CHAPTER 1

EUROCURRENCY MARKET

1.1 INTRODUCTION:

It is a market for Borrowing and Lending of currency at the center outside the country in which the currency is issued. It is different than the Foreign Exchange Market, wherein the currency is bought and sold. Euro (€) is a single currency which was launched on 1st Jan’1999. (With 11 of 15 member countries of the European Union participating in the experiment). Now Euro (€) is the official currency of 16 of the 27 member states of the European Union (EU). These 16 states include some of the most technologically advanced countries of the European continent and are collectively known as the Euro zone. The Euro is an important international reserve currency. Euros have surpassed the US dollar with the highest combined value of cash in circulation in the world. The name euro was officially adopted on 16 December 1995. The euro was introduced to world financial markets as an accounting currency on 1 January 1999, replacing the former European Currency Unit (ECU) at a ratio of 1:1.

The currency was introduced initially in non-physical forms, such as travellers’ checks and electronic bank in Euro coins and banknotes entered circulation on 1 January 2002. The Euro is administered by the European Central Bank (ECB) based in Frankfurt, and the Euro system, comprising of the various central banks of the Euro zone nations.

A one-euro coin is shown. The euro is used throughout Europe as an international currency. The symbol of the euro is €, the letter "E" with one or two cross lines.

The states, known collectively as the Eurozone: are Austria, Belgium Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain. The currency is also used in a further five European countries, with and without formal
agreements, and is consequently used daily by some 327 million Europeans. Over 175 million people worldwide use currencies which are pegged to the euro, including more than 150 million people in Africa.

The most important implications of having a common currency, the Euro, are:

- Exchange rate certainty while travelling across Europe
- No exchange risk and, therefore, no cost of hedging against it
- No transaction costs
- Increased transparency and fewer transactions for importers and exporters
- Increased liquidity in the ‘United Euro’ financial market

1.2 HISTORY OF EUROCURRENCY MARKET:

After World War II, the amount of US Dollars outside the United States increased enormously, both as a result of the Marshall Plan and as a result of imports into the USA. As a result, large sums of US Dollars were in custody of foreign banks outside the United States. Many foreign countries, including the Soviet Union, had deposits in US dollars in USA banks.

After the invasion of Hungary in 1956, the Soviet Union feared that its deposits in American banks could be frozen as retaliation. A British bank offered the Soviets the possibility of receiving its US Dollar reserves as deposits, outside the USA. This operation was considered the first to create so-called Eurodollars.
Gradually, as a result of the successive commercial deficits of the United States, the Eurodollar market expanded until today where it is available in virtually every country. Today, Eurocurrency refers to deposits in any currency residing in banks that are located outside the borders of the currency’s country. For example, a deposit denominated in Yen residing in an Australian bank is a Eurocurrency deposit, or more specifically a Euro Yen deposit. Similar external deposits apply to Euro Sterling, Euro Euro, Euro Swiss Franc, etc.

While opening up of the domestic markets began only around the end of seventies, a truly international financial market had already been born in the mid-fifties and gradually in size and scope during sixties and seventies.

This refers to the well-known ‘Eurocurrencies Market’. It is the largest offshore market. Prior to 1980, Eurocurrencies market was the only truly international financial market of any significance. It is mainly an inter-bank market trading in time deposits and various debt instruments. What matters is the location of the bank neither the ownership of the bank nor ownership of the deposit.

1.3 HISTORICAL EVENTS:

1. British restrictions on lending 1957:
   The Eurocurrency market received a major push in 1957 when the British government prohibited British banks from lending British pounds to finance non-British trade, a business that had been very profitable for British banks. British banks began financing the same trade by attracting dollar deposits and lending dollars to companies engaged in international trade and investment. Because of this historical event, London became, and has remained, the leading center of Eurocurrency trading.

