Den Europæiske Investeringsbank
Europäische Investitionsbank
Ευρωπαϊκή Τράπεζα Επενδύσεων
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EIB-Information

The EIB's Financial Product

Over the years, EIB lending has shown a steady growth. With loans totalling ECU 5.9 billion in 1984 and reaching ECU 7.8 billion in 1987, the demand for EIB finance has remained strong even during the economic recession of the mid-eighties, confirming the upward trend in the Bank's activities. In 1988, the volume of annual lending for the first time passed the ECU 10 billion mark and a significant increase in activity is expected again this year.

Why do project promoters turn to the European Investment Bank for finance?

Specific objective

The EIB's lending is directed towards capital investment projects which have one thing in common: they contribute to the balanced development of the European Community. The Bank has a specific mission and this implies a certain selectivity in what it can do. In practice, however, a wide range of investment projects across all sectors of the economy has received EIB finance because, directly or indirectly, they supported this broad objective given to the Bank by the Treaty of Rome.

First informal contact between the project promoter and the EIB normally indicates whether the investment project falls within the Bank's terms of reference. Once this has been confirmed, the promoter can expect the EIB to have a genuine interest in seeing the project implemented in the best possible fashion. Working towards the same goal, the promoter and a Bank team, consisting of a financial expert, an engineer and an economist, will discuss the project and the most appropriate form of financing. Often, the EIB's experience, built up in thirty years of project appraisal throughout the Community, proves to be helpful in fine-tuning the investment scheme and the financing package.

Operating in the same environment as many other banks, the EIB is well aware that the promoter is not only interested in the Bank's project appraisal know-how, but especially in a financial product conceived and priced in a market oriented fashion.

Excellent standing in the capital market

The conditions the EIB is able to offer are a direct consequence of its prime access to the capital markets where it raises the bulk of its funds, mainly through public bond issues and private placings. The two main credit rating agencies, Moody's and Standard & Poor's, have consistently given the Bank's issues the highest possible ('AAA') rating, commending the EIB for its sound financial position, its lending policy, the high quality of its loan portfolio, and the solid support of its shareholders, the member countries of the European Community (Moody's Sovereign Credit Report, June 1989; Standard & Poor's International Creditweek, 18 September 1988).

As written into the Treaty of Rome (Art. 130), the European Investment Bank operates on a non-profit making basis. Its Statute, which is an integral part of the Treaty, stipulates that the Bank's interest rates shall be adjusted to conditions prevailing on the capital market and calculated in such a way that the Bank can meet its obligations (i.e. re-

In brief

The European Investment Bank must borrow before it can lend. The market determines the Bank's possibilities as a borrower and a lender. Working on a non-profit making basis, the interest rates the EIB charges reflect its cost of borrowing. Consequently, it is in the interest of its borrowers that the EIB uses the opportunities offered in the different capital markets to their best advantage. Mr Marchat, who heads the Finance and Treasury Directorate, describes the Bank's experience in putting its bond issues out to bid (see page 4).

Supporting capital investment projects in all sectors of the economy, the EIB's financial product is conceived and priced in a market oriented fashion. This implies flexibility in meeting the project promoter's specific needs. The EIB, therefore, offers promoters a choice of loans, currencies, interest rate formats, maturities and grace periods. The ultimate purpose: attaining European Community objectives by facilitating the implementation of a maximum of sound capital investment (see page 1).

Attractive yes, subsidised no. That is the general rule for EIB loans. However, in special circumstances the Community or its Member States have provided interest rate subsidies to soften the Bank's conditions. From the first financial protocol between Greece and the EC to emergency aid after natural disasters: a case history (see page 3).

Outside the Community, interest rate subsidies on EIB loans are a more or less regular feature. An overview of their occurence from the Yaoundé conventions to Lomé and in the Mediterranean region will appear in a forthcoming issue of EIB-Information.

deem its bonds), cover its operating expenses and build up a reserve fund.

It is often, mistakenly, thought that the European Investment Bank can provide 'soft' money. In fact, working on a non-profit making basis, the interest rates the EIB charges are determined by its own cost of borrowing. Moreover, the Bank is prohibited by Statute to 'soften' its conditions by reducing its interest rates. Where EIB rates have been below market rates, interest subsidies were provided by third parties. The Bank's Statute allows this, subject, however, to Article 92 of the Treaty of Rome which deals with avoiding distortion of competition. The Member States or the European Community have, in specific circumstances, made funds available to reduce EIB interest rates (see the overview of such instances included in this issue of EIB-Information).

