1968

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Recommended Citation
Tempo, Vol. 14, no. 4 (1968, December), p. 13-16

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It seems that whatever area of the globe one looks at there are serious economic problems. Even the mighty dollar has come under pressure as the USA experiences its first taste of balance of payments deficits —not that a large balance of payments surplus is a pleasant situation as Germany is finding out.

As the balance of payments problems increase so do the financial restrictions imposed by governments to correct them. And with efforts to maintain currency values and to combat inflation, credit positions are getting tighter.

As a result of these trade deficits, overseas spending on defense and various forms of foreign aid, many different currencies have been found in the past few decades in the international money market in various proportions. As national economies have gone tight on credit and finally the seemingly endless supplier of funds —New York—was shut off to foreign borrowers in 1963 by the interest equalization tax, this international money pool has become the source of international finance rather than the drain.

Initially, this international money pool was used only as a means of settling up between banks. Now these funds have been activated and have become the Eurodollar market.

Although the name implies that the market is limited to Europe and dollars, this is not so. However, dollars do play a dominant role, and the market is centered and is most active in Europe. Hence Eurodollars.

Because foreign currency deposits have been held for many years, bankers have distinguished this part of the international money market by describing a Eurodollar as a currency deposit in a bank outside the country which issued the currency. Thus, dollars on deposit in the London subsidiary of a USA bank are considered to be Eurodollars.

No one actually knows the size of this market because nobody knows how much of the pool is still inactive, but the Bank for International Settlements estimates the market holds $20 billion.

The most attractive feature of Eurodollars is that for the most part they are free from government intervention and are available for borrowing to finance multinational business and government projects in what seems to be an unlimited volume. The Eurodollar market is primarily a short term market, but as the needs of borrowers—particularly corporations—are for long term financing, the international capital market brings about the transition from short term to long term.

The international capital market's tapping of the Eurodollar sources for medium and long term funds has been very successful. Governments, utilities and multinational corporations have floated enormous bond issues and found eager investors.

The investors are often anonymous, operating through Swiss bankers who are large purchasers of bonds, presumably for non-Swiss clients. In this way the investors enjoy the secrecy of receiving interest without having withholding taxes deducted. The payment of interest without deducting withholding taxes is an essential feature of these bonds.

The bonds are known as Eurobonds because they are similar in concept to the Eurodollar. They are denominated in a currency other than that of the country of issue.

The Eurobond really got off the ground in 1963 following imposition of the interest equalization tax. This tax was in effect a tariff on portfolio funds leaving the USA, which, at that time, was the central source of funds for foreign borrowers. The tax effectively closed the New York market to foreign borrowers, who then turned to the issuing of Eurobonds—often denominated in American dollars—and a whole new world was opened to the international capital market.

There were all kinds of problems at first, such as the absence of truly international syndicates to underwrite and manage these issues. However, they were soon overcome.

Originally the Eurobond market was predominately European and exclusive of USA corporations, even though bond issues were often denominated in American dollars. Borrowing corporations were quick to find that here was a volume of money to be soaked up. And in the first couple of years issues up to $25 million were impressively and successfully floated.

In 1965, as a result of the USA voluntary foreign investment restraint program, USA corporations seeking alternative means of financing overseas turned to the Eurodollar market. In September 1965 the first dollar-denominated Eurobond issue, amounting to $20 million, was made by a USA affiliate.

Since that time the number of borrowers in the market, both American corporations and others, has been increasing. Issues ranged generally between $10-25 million, and, although one issue of $50 million was made in December 1965 by General Electric Overseas Capital Corporation, it was an exception.

The imposition of the foreign direct investment program in 1968 caused an almost sensational increase in Eurobond issues from the sudden influx of USA corporations needing overseas financing—but subject to the FDI program.

In the first three months of 1968 several issues of $50 million were successfully floated—one of them by Chrysler—and this year a European corporation—Phillips—floated a $100 million issue.

It is expected that USA corporations will float issues aggregating $2 billion in 1968 compared with $0.45 billion in 1966. It is interesting to take a closer look at the type of corporation most likely to attract investors in this market and at the nature of Eurobonds themselves.

Large, well-known corporations have been most attractive to investors since Eurobonds were first issued. In fact, familiarity with a corporation's name or product has seemed more important than its balance sheet.

This opportunity to participate in the USA economy through purchasing bonds of USA corporations seem to have caught the eye of foreign investors and has allowed these corporations to raise large sums of money in a short space of time.

