
UNIT 2 INTERNATIONAL FINANCIAL MARKETS

Structure

- 2.0 Objectives
- 2.1 Introduction
- 2.2 National Markets as International Financial Centres
 - 2.2.1 Risk Differences between Domestic and Foreign Financial Markets
- 2.3 The Euro Market
 - 2.3.1 Why do the Euro Markets Thrive?
 - 2.3.2 Euro Market Interest Calculations
 - 2.3.3 Euro Market Conventions
 - 2.3.4 LIBOR : The Most Popular Rate
- 2.4 International Debt Instruments
 - 2.4.1 Euro Notes
 - 2.4.2 Euro Commercial Paper
 - 2.4.3 Medium Term Notes
 - 2.4.4 Floating Rate Notes
 - 2.4.5 Euro Bonds
- 2.5 Euro Equities
- 2.6 Euro Convertible Bonds
- 2.7 Euro Issues in India
- 2.8 Let Us Sum Up
- 2.9 Key Words
- 2.10 Answers to Check Your Progress
- 2.11 Terminal Questions/Exercises

2.0 OBJECTIVES

After studying this unit you should be able to :

- explain international financial markets and Euro markets
- explain the concept of LIBOR, LIBID and LIMEAN
- describe various international financial instruments used for raising finance
- have an overview of Indian Euro issues and discuss the Government of India Policy on ECB.

2.1 INTRODUCTION

International financial markets and operations comprise exchange deals i.e., buying/selling currencies; banking transactions i.e., deposit taking and lending; and capital market operations i.e., issuance of securities. However market segments are classified according to the nature of financial operations: (a) money markets (or exchange markets) : exchange or exchange related transactions (b) credit markets : deposit taking and lending, (c) capital markets : issuance of securities and (e) equity markets : issuance of international equities.

Commercial banks are engaged in foreign exchange business and they handle funds flow (either inward or outward) emanating on account of trade between countries, payment for services rendered or servicing of capital market offerings. Such banks are called upon to accept deposits denominated in foreign currencies and deploy them for financing various corporate, industrial or trade activities.

The Euro markets are also closely tied to the foreign exchange markets. But the two markets are quite distinct in functions (almost all Eurobanks also deal in foreign exchange).

It has become customary for borrowers to issue securities — bonds or Euro notes (explained later). For organising such business various merchant banking institutions have come to the fore. Such banks are referred to as Investment Banks, Merchant Banks or Securities Houses.

While the choice of raising finance through a variety of instruments is large comprising loans, Euro notes and bond, all markets may not be accessible to all borrowers. In this unit you will learn mainly about Euro markets, its structure and importance. You will also learn about some of the market-segments, arrangements and instruments used for raising finance in the international financial markets. Let us begin with national markets as international financial centres.

2.2 NATIONAL MARKETS AS INTERNATIONAL FINANCIAL CENTRES

Each Country has its money and capital markets. Quite similar to their domestic counterpart, international financial markets may be divided into money and capital markets. Money markets deal with assets created or traded with relatively short maturity, say less than one year. Capital markets deal with instruments whose maturity exceeds one year (or which lack definite maturity).

An important channel through which money market flows are influenced is the foreign exchange market. Inflows from abroad into a small country can swamp the domestic money market with excess liquidity. During the 1970's, for example, foreign demand for Swiss francs was very strong because of the weakness of the US dollar. The flow of money into Swiss francs pushed the Euro-Swiss franc deposit market into negative interest rates. One had to pay a Swiss bank for the privilege of placing money with it.

Subsequently, the Swiss government imposed a 10% per quarter term commission tax, so that foreigners were receiving minus 40% p.a. on Swiss franc deposits. Yet, because the Swiss franc appreciated by 50% during the year, such an operation was still worthwhile.

On the other hand, if a currency is seen to be under pressure, funds will flow out of that currency into others that are perceived to be stronger. The authorities will often then raise interest rates to defend the currency. A classic example was the ERM (Exchange Rate Mechanism) crisis of 1992, when overnight (interbank lending rates in the call market) French franc rates hit 150% p.a. It was reported that overnight Irish pound (punt) reached 48,000% during the crisis. Euro-francs were being lent at 5,000% p.a.

A related effect arises when the central bank intervenes to support, (or, alternatively to lower) the value of its currency. If the central bank intervenes

in support of its currency, it buys the domestic currency and sells foreign exchange. Thus, the amount of domestic currency in circulation declines, which tends to push up interest rates. Conversely, if it intervenes to lower the value of its currency, it supplies domestic currency to the market. Thus the supply of domestic currency in the market rises, tending to lower interest rates.

Again, on lines similar to domestic markets, in the international financial markets also we have primary and secondary markets dealing with issue of new instruments and trading in existing instruments and negotiable debt instruments, respectively.

The growth of international financial markets has facilitated cross-country flows which contribute to a more efficient allocation of resources. International financial markets can develop anywhere, provided the local regulations permit the market and that the potential users are attracted to it. The most important international financial centres are London, Tokyo and New York, all the other major industrial countries have important domestic financial markets as well but only some e.g., Germany and France have gained prominence.

The markets of Switzerland, Luxembourg, Singapore, Hong Kong and the Bahamas serve as financial "entrepots". These markets serve as financial intermediaries between non-resident suppliers of funds and non-resident users of funds.

A big difference between the Euro markets and domestic markets, for instruments in a particular currency, is that all transactions done within the domestic market are directly subject to the rules and institutional arrangements of the local financial system.

For example, when Australian investors purchase securities in Tokyo, they do so according to the rules, market practices and regulatory guidelines that govern such transactions in Japan. The same applies to those who place their funds in Japan (provided the transactions are not related Euro market).

Also, a Korean borrower who approaches a Swiss Bank for a Swiss Franc loan, borrows at rates and conditions imposed by the financial institutions of Switzerland and is directly effected by the Swiss authorities policy toward lending to foreign residents. Euro markets are free from such regulations. We will elaborate this under 2.3. It has been observed that, corporations in different countries have different financial appetites. Companies in the UK get an average of 60% to 70% of their funding requirements from internal resources in UK. German companies get about 40% to 50% of their funds from external suppliers. In Japan, when their profitability has been low, companies have relied heavily on external finance. In the mid 70's Japanese companies got almost 70% of their funding requirements from outside sources. This has now changed dramatically, and Japanese companies source 70% of their financing needs from the internal markets.

In Europe and the US, there has been no comparable transformation. Internal finance has consistently supplied the major share of financing requirements. The percentage of external finance fluctuates more or less in line with the business cycle; when profits are high, firms are even less reliant on external finance.

2.2.1 Risk Differences between Domestic and Foreign Financial Markets

There is a clear difference in the risks involved in domestic and foreign markets. Let us take an example. A US depositor in the Eurodollar market holds a claim in one jurisdiction (say, London) but receives payment in another (United States). He could be deprived of his funds at maturity by an action of either the British Government or the US Government. However, in the case of a domestic depositor, only actions by the US authorities would matter. For a depositor residing in the UK the situation is quite similar. He may own a dollar denominated time deposit in (i) a US bank, directly (ii) a Eurobank operating in Luxembourg or (iii) a London based Eurobank. In all three cases, the safety of his funds depends ultimately on the expectation that the United States will not restrict the disposition and transfer of foreign held dollar funds (i.e., that the US will continue to observe "non-resident convertibility"). In comparison to the situation of our US investor, the UK investor will face a greater risk, to the extent that the US government may restrict non-resident convertibility more readily than it interrupts domestic bank transfers. Now from the point of view of the borrower of Eurodollars to the extent that the US government may place quantitative restrictions on US banks lending to foreigners (or some other class of borrowers), these borrowers may feel safer borrowing from unregulated Euro markets. Thus the fear of capital controls, could allow Eurodollar lending rates to rise above those in the domestic market. But as we shall see under 2.3, absence of reserve requirements for Euro markets help them to lend at lower than domestic banks.

In brief, the risk on external dollar deposits and loans is somewhat greater than on deposits in, and loans from domestic markets.

The major risks in Eurodollar transactions stem from: (i) the removal of non-resident convertibility by the domestic authorities, (ii) the seizing of the assets and liabilities of the Eurobanks by the authorities where the Eurobanks operate, and (iii) the possibility that central banks may not function as lenders of last resort in Euro market centres if there is a shortage of any one currency in Euro market. Although the probability of these events occurring are low, they are of sufficient importance to warrant close examination by international depositors.

2.3 THE EURO MARKET

The prefix 'Euro' tends to create confusion for many as it denoted a currency used for financial transactions outside the country of origin of that currency, e.g. US dollar were termed as Eurodollars when they formed financial assets and liabilities (denominated in dollars) but traded outside the United States, Japanese yen traded out of Japan were termed as Euroyen, German marks traded out of Germany were termed as Euromarks, Swiss francs traded out of Switzerland were termed as Eurofranc. But after launching of the 'Euro' as the official currency of European Monetary Union (or what is also known as Euroland), Eurocurrency (or Euros) denotes the official currency of the European Union or Euroland. The currency used for financial transactions outside the country of the origin of that currency is now no more called Eurocurrency. It is rather known as Eurodollar, Euroyen, Euromarks, Eurofrancs etc. depending on which particular currency is used for financial transaction outside the country of the origin of that currency. The transactions in Eurodollar, Euroyen, Euromarks etc. are known as 'Euro Markets'.

We may thus differentiate among Eurocurrency markets, foreign currency markets and Euro markets. The main differences are that foreign currency markets signify transactions denominated in currency of the country of domicile

whereas in Euro markets transactions are denominated in the currency of the country other than the country of the domicile. For example, when a bank located in US makes transaction with a foreigner in US dollar, it is a foreign currency transaction. As against this, when the same bank makes transaction with a foreigner in a currency other than the US dollar, it is Euro transaction. So when Reliance Industries of India takes a term loan, denominated in US dollar, from a New York bank, it is raising foreign currency loan. As against this, if Reliance takes loan denominated in Yen, from the same bank, it is Euroloan. Eurocurrency market is the market in the currency of the Euroland.