Cost of borrowing + 0.15 %

Determining its interest rates, the European Investment Bank applies a very basic rule : the cost of borrowing, taking into account the coupon, the issuing price and all other costs related to the bond issue, plus 0.15 % to cover operating costs. According to this principle, rates — varying slightly with the duration of the loan — are set for each of the 15 or so currencies with which the Bank works.

The Bank's interest rates are adjusted almost weekly to keep in line with interest rate developments on the capital markets. For those currencies where the Bank has been absent from the relevant market, rates are adjusted to reflect yields in the secondary market for its own bonds or for new issues of other 'AAA' borrowers. In this way, borrowers from the European Investment Bank, at a cost of 15 basis points, have access to the world's capital markets at the conditions available to a prime borrower.

The borrower's choice

The borrower may request the loan to be disbursed in one currency, for example the borrower's domestic currency or the ecu, or in any mix of currencies. Where the loan is paid out in more than one currency, the specific interest rate for each one is applied. For reference purposes, a notional interest rate for the mix can, of course, be calculated as a weighted average.

Especially appropriate for project financing, the bulk of the EIB's lending is long-term. Maturities generally range from four to twelve years for industrial investment and up to twenty years or more for infrastructure projects.

The borrower may choose between a finance contract in which the interest rate for the currency or currencies paid out is laid down — that is the rate(s) in force on the day of signature — or a finance contract stipulating that the interest rate(s) will be the one(s) in force on the date(s) of drawdown, which could be in one or more tranches. This last arrangement is what the EIB calls an open-rate contract.

In the first case, where the interest rate in force on the day of signature applies, no commitment fee is charged if the borrower draws down the amounts agreed within 60 days.

The open-rate contract gives the borrower up to 18 months for an industrial project and up to 24-36 months for infrastructure schemes to request disbursement. In practice, the open-rate finance contract is a free-of-charge form of stand-by credit for the project promoter, as the European Investment Bank contractually commits itself to disburse the funds within four months following the borrower's request(s) (normally, the Bank's liquidity position permits much swifter disbursement). If the borrower wishes, the open-rate contract may specify the currency or combination of currencies in which the loan is to be paid out.

In both kinds of finance contracts, the interest rate can be either fixed for the duration of the loan, fixed but adjustable, or variable (see below). The Bank's standard product has been, and still is, long-term loans with fixed interest rates.

Flexibility : fixed, adjustable or floating rates

When the borrower opts for a **fixed interest rate,** the rate set in the contract will remain valid for the duration of the loan. In case of early repayment, the Bank will require indemnity. The borrower will be asked to pay a compensation which varies with the market conditions under which the Bank redeploys the prepaid funds.

The **adjustable fixed interest rate** loans the Bank offers give greater flexibility to the borrower expecting that interest rates will go down in the medium to long-term. As the name indicates, the loan is provided at a fixed interest rate, but the finance contract gives the borrower the opportunity to take advantage of a possibly more advantageous interest rate in force after a predetermined number of years, usually 4 to 10, as indicated in the contract. Alternatively, the outstanding amount may be repaid on the given date without indemnifying the Bank. In that case, 45 days advance notice must be given. Under certain circumstances a third option may exist, namely continuing the loan but with the Bank making other currencies available.

Floating rate loans are another alternative. The fixing of the Bank's floating interest rate is made on the basis of the quarterly average cost for the EIB to borrow the currencies concerned, plus the Bank's 0.15 % margin. In practice, it turns out that much of the time the resulting interest rate is well below Libor. If the Bank has been given notice 45 days before the payments of principal and interest are due, the client may effect early repayment on that date without any cost.

Most loans are repaid in six-monthly or, less often, yearly instalments of principal and interest, but if it benefits the project's implementation, individualised repayment schedules can be arranged. Repayment must take place in the same currencies and in the same proportion in which the loan was paid out.

As a rule, grace periods on repayment of principal are agreed, most often ranging from two to five years, but varying with the nature of the project.

For all loans : no additional costs or fees

There are no other costs or arrangement fees, and no commitment fees if a loan is drawn down within the time periods described above. All loans are paid out at par.

