



CHAPTER 4

Pioneering Swaps

Pioneering new ways to raise funds, the World Bank's Treasury entered into the world's first formal currency swap agreement in 1981, with U.S. technology giant IBM as its counterpart.

Driving this momentous innovation was that, at the time, interest rates in Swiss francs and Deutsche marks were almost half of U.S. dollar interest rates, so the World Bank faced significant demand from its borrowers in those currencies. However, both the Swiss and German governments limited the amount of borrowing the World Bank could do in their currencies, and by August 1981, the World Bank had reached those limits. IBM had already accessed large amounts of those currencies and was looking to increase its U.S. dollar holdings. In a transaction arranged by Salomon Brothers (which later became part of Citi), IBM swapped its borrowed Swiss francs and Deutsche marks for the World Bank's U.S. dollars.

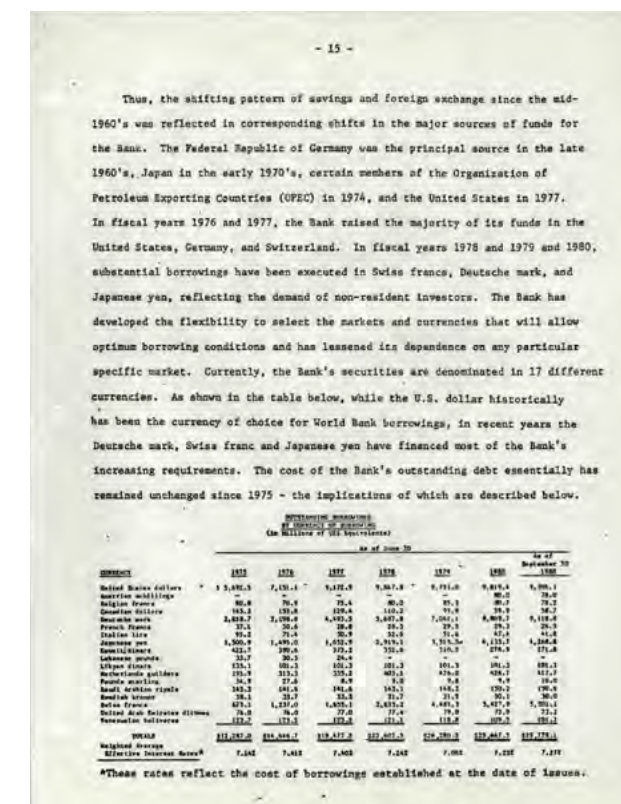
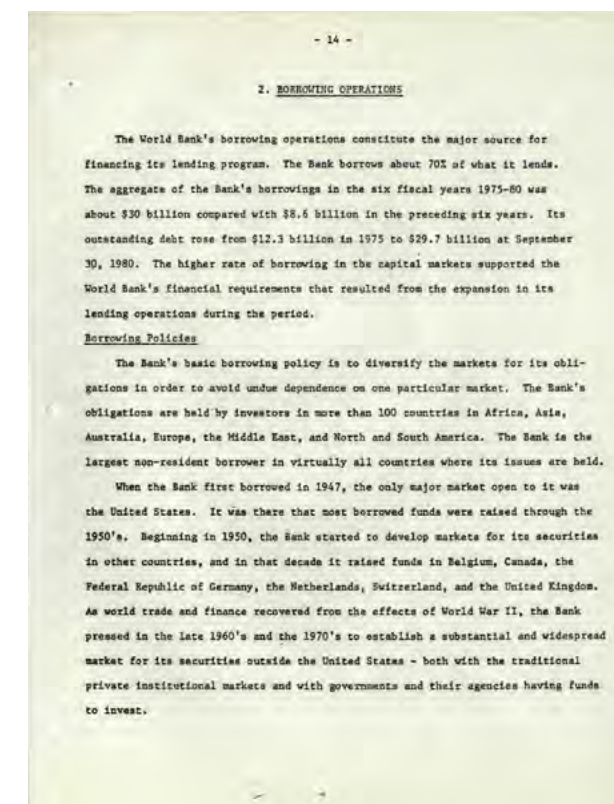
The volume of the World Bank's currency swap transactions grew quickly. In financial year 1982, the aggregate notional of currency swap transactions was \$758 million and by 1983 it had increased to \$1.73 billion. "The World Bank built a staff around swaps. Within a matter of months, we were doing swaps that no one had ever heard of before. It took three months to get Board approval on the first one,"²⁵ Eugene Rotberg said, adding the board was initially worried it would lead to derivative products that could not be regulated and would be too complicated.