The USA bond rating services and the detailed financial disclosures which are available to USA investors in bonds are not used widely by the Eurobond investors. Smaller companies attempting a Eurobond issue would probably need more selling by underwriters and issue managers and may have to offer more favorable terms.

The earliest Eurobond issues were straight, medium and long term bonds. However, the convertible bond with its relationship to equity is now the most profitable means of investing in the international capital market and of hedging against inflation. These convertible issues have become so popular that straight debt issues have recently proved difficult to place. It is noteworthy that the $50 million issue of General Electric Overseas Capital Corporation in 1965 was a convertible.

Convertible bonds may be issued on a significantly lower yield basis than straight long term bonds. The interest coupon may be as much as two percentage points lower (7% for straight debt; 5% for convertible) because of the conversion feature, while the potential dilution of equity is unlikely to be significant to a large company.

Eurobonds are issued as bearer securities with coupons attached, and the issue is arranged so as not to require the deduction of withholding taxes from interest payments. For this purpose, a USA corporation can pay interest without deduction of withholding taxes if it is an "80-20" company: that is, 80% of its annual gross revenues are derived from outside the United States. USA corporations may establish a domestic financing subsidiary if it can be qualified as an "80-20" company. Otherwise the issue would be handled through a foreign financing subsidiary domiciled in a country where there is no requirement to deduct withholding taxes.

Eurobonds are normally unsecured and rank equally with other borrowings. When a financing subsidiary is used to float the issue, an unconditional guarantee is given by the parent company. Interest is usually paid by redemption of coupons since investors seem to prefer receiving interest in this way rather than by a discount from the issue price.

However, issues are sold at a discount even if it is only slight. Bonds usually mature in five to 20 years, provide for sinking fund payments and may be called for redemption earlier than maturity.

Although Eurobond transactions are over the counter, it is generally accepted that listing on a recognized exchange is helpful for a successful issue. Most quotations are based on over the counter deals. A listing has the advantage of giving the bonds and the market publicity, as well as keeping bond holders and investors informed of current quotations.

There are two other types of issues which have been used to borrow money in the international capital market. One is short term notes up to five years, which are comparable to Eurobonds, but have no provisions for sinking fund payments. The other is bonds with warrants attached.

Short term notes were first used when the long term bond issues dropped in price in 1966 following a rise in interest rates and a lull in the New York stock market. This made short term notes preferable to investors as they have less exposure to price fluctuations.

Bonds with warrants attached are not very common. Their principal purpose has been to float bonds which needed equity participation to attract investors. The detachable warrants, which could be traded separately, provided for an extended call at a fixed price on the common stock of the issuing corporation. This equity feature lowered the interest cost, as it does with a convertible issue.

Many corporations are borrowing for the future and therefore need to invest funds obtained from a Eurobond issue which are surplus to their immediate requirements. The Eurodollar market, with its short term investment facilities, is convenient for such investments.

One of the most popular of these investments is the Eurodollar certificates of deposit or, as they are called, London CDs. These were first issued in 1966 by The First National City Bank in London, which currently has some $750 million outstanding. Investment bankers created a secondary market and gave the London CDs their marketability, making them more attractive to investors than straight time deposits.

London CDs are usually issued in denominations starting at $25,000 and increasing in $1000 steps; however, denominations as low as $10,000 have been issued. Their term is usually up to one year and interest rates are determined at the time of issue.

Depending upon the needs of the corporation and the conditions of the market, straight time deposits of Eurodollars may be more suitable.

The Eurodollar market has an advantage over the USA banking system in that foreign banks are not subject to Regulation Q of the Federal Reserve Act, which controls interest paid on dollar deposits in the USA and prohibits the payment of interest on deposits of less than 30 days. Eurodollar interest rates tend to be higher than rates in the USA.

Although corporations are borrowing more long term funds in the international capital market through Eurobonds, the continuing availability of short and medium term funds in the Eurodollar market must not be overlooked. Nor should the opportunity to arrange reserves of Eurodollars through a line of credit or a revolving commitment be passed up when future short term financing is needed but the exact timing is uncertain. Many USA banks have opened up branches in Europe to service their clients with foreign operations in this market.

Most participants in the Eurodollar and international capital markets have confidence and enthusiasm for their continued expansion and success. If these agencies continue the present policy of non-intervention in the markets, this confidence would not appear to be unfounded.

But the markets must also depend very much on the stability of the international monetary system and on the world's confidence in the dollar.

This year's currency crisis might make one wonder about that, as does the much publicized adverse USA balance of payments situation. However, this year's large volume of USA dollar Eurobond issues by USA subsidiaries must be some kind of vote of confidence by those who control the purse strings.