Fixed, adjustable and floating rate loans are the Bank's financing facilities most often used. Other projects fare best with tailor-made financing and the EIB has the financial engineering know-how enabling it to put into place more complex financing packages, structuring its finance to fit with the borrower's specific needs.

Increased flexibility serves only one goal: the attainment of European Community objectives through the implementation of sound capital investment projects. To that end, the financial product the EIB offers to project promoters is a combination of partnership, project financing experience and a growing choice of financing facilities, all at a cost reflecting the Bank's prime access to the capital markets.

A case history of reducing EIB interest rates

The preceding article explains how the EIB sets its interest rates and explains that in those cases when the Bank's rates have been below its own cost of borrowing, interest subsidies have been provided by third parties. Article 19 of the EIB's Statute allows for such a reduction of the Bank's interest rates as long as this is compatible with the Treaty of Rome, Article 92, which deals with avoiding distortion of competition.

Inside the EC, the Member States and the European Community have made interest subsidies available when it was appropriate in specific circumstances described below (one of the coming issues of EIB-Information will present an overview of the interest subsidies provided in the context of the Community's development policy).

Financial protocols EEC-Greece

Greece became a member of the European Community on 1 January 1981. Since 1962, however, Greece was linked to the Community through an Association Agreement. Two financial protocols, annexed to the Agreement, involved the EIB in lending a total of some ECU 350 million. The first came into effect on 31 August 1962 (Official Journal No 122 of 21 November 1962; Official Journal No 26, 18 February 1963). The EIB was to lend up to USD 125 million for investment bringing the performance of the Greek economy closer to the level of the European Community. The then six Members of the EEC paid for a 3 % interest subsidy on EIB loans from their national budgets, pro rata their subscription ot the Bank's capital. For up to two thirds (USD 83.3 million) of the total amount of finance foreseen, transport, energy and agricultural projects were eligible for subsidy. Lending activities were interrupted in 1967 following the military junta's coup d'état, but were resumed at the end of 1974 after democracy had been restored. Signed on 28 February 1977, the second protocol entered into force on 1 August 1978 and effectively covered the period up to accession (Official Journal No. 225, 16 August 1978). This protocol provided for ECU 225 million in EIB loans. Again, up to two thirds of that amount, reserved for investment in economic infrastructure and agricultural schemes, carried an interest subsidy of 3 %, which this time was financed from the grant aid of ECU 45 million the protocol provided from the Community budget.

European Regional Development Fund (ERDF)

When the ERDF was established in 1975 (Official Journal No. L 73, 21 March 1975) it made a total of ECU 1.3 billion in grants available for the years 1975 to 1977. Within certain limits, the funds could be used for a 3 % interest rate subsidy on loans from the European Investment Bank on the condition that the project was located in an area or region eligible for ERDF support. On 6 February 1979, the first regulation was amended, with the possibility of providing interest rate subsidies on EIB loans continuing to exist (Official Journal L 35, 9 Febraury 1979). In fact, a subsidy from ERDF funds has been applied to a loan from the European Investment Bank only once. Apparently, Member States generally prefer outright, one-time capital grants to subsidies spread out over the maturity of a loan. In later ERDF regulations the interest rebate facility is not specifically mentioned.

Financial aid for Portugal

The financial cooperation between Portugal and the EIB began in 1975 with exceptional financial aid to counter the difficult economic situation following the move towards democracy. The EIB was to provide up to ECU 150 million in loans to finance investment in industry, agriculture, energy and transport. These loans carried a 3 % interest subsidy paid out of the European Community budget at a total cost of approximately ECU 30 million (Bulletin of the European Communities No. 10, 1975). In September 1978 there followed a financial protocol between the Community and Portugal, in which ECU 200 million in EIB loans was foreseen, of which 150 million carried an interest subsidy of 3 %; the cost of the interest subsidy was not to exceed ECU 30 million, again to be paid out of the Community budget (Official Journal No. L 274, 29 September 1978). The protocol covered a five year period, but by the end of 1981 the full amount had been used. Between 1981 and Portugal's accession to the EC on 1 January 1986, a pre-accession financial aid package offered ECU 150 million in EIB loans (Official Journal No. L 349, 23 December 1980). They were directed towards projects which would facilitate the integration of the Portuguese economy into that of the Community. Up to ECU 125 million was foreseen to carry a 3 % interest subsidy from Community resources for which ECU 25 million was budgeted. As it turned out the demand for EIB loans was such that, at the request of the Portuguese Government, the maximum of pre-accession EIB lending was extended with ECU 75 million on 21 June 1983 and another ECU 150 million was added on 1 July 1984. Interest rate subsidies were not made available for the two extensions.

