

## International Financial Markets

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

1

## International Financial Markets

### World Money & Capital Markets

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

2

## International Financial Markets

- Domestic [= "on-shore" markets]
  - Domestic markets are tightly regulated by the national (& sometimes regional or local) government of that country.

3

## International Financial Markets

- Two locations
  - Home domestic
  - Foreign domestic

4

## *Foreign Bonds*

- Long-term marketable debt *floated* in a domestic market by a foreign issuer
  - "Yankee bonds"
  - "Bulldog bonds"
  - "Samurai bonds"
  - "Panda bonds"

5

## *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)*

6

### ***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

### **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

### **Off-Shore Markets**

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

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

#### **Minimum of regulation:**

- Flexibility
- Speed
- Profitability

### **Advantages of Off-Shore Markets 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

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

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

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

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

13

### 3 Sectors of Off-Shore Markets

#### *Eurocurrency market*

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

14

### 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!!!

15

### *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

16

### Eurocurrency Market

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

17

### 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.

18

## Eurocurrency Market

- Depositors
  - Corporations
  - Other banks
  - Governments
  - Wealthy individuals

19

## 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)

20

## London Interbank Bid Rate (LIBID)

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

21

## 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

22

## Eurocurrency Market: *Investments*

- Some *money-market* investments
- However, mostly loans
  - *Euroloans = Eurocredits*

23

## Eurocurrency Market: *Borrowers*

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

24

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

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

25

### ***Euroloans***

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

26

### **Euroloans**

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

27

### **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

28

### **LIBOR**

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

29

### **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.

30

## 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).

31

## 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*").

32

## *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

33

## 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.

34

## 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

35

## Eurobond Market

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

36

### **Eurobond Varieties**

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

37

### **Eurobond Varieties**

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

38

### **Eurobond Market: Advantages**

- **Advantages for issuers (1):**
  - Wider range of investors
  - Diversification of funding
  - Increase in availability of total capital
  - Greater borrowing flexibility

39

### **Eurobond Market: Advantages**

- **Advantages for issuers (2):**
  - Reduced costs for issuers
    - Lower interest rates
    - Lower fees
  - Increased international recognition for the company

40

### **Eurobond Market: Advantages**

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

41

### ***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"

42

### **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*)

### ***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

### **Syndicate: *Members***

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

### **Syndication: *Costs***

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

### **Syndication: *Costs***

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

### **Syndicate: *Costs***

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

### Syndicate: Costs

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

49

### Key Terms: Financial Markets

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

50

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

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

51

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

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

52

### Key Terms: *Capital Markets*

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

53

### 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

54

### Key Terms: Primary Markets (2)

- Flotation
- Underwritten

55

### Key Terms: *Secondary Markets*

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

56

### Key Terms: *Offshore Markets*

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

57

### Key Terms: *Eurocurrency Market*

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

58

### Key Terms: *Syndicate*

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

59