THE WORLD BANK'S PHILOSOPHER-KING

Eugene Rotberg, treasurer of the World Bank, is renowned as an innovator. He puts his success down to his trading philosophy — and a little luck. By Eamonn Fingleton

When World Bank treasurer Eugene Rotberg decided a decade ago to set up a top-class money trading desk he had a problem. How do you find crack traders in Washington? The World Bank's lid on salary levels left him no room to manoeuvre – no one, not even Rotberg himself who could probably command $500,000 on Wall Street, gets more than $90,000 a year. World Bank salaries are tax-free, but by Wall Street standards are still very low.

Rotberg's solution was to train his own trading talent from the college graduates the World Bank recruits every year. "Our trading desk people tend not to be typical," said Rotberg, with understatement. "Virtually all of them were trained here and they came here with PhDs, often in one of the pure sciences. They are mathematicians, physicists, engineers. By temperament and personality they are able to bounce back well from making wrong decisions and, of course, they have strong quantitative skills to measure risk."

It was a characteristically self-confident stroke by Rotberg, who seems almost exuberant in his pursuit of innovation. Currency swaps, a T-bill-related Eurofloater, borrowing in Kuwaiti dinars, a variable rate facility for central banks – they are some of the bold new initiatives for which Rotberg claims credit. In some cases he piloted them through in the face of scepticism from his own board.

Rotberg presides over debt of $46 billion from an office covered with artefacts collected on trips around the world. He has been hailed as the biggest non-sovereign borrower in the world – and the biggest single source of banking commissions. But even if he were not so big he would probably still be a landmark on the international banking map.

For one thing, he is something of a philosopher-king. He loves, for example, to talk about the attitudes he instils in his cash management team. "We have a trading philosophy which allows us to be more realistic than most," he said. "We try very hard not to let previous mistaken judgements interfere with our view on the market now. If we have an unrealized loss, we accept that it is a loss and do not hide behind accounting conventions to cover it over. We believe selling does not create a loss, only records it. The loss occurs whether or not you sold. Our trading people have more freedom to understand that than most."

He continued: "For us, 'hold' recommendations do not exist." Rotberg's policy is not to hold on to any security he would not want to buy again today: if its potential is mediocre he sells it. "We tend to measure ourselves against opportunities lost rather than against a more sterile index," he said.

Eugene Rotberg: "Our philosophy makes us modest."

With little prompting, Rotberg, a Philadelphia-born lawyer who entered banking after a spell as a regulator with the Securities and Exchange Commission, reeled off a list of benefits. "Number one, our philosophy makes us modest," he said. That comes as a surprise, as he is not renowned for his reticence. Rotberg's point is that by measuring decisions against opportunity lost, he and his staff are constantly reminded of their mistakes: they are not content to sit back and do just a little better than whichever index the rest of the industry is watching.

The biggest practical effect of Rotberg's philosophy is probably that it encourages – sanctions, even – aggressive trading. "We will move the portfolio from an average life of four years down to two weeks if we believe there is a high probability that interest rates are going to rise – subject to liquidity constraints in the secondary market, of course." In fact, trading turnover now is close to $3 trillion a year, which looks pretty active even though liquid assets account for nearly $15 billion.

Rotberg prides himself on the clear-sightedness with which his staff pursues investment objectives. "Take a situation where we have bought a security yielding 10% and [the price] falls to yield 11%. It may be that we now believe yields are going to rise to 11.1% so we will sell that security immediately.

"Or take a case where a security is trading to yield 10% and another of identical quality and maturity is yielding 10.25%. We will sell the former and buy the latter, irrespective of the impact on our accounting statements. If that means realizing a loss, it does not matter."

One of the most controversial aspects of Rotberg's cash management is the precau- ▶

tions he takes against what he calls "regressing to the mean". He put it this way: "Most money managers are under such pressure that they constantly hedge their bets to make sure they are not wildly wrong. With us there are no external material rewards or punishments for superb or disastrous decision-making. We believe that such rewards and punishments inhibit rational analysis of interest-rate prospects. Our egos, our fears, our concern about our jobs and about looking good do not help us predict interest rates."

Sometimes, to dramatise the point when he addresses meetings of bankers, he divides the room into three sections. He asks each section to imagine having to predict interest rates. Bankers in one section are promised high rewards for correct calls ("With $15 billion to invest we can afford to be quite generous"); the second section gets no rewards but is promised retribution for getting it wrong ("What would be an appropriate punishment – your jobs, your freedom, your physical well-being?")

The third group gets neither reward nor punishment but is simply told: "Do your best." This, according to Rotberg, is the right approach. He said: "I submit that in the extreme groups there will be an attempt to hedge bets, a regression to the mean, an attempt to cover up. It is better simply to encourage responsible managers to state what they think – with whatever degree of unsureness they feel."

The proof of the pudding is in the eating, of course: but Rotberg stonewalls questions about how his cash management performance compares to appropriate indices. Does he have such comparisons? "Of course," he said. "We measure ourselves a dozen different ways – but there is no perfect index to use. If one existed we probably would not use it because it would distract us. The only thing we would think of would be beating the index."