European Monetary System

The European Council meeting of 4 and 5 December 1978 laid the basis for the European Monetary System and, at the same occasion, decided that the EMS should include measures to strengthen the economies of the less prosperous Member States effectively and fully participating. A series of decisions followed to implement the system: one of these was the decision of the Council of the European Communities of 3 August 1979, adopting a regulation whereby the eligible State or States would obtain ECU 5 billion in subsidised loans, in annual portions of ECU 1 billion, over the five year period from 1979 to 1983 (Official Journal No. L 200, 8 August 1979).

The amount entered in the budget to cover the discounted value of these subsidies was ECU 1 billion, divided into five annual portions of ECU 200 million. Loans from the EIB's own resources (1) and from the New Community Instrument (2) for infrastructure projects and programmes were eligible for a 3 % interest rate subsidy paid out of the EC budget. The objective was to contribute to resolving the main structural problems of the State(s) concerned, in particular to reducing regional imbalances and improving the employment situation. In a separate decision of the same date, the Council designated Ireland and Italy as beneficiaries of the Regulation as they fulfilled the double condition of (a) effectively and fully participating in the mechanisms of the European Monetary System, and (b) being considered less prosperous (Official Journal No. L 200, 8 August 1979). Two thirds of the subsidies were destined for Italy, one third for Ireland.

Emergency aid

In November 1980, the regions of Campania and Basilicata in Southern Italy were stricken by a heavy earthquake. On 20 January 1981 the Council of the European Communities took the decision to make 3 % interest rebates available for up to ECU 1 billion in loans from the EIB's own resources and those from the New Community Instrument for investment helping the reconstruction of economic and social infrastructure in the stricken areas (Official Journal No. L 37, 10 February 1981).

A similar decision was taken by the Council on 14 December 1981, this time benefitting the parts of Greece which were stricken by earthquakes in February and March of that year (Official Journal No. L 367, 23 December 1981). A 3 % interest subsidy was made available for up to ECU 80 million in loans from the EIB's own resources as well as the New Community Instrument to help the reconstruction of the means of production and the economic and social infrastructure.

Following earthquakes in Greece, bringing damage to the town of Kalamata and its surroundings in September 1986, the Council decided on 7 November 1988 to stimulate reconstruction work by making a 3 % interest rate subsidy available for up to ECU 100 million in loans from the European Investment Bank (Official Journal No. L 309, 15 November 1988).

In all three cases, the rebates were chargeable to the Community budget for loans with a duration of up to twelve years.

(1) Principally the proceeds of the Bank's borrowings on the capital markets.

(2) Borrowings contracted by the Commission in the name of the EEC, within limits set by the Council, for the purpose of promoting investment in the Community. The Commission decides on the eligibility of projects for a loan within guidelines laid down by the Council. The EIB examines loan applications in accordance with its customary criteria, decides on the loans and the terms and then administers them.

The bond market . . .

The EIB's experience with competitive bidding procedures (*)

by Philippe MARCHAT, Manager of the Finance and Treasury Directorate

The EIB's experience with competitive bidding procedures designed to delegate mandates to lead bankers for its bond issues is a sensitive question, which I should like to approach from a more general context than that simply of tendering techniques in the strict sense of the phrase. The following observations reflect my own viewpoint on the issue.

This experience is inextricably bound up with **three fundamental factors** that shape both the EIB's operating environment and the trend of the markets.

1. We have the **multiplicity of currencies used by the EIB**, 17 in all, which explains the diversity of the markets to which it addresses itself. Each of these has its own usages and characteristics, to which the Bank must adjust. It does so pragmatically.

This diversity in the sources of supply for EIB funds has been rendered even more fundamental by the massive growth in the Bank's activity in recent years. In 1988, for instance, we advanced a total of 11.2 billion ecus in new loans in these various currencies. This called for operations to borrow the currencies required, in general directly, with an increasing bias towards Euro-

(*) This article is based on the speech delivered by Mr Marchat at the Government Borrowers' Forum meeting held in Helsinki on 15 June 1989, bringing together both public-sector borrowers and the finance managers of supranational development banks.

pean Community currencies, which in 1988 accounted for some 84% of the 7.7 billion ecus raised, a rise of some 30% over 1987.