2. US Restrictions on lending 1960:
   The Eurocurrency market received another push in the 1960s when the US government enacted regulations that discouraged US banks from lending to non-US residents. Would-be dollar borrowers outside the United States found it increasingly difficult to borrow dollars in the United States to finance
international trade, so they turned to the Eurodollar market to obtain the necessary dollar funds.

The US government changed its policies after the 1973 collapse of the Bretton Woods system, removing an important impetus to the growth of the Eurocurrency market.

3. **Oil Price 1973-1980:**
   The oil price increases engineered by OPEC in the 1973-74 and 1979-80 periods, gave the market another big shove. As a result of the oil price increases, the Arab members of OPEC accumulated huge amounts of dollars. They were afraid to place their money in US banks or their European branches, lest the US government attempt to confiscate them. (Iranian assets in US banks and their European branches were frozen by President Carter in 1979 after Americans were taken hostage at the US embassy in Tehran; their fear was not unfounded.) Instead, these countries deposited their dollars with banks in London, further increasing the supply of Eurodollars.

   Although these various political events contributed to the growth of the Eurocurrency market, they alone were not responsible for it.

   The market grew because it offered real financial advantages—initially to those who wanted to deposit dollars or borrow dollars and later to those who wanted to deposit and borrow other currencies.

**1.4 ORIGIN OF EUROCURRENCY MARKETS:**

During 1950s, Russians were earning dollars from the sale of gold and other commodities and wanted to use them to buy grain and other products from the West, mainly from the US. However, they did not want to keep these dollars on deposits with the banks in New York, as they were apprehensive that the US government might freeze the deposits if cold war intensified. They approached banks in Britain and France who accepted these dollar deposits. Later on till 1980s, such deposits were by and large in Europe only. So words coined were Euro Yen, Euro Rupee; in general; Eurocurrency deposits. Since 1990, the markets have expanded geographically and also in volume, but the prefix ‘Euro’ has still remained. Eurocurrency markets are in all the countries having significant international transactions and capital flows. Eurocurrency does not any longer
Eurodollar or Eurocurrency refers to bank time deposits in a foreign currency i.e. currency other than that of the country in which the bank or bank branch is located. Euro currency market is the market for such bank deposits. This prefix Euro should not be confused with the European single currency ‘Euro’. Even ‘Euros’ deposited outside Europe are called as Euro Euros.

1.5 CHARACTERISTICS OF EUROCURRENCY MARKETS:

The various characteristics of Eurocurrency Markets are:

1. **Unregulated Market:**
   
   It is a cross border market. Hence no government has full control over the transactions. Hence transacting entities escape from most of the stringent provisions and regulations. (Absence of) following regulations is specifically important:

   a. No reserve requirements
   b. No interest rate regulations or caps
   c. No withholding taxes
   d. No deposit insurance requirements
   e. No credit allocation regulations
   f. Less stringent disclosure requirements

   Government interference is minimal. Thus it is an unregulated market.

2. **Short Term Deposits and Long Term Loans:**
Deposits in Eurocurrency markets are primarily for short term. Eurocurrency loans however are for longer period of time. This leads to asset-liability duration mismatch problem for the banks.

3. **Largely wholesale market:**
   Transactions in Eurocurrency markets are very large. They are mostly within Banks and Governments, Public Sector Organizations and large MNCs. This makes the market a wholesale rather than a retail market. Also, approximately 80% of the Eurodollar market is interbank, which means that the transactions take place between banks. This also underline the near-absence of default risk in Eurocurrency Markets.

4. **Time Deposits:**
   The Eurocurrency market exists for savings and time deposits (time deposits in Indian context are popularly called as ‘fixed deposits’ and ‘recurring deposits’ in banks.) There is hardly any space in Euromarket for demand deposits (what we call as current account in banks).

5. **Eurodollar and LIBOR based market:**
   Eurocurrency interest rates are tied to a variable rate base such as the London Interbank Offer Rate (LIBOR). This reduces interest rate risk. Market is largely dominated by US Dollars over other currencies. Following breakup shows the presence of each currency.