Likewise, Euro banks can be described as a commercial bank dealing in Euro markets. Euro banks are financial intermediaries that simultaneously bid for deposits and make loans in a currency or currencies, other than that of the country in which they are located.

Over the years, Euro markets operations have centred in Asia, Europe and the United States. With the emergence of these centres, a continuous market mechanism has been established. Furthermore, the removal of exchange control and freer movement of capital, international markets have been integrated.

Euro markets consist of banks (Euro banks) that offer wholesale deposits and loans in favourable jurisdictions (Euro markets) and in a variety of currencies, usually other than that of the country in which the banks are located.

The domestic (national) disadvantages that are applicable to the operations of banks in their national markets are based almost exclusively on governmental rule and regulations (Euro banks being launch free of domestic monetary regulation.)

The Euro markets thrived and grew because national money markets were hobbled with regulations such as interest rate controls, reserve requirements and deposit insurance costs. The major currencies in the recent years have however gained enough non-resident convertibility that a Euro market segment was able to rise.

Euro markets facilitate hedging possibilities for corporate borrowers e.g.: American companies operating in the UK or Germany can borrow Eurodollars in the UK or Germany without being required to go in for Sterling or German mark borrowings (that imply currency risk exposure).

An important feature of the Euro market that needs to be noted is that it is basically "deepest" in the short-term market, where 3-6 months deposits are most popular (this does not mean that funds cannot be made available for long-term deployment). Deposit instruments focus on time deposits and negotiable Certificates of Deposits (CDs). As a matter of fact, Eurobanks have always shown a willingness to accept deposits for various maturities-short, medium or long term. The banks take into consideration borrowers requirements and have devised various instruments for preferred maturity

The Euro market is a wholesale market (generally restricted to transactions over US \$ 1 million), with participants limited to banks, financial institutions, institutional investors, major corporates and high net worth individuals.

The basic structure in Euro market operations has been medium to long term lending on variable (floating) interest rates, with an option to re-set (roll-over), the interest rate periodically at 3 or 6 months.

2.3.1 Why do the Euro Markets Thrive?

Euro market interest rates are outside the control of any central bank. Remember, that Eurodollars etc. are traded outside the country of their origin. Therefore the rules applied by the respective central bank in the country of the concerned currency do not apply. Also the monetary authority of the place where the deposit is being made (in the Euro market), is not concerned with non-residents depositing or borrowing foreign currency - which does not affect the domestic money supply (its prime concern).

In the absence of central bank regulatory requirements on currencies being traded in the Euro markets, there are no statutory reserve requirements to be maintained either. Consequently, Euro banks can offer higher yields to depositors and finer rates to borrowers, this makes the Euro markets an attractive market for depositing money as well as a source for borrowings.

Example : if the Federal Reserve Bank in the US imposed a reserve requirement of 3% on deposits of banks (domestic), then for every \$ 100 deposited, only \$ 97 could be lent out. If interest rates were 10%, a bank in the US would have to charge 10.31% ($10/97 \times 100$) to cover the cost of reserves. Therefore a bank taking a US dollar deposit in London (Euro market) could undercut its domestic US competitor doing business in New York.

It must be remembered that Euro markets can be substituted by certain major domestic (national) markets dealing in the same currencies. As a matter of fact, the supply of any currency to the Euro market originates from the respective domestic markets. The Euro markets cannot be generating any liquidity on its own. Likewise, the demand for Euro markets finance is really a demand for finance of and can be directed to the domestic market concerned. Domestic (National) markets and Euro markets can thus be considered perfect substitutes for each other. The domestic and Euro markets thus create opportunities for arbitrage operations i.e., profiting from price differences when the same asset (currency) is traded in different markets. To illustrate this point, let us consider a bank in New York raises deposits (in US dollars). These dollar deposits would be subject to Federal Reserve regulation and will attract statutory reserve requirements as well as a deposit insurance premium costs. These mandatory requirements impact the "cost of funds".

On the other hand, there are no such mandatory requirements on Euro market deposits - which are free from such costs. We could thus expect the US dollar deposits in the New York domestic market to have lower yields than the Eurodollar deposit interest rate (to compensate for the higher effective cost of the US dollar domestic deposits raised in the United States).

This "gap" between the two markets opens up an arbitrage opportunity i.e., to raise US dollar domestic deposits in the United States, then deposit proceeds in the Euro market with a view to gain from higher yields. The arbitrage ensures that the difference is enough to compensate for the higher effective cost of domestic resources.

2.3.2 Euro Market Interest Calculations

The Euro markets use two bases for calculating interest:

- a) the 365-day year is used for the British pound sterling, the Irish pound, the Kuwaiti dinar and the Belgian franc
- b) the 360-day year for all other currencies

Note: the Belgian franc is also dealt on a 360 day basis, if both parties to deal are non-Belgian. The Canadian dollar is also dealt on a 365 day basis with customers, but interbank Euro Canadian is usually 360. Given mutual agreement, any basis can be used.

It will be noted that a 365-day basis produces a lower interest amount. Thus, a 10% Eurodollar on a 360 day basis is equivalent to 10.13889% ($=10 \times 365/360$) on a 365 day basis. Equally, a 9.863% Eurodollar rate, 360 basis, is equivalent to 10% ($= 9.863 \times 365/360$) on a 365 day basis.

The application of "value date" i.e. the date on which two currencies change hands, is the same as applied in a foreign exchange transaction (market). The value date will have to be a working day in both centres where the money transfers are to take place. For example, consider a case of sterling pounds being paid in London and US dollars being received in New York. If any of the two centres has a holiday on a particular day, that date cannot be a proper value date for a US \$-£ stg. transaction.

The settlement of a spot transaction takes place two business days after the trading date [one business day for a Canadian \$: US \$ transaction and US \$: Yen transaction. Thus, a spot transaction done on a Monday will result in the settlement on the following Wednesday (assuming that Wednesday is a working day at both centres). Similarly, a spot transaction done on a Thursday will be settled on the following Monday (there are no forex transactions on Saturday or Sunday). Further Euro market practice is to pay interest at the maturity of the deal – except where periods of over one year are involved. In that case, interest is paid annually on the "anniversary" of the deal.

2.3.3 Euro Market Conventions

1) Number of Days:

Calculation include the first day of the period but not the last. e.g., with an interest period from march 7, 1999 to June 7, 1999 will be counted as

Month of March	25 Days
Month of April	30 Days
Month of May	31 Days
Month of June	06 Days
	<hr/>
	92 Days

2) Euro market convention if interest payment falls on a Non-Banking Day:

Here, the interest payment will shift to the immediate succeeding business day (Note: This stipulation is invariably spelt out in lending/borrowing agreements). In our above example, if June 07 is a non-banking day, the interest payment date shifts to June 08 (if June 08 is also a non-banking day, else the next business day) and interest will have to be calculated upto June 07 inclusive. On a 3-month rollover arrangement. The next interest payment period (or reset date) will be from June 08 to September 08.

3) Interest periods could be lengthened or shortened depending upon whether the last day falls on a holiday:

In addition to the example in (2), consider an interest period that has been set inclusive of February 28 to May 28, 1999 (Saturday) the interest period would be automatically extended to May 30, 1999 (Monday) a total of 91 days.

- 4) **Euro market convention if the interest payment date happens to fall in a new month, while the last day upto which the interest is calculated (i.e., the date immediately preceding the interest payment date) is in the previous month:**

An interest period extending from January 31 to May 01, 1999 would be calculated to April 29th.

As the interest payment date falls on May 01 and the entire period for which interest is to be paid falls earlier than the month of May, the Euro market convention requires that instead of extending the interest payment date (as in convention 2), into a new month, the interest payment date will be the immediate preceding business date which is April 29th.

April 29	Friday
April 30	Saturday
May 1	Sunday

Another example under this convention can be as follows:

If the 3 month (calendar) interest period is June 01 to September 01, the interest payment date (September 01) falls in a new month (September) and the interest is calculated upto August 31st (previous month).

The interest payment date is then shifted to August 31. Now, assuming August 31st is a business day, interest will be calculated upto August 30th. However, if the interest period is June 02 to September 02, (assuming September 02 is a business day) there is no problem, because September 01 upto which date the interest is calculated also falls in the month of September.

5) Interest Rate Quotations

The Euro market quotes two rates for a given period:

- 1) the Offered rate - at which the dealer is prepared to lend money (London Interbank Offered Rate-LIBOR)
- 2) the Bid rate - at which the dealer is prepared to borrow (London Interbank Bid Rate-LIBID)

Normal US practice is to quote the Bid rate first. Normal London market practice is to quote the Offered rate first.

Hence, $7 \frac{1}{4} - \frac{1}{2}$ in the US market and $7 \frac{1}{2} - \frac{1}{4}$ in the London market mean the same. i.e. Lend at $7 \frac{1}{2} \%$ and Borrow at $7 \frac{1}{4} \%$

2.3.4 LIBOR : The Most Popular Rate

A large volume of Eurodollar lending involves the London Interbank Offered Rate. LIBOR can be defined in two ways:

- i) The rate at which funds are offered to a first class bank in London for a specific maturity period;
- ii) The rate at which a first class bank in London offers funds to another first class bank in London;

The LIBOR rate attempts to measure the cost to a bank of raising new funds from the market in order to re-lend. This is the basis of almost all variable (or floating) rate lending in the Euro markets. In view of its importance, it must be stressed that the LIBOR concept is purely judgemental e.g.: 3-month LIBOR for US\$ 1000 million will very likely differ from 3-month LIBOR for US\$ 5 million.