2. The second factor is the phenomenon of the progressive **liberalisation** and at times considerable **development** experienced in most of these markets in recent years, especially in Europe, for instance France, Italy and latterly Spain.

In this area, when choosing its lead managers and setting up bank syndicates, the EIB, depending on the market, will generally observe procedures as handed down by Governments and public agencies when borrowing on their home markets, especially within the Community, or take its cue from other supranational institutions, especially the World Bank, on various international or non-Community markets.

3. In this general context, the EIB pursues one objective, common to all borrowers, whether or not comparable, which is to command the greatest possible degree of latitude in choosing lead managers for bond issues. That choice is absolutely vital, given that five tasks devolve upon the lead manager:

(1) preparing the prospectus and necessary documentation;

(2) choosing the members of the issuing syndicate: in the case of the EIB, this is deemed to be the entire responsibility of the lead banker;

(3) agreeing with the issuer the terms and conditions of the loan to be floated;

(4) distributing allocations from the placing among the members of the syndicate;

(5) ensuring — and this is critical for a permanent borrower like the EIB, needing constantly to return to the markets — that the paper commands a good quotation in the secondary market.

From these tasks stem various essential criteria for the choice of a lead manager, who must in particular be able to offer:

(a) adequate, well-established placing capacity;

(b) the wherewithal and experience to get the best possible terms and conditions for the issue;

(c) the capacity to guarantee that the issue will be taken into the market on the best possible conditions, to meet one of the permanent objectives of the EIB. Such a capacity is certainly a prime consideration when it comes to deciding which Bank will receive the mandate;

(d) the ability, as a market maker, to ensure that the issue is properly handled after its market launch.

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Liberalisation has advanced to varying degrees in the markets which, coupled with the constraints and usages peculiar to certain of them, means that different procedures are still being used in contention against each other for the conferral of mandates on bond issue lead managers.

While it may not be difficult to describe the various procedures that are currently practised, it is far from easy to predict the pace at which they may evolve in terms of the market, still less to quantify what advantages may accrue from one way of appointing a lead manager as compared with another. To be able to arrive at an objective, reasoned judgement, one has to be able to take stock of the market situation at the moment of the launch, to compare terms and conditions, in particular coupon and issue price and of course the way in which investors would have received the issue, had it been launched through some alternative procedure.

The ways and means whereby the placing of a mandate is decided may be numerous and varied, but in principle they have their origin in just two different philosophies: either a certain automatic order of designation is established, which must be respected by the issuer; or there is freedom of choice, to a greater or lesser extent, for the issuer but in particular room for recourse to competitive bidding.

As the EIB makes use of these various techniques, I should like now to glance in turn at their main characteristics before returning in closer detail to the question of how we handle competitive bidding as such.

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Where the choice of lead manager is imposed

There may be various reasons why the issuer does not enjoy a completely free hand in selecting a lead manager, with the choice more or less imposed upon him from outside. Where this is the case, **a number of specific techniques may be equally to hand**. These relate, if not to the composition of the syndicate, at least to the designation of the lead manager:

(1) either **the banking syndicate responsible for the placing of the bond issue is fixed**, with a single lead manager. This is still the situation for the EIB on a number of domestic public markets, such as Germany, with Deutsche Bank, Belgium with Générale de Banque or the Netherlands, with AMRO;

(2) or the **banking syndicate is fixed** but with **rotation of lead manager**. This happens for the EIB in Switzerland, with the "great syndicate" comprising the UBS, Crédit Suisse and SBC; in Luxembourg, for public issues, on the Japanese markets, until very recently, and again in the USA for yankee bond operations.

In such a system one can discern the legacy of the past, at times still potent, the static character of which is at odds with the new and dynamic trends in various markets. Moreover the fixity of this situation is tending gradually to relax. You can see this in Switzerland, for instance, where cracks are beginning to appear in the great syndicate, none of whose members feel any longer systematically obliged to take part in each and every issue given over to this syndicate. The EIB has imparted flexibility to the system by making regular calls, after complete rotation of the great syndicate, to another syndicate of local banks (the "little syndicate" — also with lead manager rotation) to handle its public issues on the Swiss market. Something similar is happening on the yankee market.

