differential could be eliminated.

We do not see any practical advantage in changing the form of call protection from non-callability to non-refundability. The Bank clearly cannot use the proceeds of equity issues to refund debt, and the use of liquid funds on hand would be bound to raise questions as to their source. We believe that there is a small marketing plus to non-callability and we recommend that the Bank retain this feature.

Redemption Prices

It has been customary following the period of non-callability for redemption prices to decline at intervals of three to five years. If the Bank wished we could have them drop annually. Within any such three to five year bracket this would be a minor disadvantage to the Bank if the call were early in the period and a minor advantage if the call were late in the period.

Sinking Fund

We believe that the pattern of a sinking fund beginning at the end of the non-callable period and retiring 50% of the issue prior to maturity has been beneficial to the secondary market and consequentially to the new issue market, and we would not recommend changing it. If the Bank were to move to a 10-year period of call protection the sinking fund might begin at 10½ years, in which case the annual payments would be somewhat smaller and the average life somewhat shorter.

One feature that might be added is an optional right to double any sinking fund payment. Such an option should be non-cumulative. We believe that this should be introduced at a time when the market is strong and that its inclusion in any particular issue should be decided at the time of that issue.

Delayed Delivery Provisions

We would recommend retaining the option of delayed delivery, with the number of delivery dates being varied according to market conditions, Whether or not a commitment fee was offered, and the amount of such fee, would be determined at the time of each issue in light of market conditions and the wishes of the Bank as to timing of receipt of the proceeds.

Listing

We would recommend continuing to list the issues on the New York Stock Exchange.

Selling Concession

We believe that the present .40% selling concession is required in order to market Bank issues and we would not recommend reducing it. On the other hand we see no need to raise it under present conditions, although such action might become advisable if the volume of Bank issues were substantially increased over present levels.

Method of Sale

We strongly believe that the best interests of the Bank would be served by continuing to sell issues by negotiation rather than by competitive bidding. We do not believe that competitive bidding necessarily results in a lower price, and we think it can be demonstrated that in fact quite the contrary is true in adverse markets. We think it is essential to marshall the strongest group of underwriters in the business behind Bank issues, rather than to have them fragmented into competing bidding groups. Finally, the history of issues offered competitively includes a large portion that were highly unsuccessful. An issuer that comes to market as frequently as the Bank must have a record of successful issues. We believe that the risk of failure of a Bank issue offered competitively far outweighs the small possibility of occasionally obtaining a marginally lower spread or offering yield by use of this method.