We are considering the dealers judgement of what it would cost to raise that amount for re-lending. It may well be that it is judged that it will cost more to raise the larger amount, because it will move the market against the dealer. Hence, normal practice for any given loan is to calculate LIBOR as an average of the rates quoted by several "reference banks" selected for this purpose. Table 2.1 shows example of Euro rates.

Table 2.1 : Euro rates

A Euro interest rates on 16-2-1996			
CURRENCY	1-MONTH	3-MONTH	6-MONTH
US\$	5 1/4-5 1/8	5 3/16-5 1/16	5 3/16-5 1/16
£STG.	6 9/32-6 7/32	6 5/32-6 3/32	6 1/32-5 31/32
DM	3 7/16-3 5/16	3 11/32-3 3/16	3 9/32-3 5/32
JAP:YEN	9/16-7/16	9/16-7/16	2 3/32-19/32
SWISS: SF	1 5/8-1 1/2	1 11/16-1 9/16	1 3/4-1 5/8

B Quotations on 17-5-1993			
CURRENCY	1-MONTH	3-MONTH	6-MONTH
US\$	3 1/8-3	3 1/4-3 1/8	3 3/8-3 1/4
£STG.	6 1/8-6	6 3/16-6 1/16	6 3/16-6 1/16
DM	7 11/16-7 9/16	7 3/8-7 1/4	7 1/8-7
JAP:YEN	3 1/4-3 3/16	3 1/4-3 3/16	3 9/32-3 7/32
SWISS: SF	5 3/16-5 1/16	5 1/16-4 15/16	4 7/8-4 3/4

C Long Term Eurodollars (17-5-1993): 2-years 4 3/16-4 1/16; 3-years 4 11/16-4 9/16; 4-years 5 1/8-5; 5-years 5 7/16-5-3/16

Libor is usually fixed at a time specified (normally 11 am London time) and invariably specified in lending/borrowing agreements. It is quoted for deposits starting from the spot date for various periods, of which the most common are 3 and 6 months.

When two top rated banks arrange an interbank transaction, the interest rate that is agreed for a loan and deposit will often be somewhere between the LIBOR and the LIBID, and possibly the average of these two rates which is referred to as LIMEAN as a reference rate for their interbank transactions.

The LIBOR convention has spread in various variations. These include:

"Sibor" [Saudi Or Singapore Interbank Offered Rate]

"Nibor" [New York Interbank offered Rate]

"Kibor" [Kuwait Interbank Offered Rate]

"Pibor" [Paris Interbank Offered Rate]

"Fibor" [Frankfurt Interbank Offered Rate]

"Dibor" [Dubai Interbank Offered Rate]

"Hkibor" [Hong Kong Interbank Offered Rate]

"Mibor" [Madrid Interbank Offered Rate]

"Mibor" [Mumbai Interbank Offered Rate], and so on;

In all cases the concept attempts to measure a bank's cost for a loan. It is quite possible to apply the concept to other Euro deposits or domestic deposits e.g.: many domestic UK loans are linked to sterling LIBOR.

A deposit in the Euro market, (unless otherwise stated), will begin on the spot date [i.e.: two business days from today). A period deposit is defined as a deal starting on the spot date and maturing on some fixed and predetermined date. The phrase "the periods" usually refer to some or all of the standard periods of 1,2,3,6,9 or 12 months.

Within the Euro markets, the Eurodollar is the foremost source of international finance. However, as confidence grew, other currencies gradually became available and the market started to permit borrowers to change the currency of outstanding periodically during the life of the loan, thereby creating a multi-currency option.

The biggest thrust to the Eurodollar market occurred during the early 70's when the oil prices quadrupled over a short period of time. Some of the oil producing countries [OPEC] did not have the capacity to deploy the revenues immediately in their domestic markets. International banks therefore became recipients of massive dollar deposits (petro dollars) from these countries and in turn were forced to rapidly look for suitable borrowers. Not surprisingly, the oil importing countries were faced with huge deficits on account of large increases in oil prices. As a result, these sovereign importers became the borrowers that the banks were so actively seeking. A cycle, therefore, developed with the oil producing countries generating unprecedented surpluses on the oil account and depositing a substantial proportion of these revenues with international banks who lent the money to the oil importing countries to pay their bills to oil producers.

With rapid development of Euro markets in "offshore" centres, strong resentment developed in a number of large banks in the United States and Japan on account of a loss of business at domestic centres, which was being diverted to the Euro market centres. The Central Bank [Federal Reserve] authorities in the US and Japan permitted Eurodollar business to be transacted "onshore", i.e. within the respective domestic markets. The International Banking Facilities [IBF] in New York (domestic market for the dollar), a dollar deposit with an IBF in New York is in fact a Eurodollar, because it is exempt from Federal Reserve requirements. The key determining factor of whether a dollar deposit is or is not a Eurodollar is whether or not it is exempt from domestic reserve requirements.

Check Your Progress A

1 What is Euro dollar market?

.....

.....

.....

.....

2 What is Eurocurrency?

.....

.....

.....

.....

3 Explain the following :

i) LIBOR

.....

.....

and place it in the market. However, the borrowing programme could be for medium or long term (say), 5-7 years or more. Banks that act as financial intermediaries agree to underwrite the paper (instrument). In reality, a borrower is able to borrow at short-term interest rates for short periods by issuing the "notes" to investors. At the same time the borrower avails of the benefits and comfort of having a committed medium to long term borrowing facility (underwritten by banks). The funding portion is divided into two separate components. The first is a long term committed standby lending facility provided by banks. The second is a mechanism for the distribution of short term debt instruments (the Euro note). The former component gives the borrower the long term assurance of availability of funds. The latter is the means by which cost-competitive funding can be achieved (since at any specific time, short term funding is usually cheaper than medium-long term funding). Typically, a Euro note issuance programme is referred to as a "Revolving Underwriting Facility" [RUF] or "Note - Issuance Facility" [NIF], where a group of banks (Syndicate) underwrites a commitment to the borrower. A revolving credit facility permits the borrower to draw-down (or use) a credit facility and repay and again draw-down and repay, till the agreed upon expiration date of the credit facility. The credit facility could be made available for any duration. Until this time limit expires, the borrower is permitted to use the facility. Under the facility, the borrower can raise funds over periods of 3-10 years by issuing notes in its own name, typically with tenors of 1-6 or 9 months.

Under this arrangement, underwriting banks are committed either to purchase the Euro notes, which the borrower cannot sell or to provide standby credit (at the expiry of an agreed upon selling period say, 3-10 working days). The credit is provided by the bank/s at a predetermined spread relative to some reference rate such as LIBOR.

If the short term market fails to provide the liquidity to the issuer, the underwriting banks provide the liquidity for the agreed period of the facility. Underwriters when required to do so fund their commitments only for the short term maturity of the notes.

The issuer is free to repay at the end of each short period e.g., 3-6 months, any amount it wishes to - depending on its requirement. The issuer may re-borrow at a later date by first offering to genuine short term investors, before the underwriters are obliged to pick up and provide liquidity again - pro rata to their underwriting commitments.

Rarely do banks put the notes on their books and fund these assets. Doing so would be considered a failure of the issue. Instead, banks sell the notes to investors in search of short term paper.

High quality borrowers can issue Euro notes even below LIBOR i.e., at around LIBID (which is about 1/8% below LIBOR).

Underwriting fees are paid on the full amount of the line of credit, regardless of the amount currently drawn. Fees may be 5 basis points for top borrowers and may range upto 15 basis points for less creditworthy borrowers.
[Basis Point (bp): one hundredth of one percent (0.01%)].

The notes are generally denominated in amounts of US \$ 100,000, \$ 500,000 or more. The US dollar is the most common currency of denomination.

Generally, placements of Euro notes is done through a tender panel (bidding banks are more often investment banks which have placement capacity). This is also called the Uncommitted Facility. The tender panel is merely an arrangement to auction off notes if and when the borrower wishes to raise funds. The tender

panel members promise to show up at the auction but make no commitment to purchase the notes. When they do want the notes (often because they think they can resell them at a small profit), they will bid an interest rate relative to LIBOR for Example a bank may buy Euro notes at a spread of LIBOR, (say) (-) 15 bp, and resell it at LIBOR (-) 18 bp (a lower yield and a higher price). Those who bid the lowest rates get the paper.

It will be noticed from the tombstone's advertisement announcing competition of the issue appearing for the Bigfoot in the newspaper that there is a division of banks into two groups (a) the first group consists of a commitment by a group of banks to provide funds to the borrower if the borrower finds itself unable to raise funds. (b) the second part is the tender panel members. The contents of the Bigfoot group tombstone is given below as an example.

The Bigfoot Group

£115,000,000

equivalent

Committed Revolving Facility

Arranged by

Credit Suisse First Boston Limited

Underwriting Banks

ABN-AMRO N.V. Banque Indosuez Credit Lyonnais
Deutsche Bank Fuji International Finance Limited Banque Paribas
Samuel Montague & Co. Limited County Bank Kredietbank
Banque Bruxelles Lambert S.A. Citibank Credit Suisse
Sumitomo Finance International Westdeutsche Landesbank Girozentrale
Finance International Westdeutsche Landesbank

Tender Panel Members

ABN-AMRO N.V. Indosuez Credit Lyonnais CIBC Limited
Deutsche Bank Fuji International Finance Limited Banque Paribas
LTCB International Limited J.P. Morgan County Bank Kredietbank
Banque Bruxelles Lambert S.A. Citibank Credit Suisse Commerzbank
Merrill Lynch Capital Markets Sumitomo Finance International
Salomon Brothers International Westdeutsche Landesbank Girozentrale

Tender Panel and Facility Agent

Credit Suisse First Boston Limited

Apart from the commitment fee that the underwriting banks receive, they have an opportunity to earn a little "turn" (on the difference between the price at which a dealer buys and that at which it sells). Of course, dealers must have developed an effective distribution capability that allows them to market pools of low cost funds on a global basis. The distribution capability can be further strengthened by making a credible commitment to investors that the bank/s will make a secondary market in the instrument which will enhance the attraction of the notes with tenors exceeding one month. Secondary market making requires the willingness to invest and to hold a "position" in the paper. Thus it demands risk capital and/or hedging capabilities. Few banks are good at this and there has been a fair concentration of this activity in the hands of about twenty large international banks.