One's main quarrel with the fixed-syndicate format — theoretically at least

— is that, by definition, it denies the issuer the best possible terms for his issue. The stimulus of competition does not automatically come into play. This however is not to deny that there are cases where the issuer may still command the best possible terms a given market may be able to offer.

Because the syndicate is pre-established, the lead manager will frequently, in the pricing, make sure that he has the blessing, if not of all other members of the syndicate, then at least of the most important of them, before putting the terms and conditions of the issue to the issuer. This prior search for minimal consensus — akin to a common denominator — makes for a real risk of the coupon and the issue price both being set higher than they could have been in the event of a single proposal coming from just one bank which would be likely to take a more aggressive stance. In other words, the chances are that concern for security and a safe placing will gain the day over the assumption of a risk, stemming from a hint of combativeness, at least where the market would allow.

In such a situation, the issuer may be expected, for each launching, to be in possession of such exact information from various participants in the market, whether or not members of the syndicate, as to be able where necessary to express a firm viewpoint, should it differ from that of the syndicate, and to engage in tight negotiations with that syndicate.

Moreover, the fixed-syndicate formula is extremely restricting and immovable when it comes to the composition of the syndicate, with possible repercussions on the way in which the issue is placed. Experience shows that this rigidity does not in general allow of progressive adaptation to the often highly mutable state of the market, because the effective placing capacity of many members of the syndicate may itself develop disparately. On the one hand, it is very difficult for the syndicate members to modify even by a few points or tenths of a point the distribution breakdown of the bonds to be placed ; indeed the least modification has implications for the percentages of all the other participants, whose immediate intercession with the lead manager will effectively block everything. Even more difficult to countenance however is the admission of new members, whose placing capacity has grown so much as to exceed that of the old members quite appreciably, and which thus cannot be used directly by the issuer.

In other words, and especially when the syndicate dates back some years, this formula tends to reflect the current state of the market less and less, which means it precludes using all possible placing opportunities at a given moment, let alone making optimal use of them. It can, on the other hand, involve making allocations to certain banks which, unable to place them effectively, will rapidly be constrained to release them, either on the market or to other syndicate members, with or without return of commission. Of course the release of bonds can take place only at the expense of the issuer, with consequences that can affect the behaviour of its bonds both in the primary market and subsequently the secondary market.

The system does nevertheless have its advantages — or at least one essential advantage, which resides in the almost structured grouping of a number of banks, periodically pooling their efforts to ensure the placing of bond issues for which they share the responsibility. Where the market situation is uncertain, or actually bad, the presence and the permanence of such a syndicate furnishes the issuer with support and solid **security** (not necessarily whole and entire) by dint of its status, placing capacity and market clout. The worse the market situation, the more appreciable these strengths become.

In a word, the "imposed" lead manager formula, while not generally and systematically enabling the issuer to be sure of commanding the best possible market terms on all issues, at least allows him, when the **economic climate** falters, to cut considerably the **risk factor** and provide a hedge against a flop. This is quite the opposite from a specific operation mandated to a syndicate, put together for such a single placing operation under closely-defined, once-only conditions.

Where there is total freedom in the choice of lead manager

There are in theory three options open to any issuer who enjoys a totally free hand in choosing his lead manager. The choice arising, in each individual case, can be shaped simultaneously by the market, economic conditions, any peculiar circumstances (for instance, special opening for pre-placing) and, of course, the capacity and power of the lead bank.

The first of these options **is the direct designation of a lead banker,** a move that can be motivated by a number of considerations :

— a pre-eminent position in a given market at a given point in time, making the bank in question more or less the obligatory, most natural channel of access to a market in which it would subsequently become one of the main market makers ;

— the existence of special links between the issuer and the designated bank, such as for instance consideration for a valued service rendered previously to the issuer ;

— designation by the issuer in consideration of a specific service rendered by the bank. Such a service might have benefited the issuer on either :

— the assets side of the balance sheet ; there might, for instance, have been a substantial (global) loan from the issuer to the bank, the size of which warranted special market issue ; or on

— the liabilities side ; we have, for example, the case — happily, somewhat rare — where the EIB is looking for a particular currency, such as the ecu, for which it is always faced with strong demand, at a time when the ecu market is not buoyant, where the chance of a currency (or even interest-rate) swap operation is offered by a bank that looks like a valid counter party, that is, one with at least an AA credit rating.

