

**International Financial Markets**

korth-M&K 1

---

---

---

---

---

---

---

---

**International Financial Markets**

- World money & capital markets
- "Off-shore" markets
- Syndicated loans and syndicated security underwriting

korth-M&K 2

---

---

---

---

---

---

---

---

**International Financial Markets**

**World Money & Capital Markets**

- Most important:
  - United States ["New York"]
  - United Kingdom ["London"]
  - Japan

korth-M&K 3

---

---

---

---

---

---

---

---

## International Financial Markets

- Domestic [= "on-shore" markets]

- Domestic markets are tightly regulated by the national (& sometimes regional or local) government of that country.

korth-M&K

4

---

---

---

---

---

---

---

---

## International Financial Markets

- Two locations

- Home domestic
- Foreign domestic

korth-M&K

5

---

---

---

---

---

---

---

---

## Foreign Bonds

- Long-term marketable debt *floated* in a domestic market by a foreign issuer

- "Yankee bonds"
- "Bulldog bonds"
- "Samurai bonds"
- "Panda bonds"

korth-M&K

6

---

---

---

---

---

---

---

---

### ***Depository Receipts***

- A certificate that is a claim on stock sold in another country
- Held in trust by a *trust bank abroad*
- *American depository receipts (ADRs)*
  - *Global depository receipts (GDRs)*

korth-M&K

7

---

---

---

---

---

---

---

---

### ***Off-Shore Markets***

- = *euromarkets*
- International money & capital markets that are free of most government regulations
- *Not physically off-shore*
  - But off-shore from "on-shore" (i.e., domestic) regulatory constraints

korth-M&K

8

---

---

---

---

---

---

---

---

### **Off-Shore Markets**

- Characteristics of the major off-shore markets
  - Favorable legislation
    - Minimum of regulation
    - Often favorable tax treatment
  - Usually requiring the use of contracts denominated in foreign currencies

9

---

---

---

---

---

---

---

---

**Off-Shore Markets**

- **Other market characteristics:**
  - **Economic & political stability**
  - **Good infrastructure (especially communication)**
  - **Skilled work-force**

korth-M&K 10

---

---

---

---

---

---

---

---

**Advantages of Off-Shore Markets  
for *Participants***

*Minimum of regulation:*

- **Flexibility**
- **Speed**
- **Profitability**

korth-M&K 11

---

---

---

---

---

---

---

---

**Advantages for Participants**

- **Avoiding government regulations in countries with which one may be in conflict**
- **Ability to avoid exchanging currencies in the FX markets**
- **Tax advantages**
- **Economies of scale**

korth-M&K 12

---

---

---

---

---

---

---

---

### **Advantages of Off-Shore Markets for *Host Countries***

- **Strengthened financial markets**
  - **Attracting foreign financial institutions**
  - **Fostering greater sophistication**

korth-M&K

13

---

---

---

---

---

---

---

---

### **Advantages for Host Countries**

- **Improved employment opportunities**
  - **More jobs**
  - **Higher skilled**
- **Increased fee and tax revenue**
- **Prestige**

korth-M&K

14

---

---

---

---

---

---

---

---

### **3 Sectors of Off-Shore Markets**

- ***Eurocurrency market***
- ***Eurobond market***
- ***Euronote & euro-commercial-paper market***

korth-M&K

15

---

---

---

---

---

---

---

---

### Off-Shore Markets

- **Note: *there is no true euro-equity market--despite common mis-use of the term***
  
- **The "euro-markets" are:**
  - **Not limited to Europe**
  
  - **Not generally in euros!!!**

Korh-M&K

16

---

---

---

---

---

---

---

---

### Eurocurrency Market

- **Deposits in a bank [*eurobank*] of foreign funds**
  - ***Deposits--not currencies!!!!***
    - ***Eurodeposits***
      - **Minimum size is generally \$1,000,000**
  
      - **CDs or time deposits--not demand deposits**
        - **Most common: 3 & 6 months**

17

---

---

---

---

---

---

---

---

### Eurocurrency Market

- **Can be in almost any currency -- except the local currency**
  - e-\$
  - e-¥
  - e-£
  - e-€
  
- **Sole exception: *international banking facilities (IBFs) in the U.S.***

Korh-M&K

18

---

---

---

---

---

---

---

---

### Eurocurrency Market

- The eurocurrency is
  - *Created when the deposit is made.*
  - &
  - *Destroyed only when it is withdrawn.*
  
- The size of the eurocurrency market equals the total of all deposits.

korth-M&K 19

---

---

---

---

---

---

---

---

### Depositors in the Eurocurrency Market

- Corporations
- Other banks
- Governments
- Wealthy individuals

korth-M&K 20

---

---

---

---

---

---

---

---

### Eurocurrency Market

- Banks accepting e-deposits can be:
  - Local banks (e.g., *British* banks accepting \$ deposits in London)
  - Banks of the country whose currency is deposited (e.g., *American* banks accepting \$ deposits in London)
  - Banks of a 3d country (e.g., *Japanese* banks accepting \$ deposits in London)

korth-M&K 21

---

---

---

---

---

---

---

---

**London Interbank Bid Rate**  
***(LIBID)***

- Interest rate that a bank in London bids on eurocurrency deposits from another bank

- inter-bank

korth-M&K

22

---

---

---

---

---

---

---

---

**LIBID Depends upon**

- The deposit (currency, maturity, size) &

- The bank

- Banks of lower quality **MUST** pay a higher LIBID for deposits.