Placement of Euro notes is also done through "single placing agents" or "group placements". The former has been quite popular. Here the issuer provides the single agent or a group with its notes at a predetermined discount to provide a pre-set yield related to LIBOR. The placing agent sells it to short term investors at the current market price and keeps the difference between the price it paid to the issuer, as compensation. Of course, if within the selling period the full amount of the issue is not subscribed, the underwriters pick up their share on the basis of pro rata commitments.

A Euro note Issuance Facility [or a Revolving Underwriting Facility] was created to provide cost competitive, medium-term funding to borrowers, while providing an adequate return to those banks which participated in the committed "standby" facility. The concept of the note issuance facility was first conceived by Citibank in 1978 as the sole bank to the borrower - Shipping Corporation of New Zealand a government guaranteed entity from a country with (at that time), prime credit standing.

By 1981, Citicorp. was able to arrange a US\$ 500 million note issue facility for the government of New Zealand with a committed standby group of 10 major banks. In 1984, the Kingdom of Sweden arranged a US \$ 4 billion 10 year facility which not only included "notes" but short-term advances as options to be bid for by the members of the tender panel. A plethora of such facilities followed from then onwards.

2.4.2 Euro Commercial Paper

An alternate to bank borrowings for large corporations with strong credit ratings is to raise funds by issuing commercial paper (CP). Commercial Paper is a short-term promissory note issued on an unsecured basis by commercial and financial institutions. Maturities range between a matter of a few days to 360 days, although on a weighted average basis, the maturities seem to be well below 90 days. In the United States and Canada secondary markets in commercial paper have been established for more than 100 years. The real expansion in commercial paper took place in the early 60's when banks were strapped for liquidity. To expand their activities, the banks developed the Certificate of Deposit (CD) approach. However, the overall cost of purchasing funds (by the banks) continued to increase. Commercial borrowers were, therefore, encouraged to rely more on the commercial paper market (rather than on bank borrowings). In these circumstances, commercial paper issued by the primary borrower (commercial institution) to the primary lender (the investor), sometimes through an intermediary (usually an investment bank), was both more flexible and cheaper.

The most prominent markets for commercial paper are the United States, Canada, UK, Japan And Australia. Euro market prominence for US \$ Euro commercial paper markets are in Singapore and the UK.

Although typical issuers of commercial paper are those with high credit ratings, smaller and less well known companies with lower credit ratings have been able to issue paper in recent years (at competitive rates), by obtaining the support from a firm with high credit rating (called credit-supported commercial paper) or by providing an asset as security (collateralizing) the issue is called asset backed commercial paper. An example of a "Credit Supported Commercial Paper" is an issue supported by a letter of credit (or guarantee). The terms of the letter of credit specifies that the bank issuing the letter of credit will pay off the CP when it falls due, if the issuer (borrower) fails to pay. The credit enhancement of a low rated CP issuer can also be backed up by a "surety bond" from an insurance company.

In the United States, some prime automobile manufacturers have formed subsidiary companies (called Captive Finance Companies), that issue commercial paper in Euro markets to finance customers of the parent. The three major US automobile manufacturers, for example, have captive finance companies: General Motors Acceptance Corporation [GMAC]; Ford Credit; and Chrysler Financial. GMAC is the largest issuer of Commercial Paper in the US.

Commercial Paper is marketed either directly by the issuer or through a dealer (investment bank). A large majority of issuers market their CP directly. These issuers require a continuous source of funds and find it cost effective to establish a sales force in the organisation to sell CP directly to investors. In the case of dealer-placed CP, the issuers use the services of a securities firm or an investment bank. CP's sold in this way are called dealer paper. Competitive pressures have forced dramatic reductions in the fee charged by dealers.

Despite the fact that CP market is larger than markets for other money market instruments (short-term instruments), secondary trading activity is much smaller. The typical investor in CP's is an entity that plans to hold it until maturity. Should an investor's economic circumstances change, such that there is a need to sell the paper, it can be sold back to the dealer, or, in the case of directly placed paper, the issuer will re-purchase it.

CP's are issued at a discount. In other words, if an investor buys a face value of US\$ 1 million of CP, he pays less than the face value, though he receives back on maturity the full face value. The difference between the two represents 'interest'. The return to an investor is made up by the difference between the purchase price and the redemption amount.

CP's are generally issued in denominations of US\$ 500, 000 and US\$ 1 million, the latter being more common. Smaller denominations of US\$ 10,000 are also issued, but very rarely.

Calculating Yield On Commercial Paper : The simple discount formula is really a mirror image of the simple interest formula (with the difference that interest is added at the end of the life time and discount at the beginning). It goes without saying that a simple discount produces a higher cost (or profit) than simple interest with the same numerical value. The simple discount formula is the same as the simple interest with one exception that "D" [Discount] substitutes for "r" (rate).

$$\frac{\text{Principal} \times D \times \text{Tenor (Days)}}{360 \times 100} = \text{Discount}$$

Now, if an exporter in the US drew a 90 day bill on a UK importer for US\$ 1 million, and the bill was discounted at 10% p.a., the amount that the importer would receive would be the principal minus the discount, i.e.

$$\frac{\$ 1,000,000 \times 10 \times 90}{360 \times 100} = \text{US\$ } 25,000$$

Then the amount to be remitted to the exporter would be US\$ 975,000. It is simple to see that as the discount is deducted at the time of selling the bill, the actual interest p.a. will be higher than the discount rate. In the case of our US exporter, interest rate equivalent of 10% p.a. discount will be

$$\frac{\$ 25,000 \times 100 \times 360}{975,000 \times 90} = 10.25641\% \text{ p.a.}$$

Instead of stating a discount rate of 10% (which hides the true percent per annum cost) the buyer or seller could have negotiated a discount to yield rate of 10.26% p.a. this would be an easier price to compare with the true interest costs in the deposit and loan markets.

Commercial Paper is normally issued on a discount to yield basis. This really means that after applying the discount, the net amount earns (or costs) "x" % p.a. which is equal to the discount to yield rate.

The main difference between discount to yield and simple discount pricing lies in the fact that a simple discount has to be converted to simple interest p.a., whereas discount to yield states the true cost (or gain).

The "Discount to Yield" or discounted amount equals :

$$\frac{\text{Face Value (Nominal Value)}}{1 + \frac{\text{Discount to Yield Rate} \times \text{Tenor}}{360 \times 100}}$$

To put it in numbers, a commercial paper of US\$ 1 million discounted at a discount to yield rate of 10% would be sold/purchased for

$$\text{US\$ } 975609.75 = \frac{\$ 1,000,000}{1 + \frac{10 \times 90}{360 \times 100}}$$

To prove that the difference between \$ 1 million and \$ 975, 609.76 represents 10% p.a. should not present a problem any more, as:

$$\frac{\$ 24,390.24 \times 360 \times 100}{\$ 975,609.76 \times 90} = 10\% \text{ p.a.}$$

As no rates are mentioned on commercial paper at discounts (or discounts to yield), the nominal values of the instruments are plain to see. It is easier to market both in the primary and secondary markets.

2.4.3 Medium Term Notes

Since the early 80's Medium Term Notes [MTN's] have emerged as a major source of funding for multinational corporations, supranationals (i.e. the World Bank, Asian Development Bank), and even governments. The market for MTN's was established as an alternative to short term financing in the Commercial Paper market and long term borrowings in the Bond market. Hence the name medium term. The Euro - MTN market has grown at a phenomenal rate. In mid 90's outstanding MTN's in the domestic and international markets was estimated to have grown to over US\$ 350 billion.

Medium Term Notes are in many respects simply fixed rate corporate bonds but for a generally shorter maturity than Euro bonds or domestic bonds. As an investment vehicle, the MTN is often regarded by institutional investors as a temporary investment that can be designed to suit the particular investors choice.

The reason is that MTN's (unlike conventional bonds), are offered on a continuous basis in smaller amounts - as little as \$2 - \$5 million at a time — rather than a single large issue. For example, an investor, such as a Pension Fund

(PF) might have \$ 7 million to invest for 11 months in a good corporate name. The PF will call several MTN dealers to find out which companies are borrowing. When the PF Treasurer makes the choice, the Note will be issued specifically for the investors choice. This special feature explains why MTN financing is often described as "investor driven". In effect, the distribution process in the MTN market resembles a commercial paper issuance programme - but without a "Revolving Underwriting or Guaranteed Facility".

Under a comprehensive MTN programme, an issuer can raise funds by issuing "fixed rate" or "floating rate" or "deep-discount" paper in any of a number of currencies. Deep Discount Bonds carry very low interest, in most cases zero, and accordingly sold at prices representing "Deep Discount" from their principal amounts. Deep Discount Bonds tend to be more price volatile than full coupon bonds and thus offer greater potential for price appreciation if interest rates should fall. The MTN is a Commercial Paper - like instrument that has a maturities ranging from 9 months to 30 years. Generally the Notes are unsecured but need not be. They pay interest on a 30/360 day basis unlike deposits that pay interest on actual/360 terms. Unlike corporate bonds, few are callable. The most distinguishing feature of a MTN from other debt instruments is that their issuance and even maturity is highly investor determined, not issuer determined.