In such a case, equal consideration has to be given to both the final conditions attaching to receipt of the currency after the swap (ecu in the event) and those covering the issue of the currency to be swapped (US or Canadian dollar or Yen, for example) to take concrete cases. Indeed, for an issuer like the EIB, ever-present on a number of markets, the problem is to obtain ecus on sufficiently keen terms to ensure ease of re-lending, without detriment to its issuer's image from the secondary market quotation for the currency originally issued and swapped.

In other words — and here we are at odds with what frequently happens in the swap market — one of the EIB's criteria for designating a bank to handle both the issue and the swap is that both of these more or less simultaneous operations should be carried out under propitious market conditions — where there is no scope for playing off one market against the other.

The second solution **is to designate a lead manager on the basis of a call for bids**. This is a procedure which the EIB has been using for some years in a number of markets, both public and private. It is now coming into more general use, which looks like the logical outcome of the double process of liberalisation and internationalisation, which has made great strides in recent years. Fortunately, such a trend gives new scope to borrowers, national and foreign alike, making calls on these markets.

It was on the German "Schuldschein Darlehen" and Swiss private placings markets that the EIB pioneered this procedure. The results were positive in both cases, enabling the Bank to reach investors who would otherwise have remained outside the orbit of its traditional operations.

The procedure was extended progressively to other private markets like Belgium and public operations, for instance on the international US and Canadian dollar markets. Then came various public and private markets within the Community, such as the United Kingdom, Italy, Spain and France.

There are a number of qualifications that need to be made about the introduction of such a procedure. As regards form, the situation varies fundamentally according to whether the mandate is conferred on the basis of simple directions sought by the issuer or after a call for bids as such.

(a) In the first case, which is a procedure used by certain governments and from time to time by the EIB, the issuer asks a small number of preselected banks to provide it with indications as to the likely terms and conditions of the market issue. This approach makes it possible to form a close conception of what the primary market is at a given moment, provided the range of banks consulted is open enough. Where necessary, it also offers a way of conferring a mandate very swiftly, but only after those simple indications have been formally translated into concrete proposals. As a matter of fact, where a number of potential lead managers sense that the borrower is likely to move swiftly onto a given market, they will often provide him with such indications without even being asked.

(b) In the second case, we are talking of competitive bidding as such. The EIB is having more and more recourse to this procedure on various markets, both international and domestic, wherever it feels this can serve its purpose. Such recourse however presupposes absolute respect for the very precise rules of the game, while use of the procedure, although ideal in theory, may not always necessarily be the best possible solution. It is as well to look at various factors, both structural and occasionally cyclical, that can bear upon the markets in question.

As far as the rules of the game are concerned, and without going too far into these, suffice it to recall Rule No 1, which is that all banks participating must be treated on a basis of precise equality, with no room to countenance special treatment for any one of them at any time. This means in particular that the date for submission of tenders must be scrupulously adhered to, that all participants must be in full possession of all the basic data and that these must be clear and explicit. Moreover, one of the pitfalls to be avoided, after the submission of tenders, is having one or other participant come up with new proposals, by definition more attractive, likely to take a procedure so far perfectly drawn up and followed, and reduce it to a run of bilateral bargaining sessions which, if the issuer became committed, could lead to all sorts of consequences more or less impossible to foresee.

Experience shows it to be ill-advised to maintain too heavy a short-list of banks: between three and five, depending on market and other conditions, would seem about right. It is often useful also to let each participant know how many other banks are involved and which: this tends to ease their task in preparing the issue and expediting the establishment of the syndicate, once the mandate has been conferred.

Another problem not always easy to resolve is to draw up a list of banks consulted for each issue. This is a question of the general policy of the institution operating on both international and domestic markets. If, like the EIB, the issuer has reached the stage of maintaining relations with a large number of banks, the better approach, if it wishes to give them all an equal chance (which could eventually be modulated), is to draw up a long list of all banks, to be consulted in turn over a number of operations in the same market, with the corresponding short-lists extracted from that long list for each succeeding issue.

In seeking greater objectivity and more efficiency, such a policy may, as in the case of the French or Italian markets, lead to the establishment of separate lists according to the specialisation or market-making activities of the banks concerned, which will not necessarily exclude their appearance on more than one list. These may also break down between Euro-markets and domestic markets.