![Currency Breakup Chart]

**1.6 PARTICIPANTS IN EUROCURRENCY MARKET:**
EUROCURRENCY MARKET

- Government
- International Organizations
- Central Banks
- Commercial Banks
- Corporations
- MNC
- Traders
- Individuals

1.7 PARTICIPANTS HAVE CONTRIBUTED IN THE DEMAND AND SUPPLY OF THE FUND, IN THE FOLLOWING WAY:

SUPPLY:

Central banks of various countries are the suppliers; they channel the fund through BIS. Increase in the Oil Revenue of the OPEC has added to the fund. MNCs and the traders place their surplus funds for the short-term gains.

DEMAND:

Government demand for these funds to meet the deficit arising due to the deficit in Balance of Payment and the rise in the oil prices. Commercial Banks needs extra funds for lending. Some also borrow for the better ‘window dressing’ in the year-end

1.8 FUNCTIONS OF EUROCURRENCY MARKETS:

The following are some of the functions of the Eurocurrency markets:

1. **Cheap Source of working capital:**
   Eurocurrency loans attract lesser interest rate than the loans of the domestic economy. This is because overhead costs are low. Since dealings are between banks with good credit rating, the costs of credit checking and processing are less. Lending rates can thus be fixed lower than domestic market.
2. **Liquidity:**
   Financial institutions find it highly profitable to hold their idle resources in Euromarkets. As there are fewer restrictions in the markets, investors can make investments in bearer securities. It has an advantage in the form of absence of tax withholding on interest. Most of the Euro deposits have maturities ranging from less than a day to few months. On an average 80% of these deposits have maturity of six months.

3. **Facilitates International Trade:**
   Eurocurrency markets provide easy loans, which facilitate international trade. Most banks prefer this form of financing to traditional forms (such as letter of credit). It’s mainly for two reasons: (i) Lower interest rate and (ii) easy procedural formalities.

   Eurocurrency markets create effective linkages between national markets and facilitate international trade as well as capital flow. It is shown in the following schematic diagram:
1.9 COMPONENTS (COMPOSITIONS) OF EUROCURRENCY MARKETS:

Composition is described in 3 areas, viz., (A) Market Participants, (B) Euro financial-Instruments and (C) Transactional Structure

A. Market Participants:
1. Commercial Banks:
   Commercial banks form the institutional core of the market.

Banks enter the euro-currency market both as depositors and as
lenders. Around twenty of the world’s biggest banks play a dominant role in the Euromarket. They attract a disproportionate volume of primary deposits which are then re-lent to other Eurobanks. These banks link the external with the domestic market, taking funds from one and placing them in other market. The breadth and depth of the interbank market enable banks to adjust liquidity positions with great ease.

2. Corporate:  
Corporations borrowing Eurocurrencies are mainly those whose name, size and good standing enable banks to make loans to them with little more than a superficial analysis of creditworthiness. But more recently the range of corporate and government borrowers has widened to embrace less good names. The main reason for this is the vast amount of funds available for lending.

3. Governments and central banks:  
Governments and central banks are also lenders in the Eurocurrency markets. In addition, international institutions such as the World Bank and various regional development banks, and institutions associated with the EU, have been regular borrowers. In the last decade the market has also seen an expansion in government and government-related borrowers. This is especially true of the medium-term EuroCredits market, which has become widely tapped for infrastructure projects and for financing balance of payments deficits.

4. Private Individuals:  
Private individuals are minor participants in the Eurodollar markets. High net worth individuals have, however, always been significant participants as investors in the Eurobond market, where the fact that payment of interest is gross of tax (without deduction of tax) and securities are bearer securities gives the market anonymity and an obvious attractiveness from a tax point of view.
B. Euro financial-Instruments:

1. Eurodeposits:
   Most deposits in the Eurocurrency market are time deposits at fixed interest rates, usually of short maturity. Around three-quarters of deposits in London Eurobanks have maturities of less than three months. Many of these deposits are on call; thus they can be withdrawn without notice. Most of the time deposits are made by other bank, but many are made by governments and their central banks as well as Multinational Corporation. A few are made by wealthy individuals, often through a Swiss bank. Deposits come in many forms. Besides negotiable Eurodollar certificates of deposit (sometimes termed London dollar CDs), there are various similar certificates of deposit.