Corporate Bonds are issued infrequently and often entail heavy issuance costs. Therefore, the borrower wants to do an issue in large amounts at a known cost and get it distributed as widely as possible. This means that there must be an underwriting syndicate. This is not the case with MTN's. MTN's are issued through dealers (a) at the time; (b) in the amount; and (c) for the maturity that the investor wants.

MTN's have traditionally been sold on a "best effort basis" i.e. there is no guarantee by the dealer to market the notes. (This is in contrast to an underwriter in the conventional bond market who has guaranteed the subscription.)

Through its agents, an issuer of MTN's posts offering rates over a range of maturities. e.g., 9 months to 1 year, 1 year to 18 months, 18 months to 2 years, and annually thereafter. In the Euro markets, MTN rates are generally quoted on a floating rate basis on an index such as the LIBOR. In domestic markets, many issuers post rates as a yield spread over a Treasury Security of comparative maturity. The yield spread is illustrated below:

MEDIUM TERM NOTE			TREASURY SECURITY	
Maturity Range	Yield%	Yield Spread of MTN over Treasury Securities (basic points)	Maturity	Yield%
2 - 3 years	4.35	35	2 years	4.0
3 - 4 years	5.05	55	3 years	4.50
4 - 5 years	5.60	60	4 years	5.00

Let us now illustrate the MTN funding process. Assume, Hoechst A.G. (a German pharmaceutical company) tells its Dealers that Hoechst will accept any money in the 1-5 year range at a certain spread relative to the bench-mark

Treasury Yields. The Dealers would let their customers know from day to day who was offering MTN's, at what rates and the paper would be sold only on a "best effort basis" (i.e., without a commitment to the issuer for a confirmed sale), if and when an investor wanted it.

Now, consider a Swiss Bank Trust Department calls the Dealer and says: "we'll buy US\$ 20 million of 3½ year Hoechst MTN at over 30" - the deal would be struck there and then. Hoechst's Treasurer will be contacted to confirm the transaction. It will be quite evident that this process is much easier than waiting for the right Eurobond to be issued. It is also cheaper for Hoechst. Although, perhaps less predictable than a \$ 250 million underwritten Eurobond. Hoechst will still get its funding of its quarter billion, although, perhaps in dribs and drabs!!

The MTN market provides corporations with the ability to raise funds discreetly, because the issuer, agent and the investor are the only participants that have to know about the primary transaction. In contrast, the investment company obtains information about underwritten bond offerings from a variety of sources.

Corporations often avoid the bond market in periods of heightened uncertainty about interest rate and the course of the economy (such as the period after the 1987 stock market crash or the south east Asian financial crisis of 1997). Similarly, corporations in distressed industries (commercial banks in the second half of 1990's), can use the MTN market to raise funds quietly rather than risk negative publicity in the high profile bond market. Thus, during periods of financial turmoil, the discreet nature of the MTN market makes it an attractive alternative to the bond market.

Maturities of MTN's reflect the financing needs of various classes of borrowers (issuers). Financial firms (banks) tend to issue MTN's with maturities matched to loans made to customers. Consequently, in the financial sector, maturities are concentrated in a range of 1-5 years and only a small proportion are longer than 10 years. Non financial firms, in contrast, often use MTN's to finance long life fixed assets (plant and equipment). Resultantly, maturities issued by non financial corporations cover a wider range.

2.4.4 Floating Rate Notes

The Floating Rate Note (FRN) as the name implies, is an instrument whose interest rate floats with prevailing market rates. Like Eurodollars deposits, it pays a 3 or 6-month interest rate set above or below LIBOR. Like international loans, the interest rate is re-set every 3 or 6 months, to a new level - based on the prevailing LIBOR level at the reset date. The term Floating Rate Note is taken to mean an intermediate to long term debt security whose interest rate is pegged to a short term rate or rate index and adjusted frequently.

Floating Rate Notes issued outside the country of the currency of denomination are issued in the form of Euro bonds. This feature makes them in some respects as much a capital-market instrument. The pricing framework really defines the character of the instrument. FRN's are priced in part like money market instruments (less than 1 year maturities) and in part like conventional fixed rate bonds (over 1 year). The bulk of FRN's are held by banks and financial institutions, whose cost of funds varies with short-term rates, because an FRN pays a rate that is tied to changes in short term interest rates. Financial institutions also bought FRN's as medium-term substitutes for loans. Some banks, with a low cost of funds (but a shortage of prime borrower customers), were looking for a way to earn a spread with little risk or effort go for FRNs.

Most FRNs can be characterised by the following features:

- a) **The Reference Rate** : The interest rate to which the coupon payment is linked. This is normally a short-term rate. Therefore, some see FRN as a substitute for money-market instruments. In the Euro market the reference rate is usually the LIBOR. Few FRNs have used other reference rates as LIBID, LIMEAN or US Treasury Bill rate. The rate is usually set at the beginning of each coupon period, and interest paid in arrears.
- b) **The Margin** : It is the spread between the coupon payment and LIBOR. Coupon payments are generally LIBOR plus (or minus) some fixed amount. The spread reflects the differential risk at the time of issue between investing in the FRN and investing in a bank deposit paying LIBOR. [LIBOR is itself about 1/8% higher than prime banks bid rate - LIBID in the interbank market]. An FRN also carries a default risk of the issuer over the life of the Note and liquidity risk (ability to sell in the secondary market).
- c) **The Reference Rate Period** : The maturity of the security to which the coupon is linked, such as 3-or-6 month Eurodollar deposit is called reference rate period. An FRN coupon is quoted as LIBOR - period rate and the margin e.g., 6 month plus 3/16%.
- d) **Frequency Of Re-Set** : Frequency between coupon re-set dates normally coincides with the reference-rate period.
- e) **Coupon-Payment Frequency** : This is the interval between coupon payments and normally coincides with the coupon reset periods.
- f) **Maturity** : It is the date on which the principal on the FRN will be redeemed. Many FRN's have a call feature i.e. the issuer may (at its option), redeem the FRN at certain specified dates prior to maturity.

A "plain vanilla" FRN is a fixed-maturity bond whose reference - rate period frequency of reset and coupon payment are all of the same length.

A "mismatch" FRN is one in which the reference-rate period, the frequency of reset, and/or the coupon payment period are of different lengths. Let's illustrate mismatch FRN.

XYZ Bank has issued a mismatch FRN maturing April 2005 that pays 6-month LIBID flat (meaning the margin over LIBID is zero). The rate is reset monthly but is paid semi-annually. The coupon is the arithmetic mean of the six 1-month interest periods (within the 6-month coupon period).

The method usually followed for calculating the LIBOR rate to be used as a reference rate to reset coupons would be as follows :

On the second business day prior to the beginning of each coupon period, the agent bank collects the offered quotations prevailing at 11:00 am on that day for inter bank deposits with the London branches of leading banks from a series of reference banks. Thereafter, the arithmetic mean of these rates, rounded off to the nearest 16th, is taken as LIBOR. Using this rate, the coupon is then calculated on an actual/360 - day basis, rounded upwards or downwards to the nearest cent on each Note. An Agent Bank calculates and publishes the coupon rate for each period.

2.4.5 Euro Bonds

The International Bond Market consists of the Euro bond market, the Foreign Bond market and those Domestic Bond market (such as the US, Japanese and French markets), in which global bond investors participate actively. The most international of these markets is the Euro bond market. The Euro bond market raises over US\$ 200 billion per annum in new capital for corporations, financial institutions and governments.

Domestic Bonds are usually fixed-interest, fixed-maturity claims with ranging maturities from 1-30 years. They are issued by domestic residents, in the domestic currency, and largely sold to domestic residents.

Foreign Bonds are issued within the domestic market of the currency of denomination, but they are issued by non-resident borrowers. For example, a bond issued within the UK by a non resident issuer such as the Asian Development Bank is a Foreign Bond. Euro bonds are usually issued in the market for the borrower by a syndicate of banks from different countries and placed in countries other than the one in whose currency the bond is denominated. If the German firm issued a bond in French francs in England, Switzerland, the issue is a Euro bond.

Companies might need medium and long term funds for expansion, new investments or for acquisition. Banks and financial institutions need longer term money to fund their loan portfolios or to increase their capital base as defined by the regulatory authorities. Euro bond is their popular choice.

The process of issuing a Euro bond begins with a discussion between the borrower and its bankers.

The issuer specifies the following:

- a) desired currency of denomination
- b) the amount
- c) the target rate (an interest rate at which the issuer would be willing to borrow)

If the bank obtains a mandate (formal authorisation), this bank becomes the lead manager of the Euro bond issue (there can be more than one lead manager) on the instructions of the issuer (or if the deal is large or complex), the lead manager/s may invite other banks to be co-managers. Together they form the management group, who negotiate the interest rate and other terms of the deal in such a way to be acceptable to the target investors. The lead manager/s and their lawyers also prepare the documentation and obtain necessary clearances.

The bond will normally be listed in Luxembourg or in a similar location where listing is cheap and there is no prospects of present or future withholding tax (the listing is a mere formality to satisfy those investors who are permitted to invest in listed securities. Few of the bonds will ever be traded on the Luxembourg exchange).

The key role of the management group is to form an underwriting group of a number of banks, investment banks and security houses (25, 50 or upto several hundreds), from different countries. The managers will undertake the task of sending out an invitation fax or telex to many banks inviting their participation in the deal. The underwriter (which include the management group), are selected on the basis of their ability to place the bonds in different sub-markets of the Euro

bond universe. The underwriters demonstrate their confidence in their own ability by committing themselves to purchase a share of the bond issue at a set price from the issuer.

When a bank underwrites a bond issue, it is in effect giving the issuer a put option (this is called a "put to seller", when the option writer is obligated to buy the underlying bonds or shares, at an agreed upon price). If an XYZ June 40 were "put to seller" for instance, the Writer (underwriting bank), would have to buy 100 shares of XYZ at \$ 40 a share from the put holder (issuer), even though the current market price of XYZ may be far less than \$ 40 a share.