- Not the nature of the depositor

korth-M&K

23

---

---

---

---

---

---

---

---

**Eurocurrency Market:**  
***Investments***

- Some *money-market* investments

- However, mostly loans

- *Euroloans = Eurocredits*

korth-M&K

24

---

---

---

---

---

---

---

---

**Eurocurrency Market:**  
***Borrowers***

- **Corporations**
- **Other banks**
- **Governments**
- ***Not* individuals**

korth-M&K 25

---

---

---

---

---

---

---

---

**Eurocurrency Market:**  
***Lenders***

- **Unilateral**
- **Multilateral**
  - ***Syndicate***
    - ***Eurosyndicate***

korth-M&K 26

---

---

---

---

---

---

---

---

**Size of Euroloans**

- **Small: \$1,000,000**
  - ***"Jumbo"*: > \$250,000,000**

korth-M&K 27

---

---

---

---

---

---

---

---

**Euroloans**

- **Type of eurocredit**
  - **Direct loan**
  
  - **"Stand-by" facility**
    - *Tranches*
  
    - **Line of credit**
      - **"Revolving" commitment**

korth-M&K 28

---

---

---

---

---

---

---

---

**London Interbank Offer Rate**  
**(LIBOR)**

- **The interest rate at which one eurobank will offer to lend to another eurobank**
  - **Note: LIBOR is *not* bank's cost of capital**
  
- **LIBOR is the almost-universal lending rate in international banking.**
  - **Even used frequently with domestic loans**

korth-M&K 29

---

---

---

---

---

---

---

---

**LIBOR**

- **Depends upon the nature of the loan**
  - **Currency**
  
  - **Maturity**
    - *Yield curve*
  
  - **Size of loan**
    - **Offshore-market rates are more attractive than domestic rates.**

korth-M&K 30

---

---

---

---

---

---

---

---

### LIBOR

- Most borrowers pay *LIBOR+*
  - The spread will increase:
    - The lower the quality of the borrower &
    - The greater the risk of the project
  - *Collateral* or other security reduces the spread.

korth-M&K

31

---

---

---

---

---

---

---

---

### LIBOR

- Most e-loans have *floating rates* with a 3 or 6-month *rollover* (or *reset*).
- On the *rollover date*, the interest rate will change to the LIBOR in effect on that day.
- The new LIBOR will remain until the next rollover (3 or 6 months later).

korth-M&K

32

---

---

---

---

---

---

---

---

### Bank Loans

- For any loan, fixed or floating, the interest rate is determined at the *beginning* of the loan period.
- However, the payment is always made at the *end* of the period ("*in arrears*").

korth-M&K

33

---

---

---

---

---

---

---

---

### ***Eurobond Market***

- Long-term negotiable instruments in the euromarkets
  - Up to 100 years!!! [“century bonds”]
  - Even *perpetuities*
- The largest bond market in the world
  - Mostly *bearer* bonds

korth-M&K

34

---

---

---

---

---

---

---

---

### **Eurobond Market**

- Both large corporations and governments are major issuers in the eurobond market.
- Because of the *absence of regulations* to protect investors, only issuers with good credit ratings are welcome in the eurobond market.

korth-M&K

35

---

---

---

---

---

---

---

---

### **Eurobond Market**

- *Underwritten in the primary market*
  - The underwriter *guarantees* that the bonds will be sold at the agreed-upon price.
  - If not, the underwriter must bear the loss
  - Underwriting fees

korth-M&K

36

---

---

---

---

---

---

---

---

**Eurobond Market**

- **Active *secondary market***
  
- **Both secured (i.e., mortgage) eurobonds and unsecured exist.**

korth-M&K 37

---

---

---

---

---

---

---

---

**Eurobond Varieties**

- **"*Straight*" ("plain vanilla")**
  - **Fixed rate**
  - **No special features**
  - **Most common of all eurobonds**

korth-M&K 38

---

---

---

---

---

---

---

---

**Eurobond Varieties**

- **Special features**
  - ***Floating-rate notes (FRNs)***
  - ***Callable bonds***
  - **Equity-related**
    - ***Convertible eurobonds***
    - ***Eurobonds with equity warrants***
  - ***Zero coupon***

korth-M&K 39

---

---

---

---

---

---

---

---

### **Eurobond Market: *Advantages***

#### **■ Advantages for issuers (1):**

- **Wider range of investors**
- **Diversification of funding**
- **Increase in availability of total capital**
- **Greater borrowing flexibility**