Last but not least, bear in mind that a call for tenders is not in itself an adjudication. In other words, the issuer is not constrained systematically to confer his mandate on the lowest bidder. He retains complete freedom of discretion and is able to decide if, in the light of the market situation, the lowest tender is realistic and such that he can mount an operation with a guarantee of success.

Such an assessment obviously oversteps the bounds of the formal call for bids and touches upon the crux of the problem. The delicacy of the situation may be heightened by the fact that every issuer, *a fortiori* when he is using competitive bidding, is clearly out to secure the best possible terms for the issue he is planning to float. This means that the terms and conditions attaching thereto must be the keenest possible, that is to say the lowest possible within the mar-

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ket. In other words the main difficulty is to maintain a clear view, at any given moment, of the borderline between what is inside and what is outside the market (because of the increasing frequency and acuteness of fluctuations, stemming largely from the process of internationalisation).

This is of the essence to every issuer, stemming from recourse to competitive bidding, which by definition is a very efficient tool for getting the best possible market terms at any given time. But it is a tool to be wielded with caution. If the issuer is not on his guard, competition between banks to land a mandate, perhaps at any price, may in fact lead to issues of indeterminate success or even flops.

Experience also shows that competitive bidding is not necessarily the answer for all prospective issues: to get the most out of the benefits it offers, a number of conditions need to be fulfilled. The market concerned needs first of all to be sufficiently developed and adult and to afford minimal liquidity, without which there is no way the call for bids can work. Today, for instance, such preconditions seem to obtain on the Japanese samurai and Euro-yen markets. There, as a first exercise, the EIB, with certain exceptions in the Euro-yen sector, mandated a syndicate consisting of four major security houses with lead manager rotation. We have now come to think it both preferable and possible — and we have let this be known — once the last cycle has been completed, to move on to competitive bidding, which could of course include, in the Euromarket, the London subsidiaries of the major Japanese banks, alongside the security houses.

These considerations apart, an objective review of the various markets — international, domestic or Euro — brings me to the personal conclusion that competitive bidding, attractive and effective though it may be, is not necessarily a universal panacea, nor will it systematically in all cases enable the best advantage to be taken of whatever scope exists in a given market at a given time.

Before wielding this tool to launch an issue, we would do well objectively to analyse the situation, for our findings may well vary with economic conditions. On some markets, for instance, such as domestic markets or recently-opened Euromarkets on the threshold of development — witness the Portuguese market — the banks are not numerous enough nor of sufficient capacity yet to justify setting them in competition with each other through formal competitive bidding. In other cases, as with very specific markets — some of the Euromarkets and even the ecu market, depending on cyclical trends — the limited number of true market makers and their high degree of specialisation may also argue for excluding the option of competitive bidding. Then again, there are markets where, under normal conditions, competitive bidding is feasible when things are going well and the market is holding up, but where temporary difficulties may put the procedure off the agenda in the interests of efficiency and good sense. Finally, there are still other markets — Germany being a case in point — where, for the time being at least, the procedure to be followed for public issues precludes recourse to competitive bidding.

A third possibility is **adjudication** which, as I have already noted, differs from competitive bidding only in the automatic choice that results from the tenders received. Recourse to this procedure implies that the issuer declines any freedom of choice and any alternative evaluation of bids received in the light of market conditions. In the case of the EIB, this procedure is only used in very particular cases where the automatic selection factor seems unlikely to be a potential source of problems. We may follow that route for operations under our commercial paper programme for such amounts as we care to decide.

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These were the thoughts I wanted to express, in the light of my experience, on the main issuing techniques and in particular competitive bidding. On this fascinating but very delicate topic, we need to be above all pragmatic and very alert in a constantly changing environment; competitive bidding techniques are no exception to the rule and should, at all events, be handled with caution.

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Below are the ECU's values in national currencies, as at 30 June 1989; these rates are applied to the third quarter in preparing financial statements and operational statistics of the Bank:

DEM	2.06770	BEF	43.2974
GBP	0.683449	LUF	43.2974
FRF	7.02120	DKK	8.04631
ITL	1 495.95	GRD	178.135
NLG	2.33055	IEP	0.777479
ESP	131.581	PTE	173.147
		USD	1.05900

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