A third level of participation in the issue is the selling group of banks and dealers who actually sell the bonds to end investors. This selling group consists of the managers, the underwriters and other banks/dealers, who will try to sell the bonds but are not committed to purchasing them if they cannot sell.

A typical Euro bond issuance "Syndicate" consists of three overlapping parts: (a) the managers (b) the underwriters and (c) the selling group. A manager's commitment is a proportional responsibility: i.e., if one of the selling group fails to come up with its allotted amount (to sell and noncommittal), on the closing date, all managers are responsible for paying that amount to the issuer on a pro rata basis. (each manager is responsible for the amount of its commitment).

Once the syndicate is in place, the bond can be announced — with its features and tentative terms. The preliminary version of the prospectus, called "the Red Herring" will have been prepared. Members of the selling group will now actively canvass the potential investors for their interest in the deal. The Red Herring will be perused by the "sales-people", who are calling their clients to solicit interest in the bond. Although the precise terms of the bond remain provisional until the offering date, the bonds may actually begin trading before this date in a sort of "when issued market", called the Grey market. The Grey market is a short-term forward market, enabling investors to assure themselves of a certain investment at a known price for the bonds issued. It also allows members of an underwriting syndicate to verify their placement of bonds to be issued. This reduces the inherent uncertainty in a bond issue and ultimately reducing the spread paid by the issuer. Because the final issue of the bond has not been set, Grey market prices are expressed as a discount (or very rarely as a premium), for instance a World Bank bond may quote a price of "less 3/8", which means that it is being offered to sell bonds at 3/8 percentage points below of final offering price. Now, if the final offering price is 101, the Grey market dealer will deliver them at 100 5/8. A Grey market can only work for bonds whose issuers are well known and whose nonprice features are established. After a few days or weeks of this preplacement, the selling group members will give a feedback to the Lead managers. Thereafter, the Lead managers would have gained sufficient confidence to return to the issuer with a commitment to the final terms.

The key feature will be the coupon. If necessary (and market response warrants), the amount or even the maturity of the Euro bond will be adjusted to meet investor preferences. If the bond carries any "sweeteners" such as warrants or a convertibility feature, the terms may be altered. When the Lead Manager/s reach agreement with the issuer, the documents are finally signed on the offering day. A final version of the prospectus is printed and distributed and the bonds are publicly offered. Members of the syndicate will try to sell the bonds at the offer price printed on the front of the prospectus (or a higher price, if they can).

Bonds are often placed at a price below the offer price. Selling Group members buy the securities at the issue price (minus the dealers discount selling commission), and may pass along a higher proportion of that discount to other dealers or even to institutional investors. In short, competition prevails. An important responsibility of the Lead Manager is stabilisation. This is achieved by intervening in the market to support the price of the new issue. The Lead Manager is permitted to undertake stabilisation in the primary market by direct participation and/or by readjusting the amount allotted to various members of the Selling Group. Two weeks after the signing, on the closing date, the securities are delivered to buyers in exchange for cash. The borrower receives the funds.

Repurchasing Euro bonds: If a company can issue Euro bonds it can also buy back the bond from the market. One common reason may be that the borrower is flushed with funds and no longer needs the debt. It also makes no sense to have large cash holdings and place them on deposits earning LIBOR (-) 1/4%, while paying a coupon of Treasury plus 1% to bond holders. Having cash is not a necessary precondition. The borrower may wish to refinance on difference or better terms.

One possible reason for a debt-repurchase plan might be to retire debt of one currency (say, Swiss franc debt) and replace it with (say, German marks), that better suits the companies needs. However, repurchasing a bond is a costly and time consuming process — especially if the bonds are widely spread in a lot of different countries. It has been estimated that a borrower has to pay around 30bp, more over the current market price to persuade a significant number of bond holders to sell their bonds. With high degree of development of the currency and interest rate swap market, it is far more efficient to alter the currency or rate character of one's debt by means of an offsetting swap, than to buy back and reissue bonds.

The Secondary Market : Although most Euro bonds are privately placed or traded briefly following initial issuance and closely held by investors (institutional or otherwise), some — particularly those issued in large amounts, trade actively in a secondary market. For these bonds, 2-way prices are quoted (by market makers) in Zurich, London and Hong Kong and elsewhere. The market maker quotes a bid price and an offer price. If you buy from him at his offer price, you'll pay that price plus accrued interest. Issuers whose bonds are traded actively include for example, various governments, or Asian Development Bank, European Investment Bank, major banks such as Dia-Ichi Kangyo and prominent corporations such as General Electric. Some of these bonds, such as the World Bank issues, become "bench-mark" Eurobonds used as key indicators for pricing of other comparable issues.

Most dollar denominated Euro bonds are today quoted in relation to the "Treasury Curve". This means that their yields are seen as a spread over the bench-mark US Treasury Bond of comparable maturity. Yields in the Euro bond market are conventionally quoted in terms of Yield to Maturity (YTM) assuming annual payment. Euro bond coupons are paid once a year. To compare them with Treasuries, the yield has to be converted to a semi-annual basis.

A potential, more serious problem arises when Euro bonds have call features. Many dealers handle this by substituting a quotation based on "yield to first call" in place of "yield to maturity". This of course in no way properly accounts for the value of the call option in the bond.

Asset Backed Bonds : At one time, Euro bonds traded on the "name" of the borrower. Today, Euro bond investors are prepared to look at a much wider range

of issues. The primary attraction of many of which is that they carry a high rating from Moody's or Standard & Poor's. Asset Backed Euro bonds are among the most interesting of the ratings-driven type Eurobond. Asset Backed Bonds are designed to obtain a high rating from credit rating agencies, allowing the issuer to pay a lower interest rate than it would on "general obligation bonds" (i.e., carrying a normal obligation to honour).

Let us take an example, Sears Roebuck, (departmental chain in the US) has issued a fixed-interest Eurobond designed to raise money for financing short-term loans to its customers. The bond is neither guaranteed by Sears Roebuck itself, nor by Sears finance subsidiary "Sears Receivables Financing Group". Yet the bond carried a triple-a rating [AAA]. How was this possible? The way a bond such as this is able to qualify for a rating agencies' top rating (despite the maturity mis-match and default risky assets - customers receivables, is through overcollateralisation. Say, for example, Sears puts up (say) \$ 135 worth of receivables for every \$ 100 of the Eurobond. Thus the value of the collateral can fall by 35% before the bond holder is hurt. Further more, Sears may promise to "top up" the collateral if its value falls below a certain multiple, say 130% of the value of the bond. Finally, a 3rd party guarantee for a fraction of the collateral may also be provided to give additional assurance to the bond holder.

These "cushions" are provided for two reasons: (a) the rating agencies set out a criteria for providing AAA ratings, including the degree of overcollateralisation (required for different types of collateral) e.g., junk bonds will require a higher level of collateral than mortgage-backed securities, and (b) the potential investors may require even more, that a well known insurance company provide a contingent guarantee.

For all this, the investor must give up some yield. Despite their high rating, AAA Asset Backed Euro bonds still provide significantly higher spreads than do direct issues of top borrowers carrying the same AAA rating. The reason is not the default risk but the "prepayment risk". Each transaction is typically engineered to pay down early, in the event that the excess spread created by cash flows falls below certain levels as decided by rating agencies.

The spread is defined as the excess of the cash flow from the assets, expressed as an interest rate, over the bonds coupon. Many deals have a "spread trigger" say, 450 basis points above the coupon. If the spread fall below that level for 3 months in a row, this will "trigger", a pay - down action of the principal. In a recession, rising defaults could "trigger" these protective covenants in asset-backed bonds, causing the bonds to repay principal early and exposing investors to re-investment risk.

2.5 EURO EQUITIES

Compared to various debt financing instruments, issuance of Euro equities stands out as a distinct source of raising finance in international financial markets. By means of such issues, the issuing company offers ownership rights (as distinguished from creditorship rights in the form of debt). The two classes of equity linked instruments used for raising money abroad are (1) International Depository Receipts and (2) Euro Convertible Bonds.

A Depository Receipt is defined as a negotiable certificate providing the holder with the benefit of ownership of equity shares of the issuer company. Various types of Depository Receipts are : American Depository Receipts [ADR's], European Depository Receipts [EDR's], Global Depository Receipts [GDR's].

An ADR (or EDR) is a document evidencing ownership of a share (or shares) held on the investors behalf by a US or respective European based bank in a foreign country. For example, Chase Manhattan Bank may have its branch in Singapore take custody of a number of shares of Straits Shipping Company Singapore. Chase New York will then issue a "receipt" stating that "x" shares of Straits Shipping are held in Chase Singapore and will continue to be so held as long as the ADR exists. Chase New York will then arrange for the Straits Shipping ADR to be listed for trading on (say), the American Stock Exchange.

The Securities And Exchange Commission (SEC) of the US (which is the counterpart of SEBI - in India), requires issuers of ADRs to comply with US regulations regarding the disclosure of corporate information. The ADR's were not "fungible", which means that the issuing company would have to issue different receipts for different markets e.g. American and European markets. This had made it difficult for cross-border trading. The Global Depository Receipt evolved as a logical progression, as GDRs facilitated the raising of capital both in the United States and in Europe simultaneously through a uniform security.

A GDR is an instrument to raise equity capital in multiple markets outside the issuers domestic market through one security - which is traded in a foreign stock market. A GDR may represent one or more shares and the holder can at any time convert it into the number of shares it represents. The underlying shares are already listed in the domestic stock exchange and the depository release them from its original inventory. Till conversion they do not carry direct voting rights (may do so through the depository).