Is he satisfied with the performance? "We are satisfied with the management concepts behind it. We're satisfied they are workable and that they create an environment where our staff can use their judgement in how to position the portfolio."

One thing is certain: despite the World Bank's low salary ceiling, Rotberg has little trouble keeping good trading people – he loses one of his 10 traders about every two years. Washington has the advantage of being a pleasant place to live, particularly for traders with families, but Rotberg reckons that it is his trading room philosophy that has helped keep his traders.

When it comes to figures, he seems more comfortable talking about the liabilities side of the balance sheet. Well-known for selling the bank to anyone who will listen, he reeled off the bank's achievements with well-oiled ease. In fiscal 1984 there was:

- greater diversity of currencies borrowed than ever before. New currencies included Ecus, Euro-Canadian dollars and the Luxembourg franc;
- A big raid on the sterling market, where World Bank borrowing was a record $452 million;
- Record borrowing in Swiss francs, yen and Deutschemarks;
- The introduction of floaters both in Europe and the US. The European notes were linked to US Treasury bill rates rather than Libor. (Rotberg thinks Libor is not only too volatile but an inappropriate benchmark for the World Bank.)

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>
> Richard Davis
> Bank of America

But the biggest news, in Rotberg's view, is the further improvement in the World Bank's credit standing. "Some of our borrowing was conducted at just 20 basis points over US Government bonds of similar maturity," he said. "By comparison, in previous years we had to pay as much as 50 to 150 basis points. Part of the improvement reflects better overall market conditions, of course, but there is no doubt our credit perception has improved too. We paid similarly low premiums over benchmark rates in Germany and Japan."

Borrowings last year totalled $9.8 billion compared with $10.3 billion in 1983; and the average maturity was 5.8 years against six years for 1983. The average cost was 8.4% compared with 8.8% for 1983; the bank's interest costs had been consistently rising since 1979, when nominal interest rates averaged 7.2% on total borrowings.

Rotberg has been using a growing number of devices to keep borrowing costs down and never misses an opportunity to make the point. His biggest coup has been correctly calling the dollar's performance on foreign currency markets in recent years. From the mid-1970s, he has been borrowing heavily in Swiss francs, Deutschemarks and yen, in which he received not only much lower nominal interest rate costs but a big depreciation in exchange rates against the dollar.

In the seven years ended June 1984, Swiss franc borrowings alone totalled the equivalent of more than $10 billion at a nominal interest rate averaging 6.1%. Borrowing in dollars would have entailed interest costs averaging nearly 12% for the same maturities. A further $9 billion was raised in Deutschemarks during the period, at an average nominal interest cost of 8.1%; and nearly $8 billion was raised in yen, costing a nominal 8.2%. Overall, the average nominal interest rate cost for the three currencies was 7.4%. To borrow in appreciating dollars, Rotberg would have had to pay 11.7%.

Exchange rates have been almost as valuable in cutting costs as the nominal interest rate gap. Again, Rotberg has the facts at his fingertips: the exchange rate benefits for Swiss francs, Deutschemarks and yen over the years have totalled $4.5 billion (measured at rates at the end of July). Rotberg reckons the effect of his non-dollar borrowing programme was the equivalent of borrowing dollars at 4.7%.

Even Rotberg admitted the performance owed a little to luck. "When we borrowed in Switzerland, for instance, we were not necessarily saying that the Swiss franc would decline against the dollar," he said. "All we had to satisfy ourselves about was that the nominal rate gap would more than make up for any conceivable appreciation that the Swiss franc might enjoy versus the dollar."

Rotberg continued to avoid the dollar last year. He used currency swaps extensively to increase his exposure to Swiss francs, Deutschemarks, Dutch guilders and Austrian schillings. Non-dollar borrowing accounted for all but $1.533 million of the bank's medium- and long-term borrowing of $8.2 billion last year. Dollar exposure was reduced to $770 million after swaps – representing only 9.4% of the medium- and long-term total. The equivalent figure in 1983 was 34% after swaps, totalling about $1.7 billion. Swaps continue to reduce borrowing costs: Rotberg said that swaps knocked about 0.8 of a percentage point off his medium- and long-term programme's costs.

The continuing success of currency swaps, which have accounted for nearly $4 billion of the bank's borrowings since the programme began in the early 1980s, has left Rotberg ready to experiment with other instruments. In particular, he can be expected to make his debut soon in the interest-rate swaps market. On past form, his moves should be worth watching. He gets widespread credit among international bankers for far-sightedness in pioneering currency swaps. The comments of Richard Davis, a director of Bank of America's investment banking operation, were typical: "There were huge killings to be made on the spreads in some of the early swaps and he was there to get them. There are a lot of bankers who are opportunistic and can spot a good deal but it requires a special sort of person to act fast given the bureaucracy he must have to deal with at the World Bank. He was moving when most corporate treasurers were trying to think of reasons to stay out of swaps."