Currency swaps opened a new era in funding diversification, but, this time, with risk management built-in. These swaps allowed for tapping markets

around the world but also converting the liability to a different currency more appropriate to risk management. For example, in 1983, the World Bank issued its first European currency unit bond, a \$43 million equivalent ten-year issue. The "availability of swap opportunities was an important consideration in the decision"²⁶ to issue in European currency units, the World Bank said in its 1985 annual report.

In a further innovation two years later, the World Bank executed its first interest rate swaps in which it received fixed rate U.S. dollars and paid floating rate dollars based on the three-month World Bank Treasury bill rate. By the end of 1985, the aggregate notional of all swap transactions entered into by the World Bank was \$5.15 billion. As of the end of the World Bank's 2018 fiscal year, with swaps now used more broadly but exclusively to eliminate currency and interest rate risk on the International Bank for Reconstruction and Development (IBRD) balance sheet, that number had grown to \$600 billion. A remarkable amount but dwarfed by the \$514 trillion²⁷ notional of the currency and interest rate swap market that World Bank Treasury helped create.

In its 1985 annual report, the World Bank said the use of swaps lowered the World Bank's cost of funds in three ways: by increasing access to nominal low-cost currencies, by allowing the World Bank to access currencies at a lower cost than through direct market



Extract from "The World Bank: A Financial Appraisal", by Eugene Rotberg, Vice President and Treasurer; January 1981. Photo © World Bank Archives

borrowing, and by broadening the World Bank's investor base through borrowing in a wider range of markets than otherwise would have been possible. Rotberg's openness to new ideas was the key to the extraordinary creativeness in the World Bank's fundraising at this time. Ken Lay, who joined the World Bank in 1982 and became Treasurer in 2006, said: "Everyone who has taken up that job after Rotberg has recognized that it was their main obligation to maintain and further develop that atmosphere."²⁸

Structured Bonds

During the 1980s, the World Bank's borrowing program was marked by increasing sophistication, including the development of numerous new structured bond types such as long-dated zero-coupon issues. A zero-coupon bond pays no interest until maturity. Long-dated zero-coupon bonds are popular with investors that have long-dated liabilities, such as pension funds and insurance companies, because they are long-duration assets that have no coupon reinvestment risk. The World Bank executed 30-year zero-coupon issues in Swiss francs and

Deutsche marks. As explained in the 1986 annual report, the World Bank "took advantage of anomalies in the yield curve to 'synthesize' a conventional 30-year bond issue by executing a 15-year issue and a series of zero-coupon bonds maturing in 16 to 30 years."²⁹

Over the decade from 1978 to 1988 the amount of IBRD's bonds outstanding rose by over 250 percent from \$22.6 billion to \$79.8 billion. The World Bank continued to expand to new markets, and in 1988, it issued in its 25th currency, New Zealand dollars. The 75 million New Zealand dollar (\$45.5 million equivalent at that time) five-year issue was launched in the so-called Eurokiwi offshore market. As of early August 2018, World Bank Treasury had issued in 63 currencies over its history, averaging 25 annually, and a total amount of debt outstanding of \$205 billion.

The dollar's decline in mid-1985 had led some within the World Bank to believe that demand for dollar-based securities from non-dollar-based investors in Europe and Japan would also decline. To address this, the World Bank launched a program called Continuously Offered Longer-Term Securities, or COLTS, for the U.S. market, with the investor free to choose any maturity to within a 3- to 30-year period.

“ANZ Bank is proud to be a trusted partner of the the World Bank, having supported many of its impressive achievements in the Kangaroo and Kauri markets. This is a partnership that goes well beyond the parties directly involved, inspiring development, innovation and confidence in these markets more broadly, whilst contributing to the World Bank’s commendable mission of eradicating poverty and inequality through sustainable economic development.”

Shayne Collins, Managing Director Markets,
ANZ (Australia and New Zealand Banking Group Limited)

The COLTS program, with sales limited to North American investors, was an innovative attempt to adapt the structural features of the short-term commercial paper market to the long-term bond market. It gave the World Bank the flexibility to direct demand to particular maturities it preferred at specific times by offering the preferred maturities.

The World Bank’s 1986 annual report said that COLTS was established as a \$500 million program “sold through agents and tailored to fit buyers’

maturity and cash-flow requirements.” The initial placement agents for the COLTS program were Goldman Sachs, Merrill Lynch, Lehman Brothers, and Salomon Brothers. The following year those firms were joined by Morgan Stanley and First Boston (a predecessor of Credit Suisse). Later, those dealers were joined by a number of smaller, regional dealers all across the United States. While COLTS was entirely focused on the U.S. market, it was soon joined by another innovation by World Bank Treasury that had a worldwide focus—global bonds.



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