Issuers have found it advantageous as a GDR programme expands the market for its shares through a broadened, liquid and more diversified exposure which increases or stabilises the share price. It enhances the issuing companies image and propels it into a global stage. GDRs are quoted in US Dollars. After a period of 45-180 days, referred to as a "cooling off period", a GDR becomes a fungible i.e., the investor may sell his GDR. The holder simply instructs its depository to cancel the GDR. The Depository (overseas) asks its custodian (say-in India) to release shares to the counterparty and the custodian releases the share certificates - which are delivered in the (Indian) market. The custodian completes the settlement process, receives the money through the local stock exchange settlement system, adjusts for the capital gains tax and remits the foreign exchange equivalent at the prevailing market rate to the US dollar account of the investor abroad. Instead of directly dealing with the foreign depository, the investor may go through an intermediary (foreign broker), who would co-ordinate the settlement process, receives the remittance from the Indian Custodian and credits the investors account. In effect the investor has sold his GDR and received the dollar value.

GDRs are marketed through a syndication process. Similar to the one as described for Euro bonds 2.4.5.

It is the responsibility of the Lead Manager to construct an appropriate syndicate of other participants (Banks/FIs), and underwriters. The Lead Manager prepares an in-depth research report regarding issue timings, pricing and the numerous variables that may affect market sentiments (international economic, political news and events). They also assist in the selection of the foreign depository, foreign legal advisors and compliance with the listing requirements of stock exchanges where the GDR is to be listed. It takes around 11-12 weeks for a GDR issue to be formalised between the issuing company and the Lead Manager.

As part of the pre-issue work, the issuing company needs to obtain authorisation from its share holders for taking a decision to raise additional equity in the global market in the form of foreign currency. The general body has to approve the proposal by a special resolution under section 81 of the Companies Act 1956 (a special resolution requires 75% of shareholders voting.)

The issuing company has to make a request to the Ministry of Finance, Government of India to allow it to enter the global market. The approval from the Government specifies the price range within which the final price will be settled after studying reports of investor feed-back. The Ministry of Finance approval is followed by the approval from the Reserve Bank of India and the Department of Company Affairs for exemption of procedures of local issues.

Proper pricing is crucial for a successful issue. Normally a good issue will be characterised by a firm or rising share price after the issue. If the price drops soon after the issue then the issuer gains at the expense of the investor. This may have an adverse effect not only for the issuing company but more importantly for other companies issuing GDRs from the same country. If the price increases after the issue, it is to the expense of the issuer. This may have a positive impact on the issuing company and for future issues of other companies. On completion of pricing, the allotment of the issue would be completed and notified to the syndication. The role of the depository is now very important as they issue the GDRs to the syndicate (underwriters), who place them with the ultimate investors. The depository also collects and remits the foreign exchange proceeds from the issue. It is also the depositories' responsibility to pay dividend to the investor.

2.6 EURO CONVERTIBLE BONDS

A large proportion of new issues of Euro bonds are called bonds but behave like equity - because they incorporate equity options. In other words, the investor obtains some sort of equity participation along with the bond itself. This feature is much more prevalent in the international market than in the domestic bond markets. The feature offers one way in which investors can reap the benefits of an equity play.

By definition, an Euro Convertible Bond is a quasi equity issue, outside the domestic market, which provides the holder with an option to convert from a debt instrument (investment) into an equity investment i.e., to a certain number of equity shares at a predetermined price.

A special feature nowadays is to allow Euro Convertible bond to convert to GDRs. Till the conversion takes place, interest is paid in US dollars and bond redemption is done in US dollars.

For the convertibility into shares, the option can be exercised at any time or at specified points during the convertibles life. No further money changes hands as the investor merely exchanges the convertible bond for a specified number of shares. The prevailing share price thus becomes an important determinant of the conversion decision. If there is no growth and the potential performance of the share price remains low then no conversion of debt to equity will take place. However, if the share price is growing, Euro Convertible bond the investor can capture any benefit of the share price movements.

The fixed annual coupon on Euro Convertible bond is normally lower than equivalent straight bonds. The difference reflects the value of the conversion option. In fact, the investor in Euro Convertible bonds usually pays a conversion

over the share price to obtain a return. Most convertibles of growing companies are likely to be converted. Conversion in this scenario enables the company to sell shares at a premium, while if not converted, enables the company to carry low coupon debt.

Call and Put Options are introduced while structuring Euro Convertible Issues. Under the call option, an issuing company can buy back the bonds by giving notice of its intention to do so. Whereas, investors can sell the bonds back to the issuer under the put option. As for the call option, cut-off points are provided in terms of closing price of shares. Typically, issuing companies are not allowed to exercise the call option and redeem the bonds unless the closing price of shares (for a period of 30 days prior to the notice of redemption), is at least 140-150% of the conversion price as originally agreed. Euro Convertible Bond issues are also arranged through a Syndication similar to the one described for Euro bonds under 2.4.5.

2.7 EURO ISSUES IN INDIA

Indian companies have been raising funds from international financial markets by issuing Euro bonds, Euro convertible bonds and Euro equities. The first GDR were issued by Reliance industries in May 92 with an issue size of US\$ 150 million. The market at that time for Indian issues was so under developed that Reliance had to give discount upto 17% to GDRs to get the issue fully subscribed. Till March 1997/98 Indian companies could raise US\$ 5,180 million.

Amounts raised by Indian corporates through GDRs and ADRs declined from US\$ 645 million in 1997-98 to US\$ 270 million in 1998-99. Depressed capital market, industrial slackness at home and adverse emerging market sentiments affected GDR prospects unfavourably last year. However, there has been a turnaround in the first half of the current financial year with large issues raised in the ADR/GDR market. The successful ADR issues include M/s Infosys Technologies (\$ 75 million), M/s Satyam Infoway Ltd. (\$ 86 million) and M/s ICICI (\$ 315 million). To facilitate conversion of its GDRs into American Depository Shares (ADS), ICICI listed the ADS on the New York Stock Exchange with effect from 17 November, 1999 after complying with stringent listing requirements of the Securities and Exchange Commission (SEC) of the USA, including adherence of GAAP standards.

Considering the enhanced opportunities of Indian software companies for expanding globally, operational norms governing their overseas investments and mode of financing acquisition of overseas software companies have been liberalised. In December, 1999 a notification was issued by the Ministry of Finance permitting Indian software companies, which are listed in foreign exchanges and have already floated ADR/GDR issues, to acquire foreign software companies and issue ADRs/GDRs without reference to the Government of India or the RBI up to the value limit of US\$ 100 million. For acquisitions beyond US\$ 100 million, proposals would require examination by a Special Composite Committee in the RBI.

With a view to further liberalise the operational guidelines for ADR/GDR issues. It has been decided to dispense with the track record scrutiny process for ADR/GDR issues and the two stage approval by the Ministry of Finance. Indian companies would henceforth be free to access the ADR/GDR markets through an automatic route without the price approval of the Ministry of Finance subject to the specified norms and post-issue reporting requirement. As ADR/GDR are reckoned as part of FDI, such issues would need to conform to the existing FDI

policy and permissible only in areas where FDI is permissible. Such ADR/GDR issues would, however, be governed by the mandatory approval requirements under the FDI policy.

In India External Commercial Borrowing (ECBs) are governed by guidelines on External Commercial Borrowing Policy and Procedures issued from time to time. The 1996 guidelines were framed to increase the transparency in policy and simplifying the procedures to give Indian industry easier access to external funds to support investment and economic activity. One of the basic objectives of these guidelines was to give priority and provide greater flexibility to investors in critical infrastructure sector, to give priority to exporters in accessing ECB resources and to give additional flexibility to these incurring long term debts. The GOI has extended ECB facility for rupee expenditure for infrastructure sector such as roads, (including bridges) ports, industrial parks, and urban infrastructure (water supply, sanitation, sewerage etc.) Previously this facility was given only to power, telecommunication and railways.

Disbursements under ECB (including US\$ 4230 million from RIBs), were US\$ 7226 million in 1998-99, almost at the same level as in 1997-98 (US\$ 7371 million). Subdued demand for funds from borrowers due to slackness in domestic industry and higher premia for emerging market borrowers in the international market contributed to lower disbursements excluding RIBs. However, since repayments fell from US\$ 3372 million in 1997-98 to US\$ 2864 million in 1998-99, net overall borrowings showed an improvement from US\$ 3999 million in 1997-98 to US\$ 4362 million in 1998-99.

The sluggish trend in disbursements has continued in the current year. In the first quarter of the current financial year, disbursements were US\$ 621 million against US\$ 754 million during the corresponding period in the previous year. Repayments at US\$ 631 million were only marginally higher by US\$ 9 million. Therefore, there has been net repayment in the first quarter of 1999-2000 as compared to net borrowing of US\$ 132 million in the corresponding period of the previous year.

ECB guidelines in 1999-2000 were further liberalised and procedures streamlined to facilitate better access to international financial markets, keep maturities long, costs low and encourage infrastructure and export sector financing.

ECB approvals in 1998-99 were much lower at US\$ 5200 million compared to US\$ 8712 million in 1997-98. In 1999-2000 (up to end-December), approvals amounted to US\$ 2136 million (Table 2.2). The Power sector accounted for the highest approvals of US\$ 1699 million followed by US\$ 218 million for Petroleum and Natural Gas. The third largest recipient of approvals was Ports and Roads with US\$ 80 million. There has been no approval in Telecom, Civil Aviation and Railways so far in the current financial year.

It is expected that as the domestic industrial recovery gathers pace and emerging market spreads narrow, ECB will be accessed more in the coming months.

Table 2.2 : Status of ECB Approvals

Sector	(US \$ million)		
	1997-98	1998-99	1999-2000
Power	3014	3998	1699
Telecom	1492	75	0
Shipping	210	37	27
Civil Aviation	373	0	0

Petroleum & Natural Gas	230	40	218
Railways	179	15	0
Financial Institutions	795	150	50
Ports, Roads, etc.	61	0	80
Others (including exporters)	2358	885	62
Total	8712	5200	2136

* as on 31.12.99

Source : ECB Division, Ministry of Finance, Government of India.