korth-M&K

40

---

---

---

---

---

---

---

---

### **Eurobond Market: Advantages**

#### **■ Advantages for issuers (2):**

- **Reduced costs for issuers**
  - **Lower interest rates**
  - **Lower fees**
- **Increased international recognition for the company**

korth-M&K

41

---

---

---

---

---

---

---

---

### **Eurobond Market: Advantages**

#### **■ Advantages for investors:**

- **Opportunity for greater diversification**
- **Higher rate of return**
- **Flexibility**
- **Anonymity**

korth-M&K

42

---

---

---

---

---

---

---

---

***Euro-Notes  
& Euro-Commercial-Paper***

- Short-term *negotiable* instruments in the euromarkets
  - Mostly 30 - 180 days
  - *Promissory notes* (i.e., unsecured)
    - "Full faith & credit obligation"

korth-M&K 43

---

---

---

---

---

---

---

---

**Euro-Notes  
& Euro-Commercial-Paper**

- Sold at a discount, with full face value paid at maturity
  - Generally sold in *bearer form*
  - Active secondary market
  - *Underwritten: euronotes*
  - Not underwritten: *euro-commercial paper (ECP)*

korth-M&K 44

---

---

---

---

---

---

---

---

***Syndicated Loans***

- ***Syndicate***
  - A group of *commercial banks* that offer a *joint loan*

or

- A group of *investment bankers* (also called *merchant bankers*) that jointly underwrite a *stock or bond issue*

korth-M&K 45

---

---

---

---

---

---

---

---

### Syndicate: *Members*

- Lead manager(s)
  - *Mandate*
- Co-managers
- Underwriters
- *Participants = providers*

korth-M&K

46

---

---

---

---

---

---

---

---

### Syndication: *Costs*

- "*Front-end*" = "*up-front*"
  - *Management fee*
  - *Underwriting fee*
  - *Participation fee*

korth-M&K

47

---

---

---

---

---

---

---

---

### Syndication: *Costs*

- *Fees paid "in arrears"*
  - *Commitment fee*
  - *Agent fee*

korth-M&K

48

---

---

---

---

---

---

---

---

### Syndicate: Costs

- Interest charges
  - Also paid in arrears
  - Fixed rate
  - Floating rate

korth-M&K

49

---

---

---

---

---

---

---

---

### Syndicate: Costs

- Other borrowing costs
  - *Compensating balances*
  - *Currency risk (if borrowing cross-currency)*

korth-M&K

50

---

---

---

---

---

---

---

---

## Review of Money & Capital Markets

korth-M&K

51

---

---

---

---

---

---

---

---

### Key Terms: Financial Markets

- Money vs. capital markets
- Primary vs. secondary markets
- OTC vs. exchange-traded
- "On-shore" vs. offshore markets

korth-M&K

52

---

---

---

---

---

---

---

---

### Key Terms: *Money Markets* (1)

- Short-term
- *Very liquid*
  - Convert to cash quickly
  - With minimum risk of loss of value
- Debt only

korth-M&K

53

---

---

---

---

---

---

---

---

### Key Terms: *Money Markets* (2)

- Money-market instruments
  - Treasury *bills* ("*T-bills*")
  - *Certificates of deposit (CDs)*
  - *Commercial paper*
  - *Bankers' acceptances*

korth-M&K

54

---

---

---

---

---

---

---

---

**Key Terms: *Capital Markets***

- Long-term
  - Long-term debt
    - *Yield curve*
  - All equity

korth-M&K 55

---

---

---

---

---

---

---

---

**Key Terms: *Primary Markets (1)***

- The *1<sup>st</sup>* time that debt or equity is issued
- Subject to special rules
- Sold by merchant banks

korth-M&K 56

---

---

---

---

---

---

---

---

**Key Terms: *Primary Markets (2)***

- Flotation
- Underwritten

korth-M&K 57

---

---

---

---

---

---

---

---

**Key Terms: *Secondary Markets***

- 2d, 5<sup>th</sup> & 50<sup>th</sup> time sold
- *Brokers* bring buyer and seller together

korth-M&K

58

---

---

---

---

---

---

---

---

**Key Terms: *Offshore Markets***

- Free of most regulations from any country
- 3 sectors
  - Eurocurrency
  - Eurobonds
  - Euro-commercial paper

korth-M&K

59

---

---

---

---

---

---

---

---

**Key Terms: *Eurocurrency Market***

- Deposits in banks
  - Of currencies foreign to the local market
- LIBID
- LIBOR

korth-M&K

60

---

---

---

---

---

---

---

---

**Key Terms: *Syndicate***

- **Group of banks working together**
  - **Commercial banks—syndicated loan**
  - **Merchant banks—syndicated flotation of debt or stock**

korth-M&K

61

---

---

---

---

---

---

---

---