ECB 1999-2000 GUIDELINES

a) Average maturities for ECB

ECBs should have the following minimum average maturities:

- Minimum average maturity of three years for external commercial borrowings equal to or less than USD 20 million in respect of all sectors except 100% EOUs;
- Minimum average maturity of five years for external commercial borrowings greater than USD 20 million in respect of all sectors except 100% EOU;
- 100% Export Oriented Units (EOUs) are permitted ECB at a minimum average maturity of three years for any amount.
- Bonds and FRNs can be raised in tranches of different maturities provided the average maturity of the different tranches within the same overall approval taken together satisfies the maturity criteria prescribed in the ECB guidelines.

b) USD 5 million Scheme

All Corporates and Institutions are permitted to raise ECB upto USD 5 million at a minimum simple maturity of 3 years.

c) Exporters/Foreign Exchange Earners

Corporates earning foreign exchange are permitted to raise ECB upto thrice the average amount of annual exports during the previous three years subject to a maximum of USD 200 million. The minimum average maturity will be three years up to USD 20 million and five years for ECBs exceeding USD 20 million. 100% EOUs are permitted to have foreign currency exposure up to 60% of the project cost.

d) Infrastructure Projects

Holding companies/promoters will be permitted to raise ECB upto a maximum of USD 200 million to finance equity investment in a subsidiary/ joint venture company implementing infrastructure projects. This flexibility is being given in order to enable domestic investors in infrastructure projects to meet the minimum domestic equity requirements. In case the debt is to be raised by more than one promoter for a single project then the total quantum of loan by all promoters put together should not exceed USD 200 million.

e) Long term Borrowers

ECB of eight years average maturity and above will be outside the ECB ceiling, although the MOF/RBI's prior approval for such borrowings will continue to be

necessary. The Government will review the extent of debt under this window periodically.

f) On-lending by DFIs and other Financial Intermediaries

While DFIs are required to adhere to the average maturity criteria prescribed, namely, minimum of five years for loans of more than USD 20 million equivalent and minimum three years for loans less than or equal to USD 20 million for their borrowing, they are permitted to on-lend at different maturities. They may also on-lend for project-related rupee expenditure. However, other financial intermediaries are required to adhere to the general ECB guidelines on maturity as well as end-use in their on-lending programmes.

g) Proceeds from Bonds, FRNs and Syndicated Loan

Corporate borrowers who have raised ECB for import of capital goods and services through Bonds/FRN/Syndicated loans are permitted to remit funds into India. The funds can be utilised for activities as per their business judgement except investment in stock market or real estate, for up to one year or till the actual import of capital goods and services takes place, whichever is earlier. In case borrowers decide to deploy funds abroad until the approved end-use requirement arises, they can do so as per the RBI's extant guidelines. RBI would continue to monitor ECB proceeds parked abroad.

h) ECB Entitlement for New Projects

All green field projects other than infrastructure projects will be permitted to avail ECB to the extent of 35% of the total project cost, as appraised by a recognised Financial Institution/Bank, subject to the fulfilment of other ECB guidelines.

All infrastructure projects will be permitted to have ECB exposure to the extent of 50% of the project cost as appraised by a recognised financial institution/bank, subject to fulfilment of other ECB guidelines. Greater flexibility beyond 50% of the project cost may be allowed in case of power sector and other infrastructure projects based on merits.

i) Pre-payment of ECB

Presently, prepayment facility is permitted subject to certain conditions if they are met out of inflow of foreign equity. In addition to this the corporates can avail of either of following options for prepayment of ECBs.

- i) 10% of the outstanding ECBs once during the life of a loan
- ii) All ECBs, with residual maturity up to one year.
- iii) 100% prepayment is allowed where the source of funds is from Exchange Earners' Foreign Currency accounts.

j) Refinancing the Existing Foreign Currency Loan

Refinancing of outstanding amounts under existing loans by raising fresh loans at lower cost may also be permitted on a case-to-case basis, subject to the condition that the outstanding maturity of the original loan is maintained. Rolling over of ECB will not be permitted.

k) Liability Management

Corporate can undertake liability management for hedging the interest and/or exchange rate risk on their underlying foreign currency exposure.

l) End use Relaxation

ECBs can be used for any purpose except investment in real estate and in capital markets.

m) Government Equity Holding in PSUs

In view of on-going dis-investment programmes, borrowing by PSUs should not incorporate any covenant that Government will continue to hold at least 51% of equity in PSUs concerned.

n) Operating Expenses

Operating and out-of-pocket expenses incurred for ECB approvals, not resulting in loans, are allowed as per prevailing RBI guidelines on current account transactions subject to a cap.

o) Simplification of Approval Procedures

The Regional Offices of RBI would take loan agreement/documents on record of all ECB approvals once the Government/RBI has approved them.

Default interest not exceeding 2% over the applicable rate will be incorporated in the approval letter/taken on record letter itself. No further approval would be required from the Government/RBI.

p) Structured Obligation

In order to enable corporates to hedge exchange rate risks and raise resources domestically, domestic rupee denominated structured obligations would be permitted to be credit enhanced by international banks/international financial institutions/joint venture partners subject to certain condition. The denomination of debt service in the post default situation may be in rupees or in forex as envisaged in the contract document.

(Source : Economic Survey 1999-2000)

Note: Students should update themselves with amendments and notification issued from time to time by Government of India.

Check Your Progress B

1 List the international financial instruments for raising finance.

.....
.....
.....
.....

2. Differential between Euro bonds and foreign bonds.

.....
.....
.....
.....

3 Explain briefly :

i) GDRs

.....
.....
.....
.....

ii) ADRs

.....
.....
.....
.....

2.8 LET US SUM UP

International financial markets and operations comprise buying and selling currencies, deposit taking and lending and issuance of securities. Market segments are classified according to the nature of financial operations. Money markets deal with exchange or exchange related transaction, credit markets deals with deposit taking and lending. Capital markets and equity markets are concerned with issuance of securities and issuance of international equities respectively.

Euro market transactions are the financial transactions denominated with currency outside the country of its origin. Eurobanks are other banks which take deposits and make loans in a currency or currencies other than that of the country in which they are located. Euro markets consists of Eurobanks that offer wholesale deposits and loans in favourable jurisdiction and in a variety of currencies other than that of the country in which the banks are situated. These Euro banks are entirely free of market regulatory controls. Euro market operations basically have been medium to long-term lending with floating interest rates. Euro currency is the currency of Euro land and transation in the Euro currency are known as Euro currency market :

These markets thrive as they are outside the control of any central bank. Consequently, Eurobanks can offer higher yields to depositors and finer rates to borrower which makes Euro markets attractive. Euro markets have two basis for calculating interest : (a) the 365-day year is used for British Pound Sterling, the Irish Pound, the Kuwaiti Dinar and Belgium Franc; (b) the 360-day year for all other currencies. According to Euro-market conventions : (a) while calculating interest the first day of the period is included not the last day (b) if interest payment falls on a non-banking day, it will shift to next business day; (c) interest period could be lengthened or shortened depending upon whether the last day is holiday; (d) if the interest payment date happens to fall in a new month, while the last day upon which the interest is calculated is the previous month then the interest payment date will be the immediate preceding business date. Euro market quotes two rates for a given period (1) LIBID and (2) LIBOR.

The important instruments that are used to raise finance are Euro notes, Eurocommercial papers, Medium-term Notes, Floating Rate Notes, Euro bonds and Euroequities. Under Euro notes a debt instrument with short-term maturities is structured and placed in the market. A commercial paper is also a short-term promissory note issued on unrecurred basis by financial institutions. Medium-term Notes and Floating Rate Notes are mostly in use. Eurobonds are usually issued

by a syndicate. Euroequities are a distinct source of raising finance in international financial markets. Under this issue company offers ownership rights to the buyer. Two classes of equity linked instruments are mainly used namely International Depository Receipt and Euro-Convertible Bonds. Indian Companies have been raising finance through Euro-Bonds and Euro-Equities and have been floating ADR/GDR.

The Government of India has issued guidelines for External Commercial Borrowings in 1996 and recently in 1999-2000 have liberalised the procedure for these borrowings.

2.9 KEY WORDS

Eurodollar : Dollar deposited in a bank outside its country of origin.

Euro market : Transactions in Eurodollar, Euroyen etc.

Euro banks : Which accepts deposits and make loan in foreign currencies.

London-Interbank Offered Rate (LIBOR) : The rate at which funds are offered to a London or by a London bank to another London Bank.

Euro-Commercial Papers: Commercial paper is a short-term promissory note issued on an unsecured basis by commercial and financial institutes.

Floating Rate Note : An instrument whose interest rate floats with prevailing market rates.

Eurobonds : A bond placed in the countries other than are in whose currency it is denominated.

Euro-convertible Bond : It is a quasi-equity issue, outside the domestic market, provides an option to convert from debt.

LIMEAN : The average of LIBID and LIBOR.

Medium-term Note : Fixed rate corporate bonds for a shorter maturity than Euro-bonds or domestic bonds.

Foreign Bond : The bond sold outside the borrower's country denominated in the currency of the country of issue.

2.10 ANSWERS TO CHECK YOUR PROGRESS

A4 (i) False (ii) False (iii) True (iv) True (v) False

2.11 TERMINAL QUESTIONS/EXERCISE

- 1 What is Euro market? Explain the reasons of its existence.
- 2 What are Euro Bonds? What are its characteristics?
- 3 a) How are GDRs priced?
b) What are the characteristics of GDRs?
- 4 Evaluate the performance of Indian Euro Issues.