2. Euroloans:
   Many Eurodollar loans are direct, bank-to-customer credits on the basis of formal lines of credit or customer relationships. However, the market has developed the technique of loan syndication for very large currencies. Interest on syndicated loans is usually computed by adding a spread to LIBOR, although the US prime rate is also used as a basis for interest pricing. LIBOR interest rates change continuously.

3. Eurobonds:
   Eurobonds are international bonds denominated in a currency different from that of the country in which they were issued. Eurobonds are transferable securities, and the Eurobond market is a significant factor in international finance; the size of the international Eurobond market exceeds that of the U.S. bond market.

4. Other Instruments:
   Other Euro financial instruments include Euro commercial papers, Euro certificates of deposits, etc.
C. Transactional structure of Euro Markets:

The Euro currency market is entirely a wholesale market. Transactions are rarely for less than $1 million and sometimes they are for $100 million. Like the foreign exchange markets, the vast bulk is confirmed to inter-bank operations. The largest non-banking companies have to deal via banks. Borrowers are the very highest pedigree corporate names carrying the lowest credit risks. The market is telephone linked or telecommunication linked and is focused upon London, which has a share of around one third of the Eurocurrency market. All Euro-currency transaction are unsecured credits, hence the fact that lenders pay particular attention to borrowers status and name.

1.10 ADVANTAGES AND DISADVANTAGES OF EUROCURRENCY MARKET

ADVANTAGES OF EUROCURRENCY MARKET:

1. It helped the economics to solve the liquidity problems:
2. It provided better investment opportunities.
3. Funds are also by the commercial banks of various countries for domestic credit creation and window dressing.
4. This facilitated the growth and development of various countries like Brazil, South Korea, Taiwan and Mexico etc.
5. Its international acceptance has helped in the international trade to expand and accelerated the process of globalization.

**DISADVANTAGES OF EUROCURRENCY MARKET:**

1. For many economies it a new concept.
2. For many economies also considered that the speed of its growth or expansion is Too fast.
3. For many economies, they feel this market gives a chance to avoid many a regulations that they try to impose on their national money market.
4. Affects international monetary stability

**1.11 RISKS OF EUROCURRENCY MARKETS:**

The unregulated environment dictates many risks such as

1. Foreign exchange volatility risk
2. Individual bank risk
3. System risk
4. Uncertainty in the interaction of legal system between host country and home currency
5. Unsecured credit transaction risk

**1.12 FINANCIAL ADVANTAGES:**

1. **Lack of Regulation:**
   Prime advantage is lack of government regulation. This is mainly related to Cash Reserve Ratio (CRR) and disclosure requirements.

2. **Higher Interest rate on deposits:**
Lack of regulations allows banks to offer higher interest rates on Eurocurrency deposits than on deposits made in the home currency, making Eurocurrency attractive to those who have cash to deposit.

3. **Lower interest rate on loans:**

The lack of regulation also allows banks to charge borrowers a lower interest rate for Eurocurrency borrowings than for borrowing in the home currency, making Eurocurrency loans attractive for those who want to borrow money.

In other words, the spread between the Eurocurrency deposit rate and the Eurocurrency lending rate is less than the spread between the domestic deposit and lending rates.

### 1.13 EURO CURRENCY NOTES MARKET:

Euro – notes are instruments of borrowing issued by borrowers directly to investors without using banks as intermediaries, with or without the underwriting support to the issue.

They have shorter maturities than bonds. Maturities normally range from 15 days to five years. There are five types used in this market.

1. **Banker’s Acceptance (BA):**

   This instrument is used to finance domestic as well as international trade. On completing the transaction, the exporter hands over the shipping documents and letter of credit (LC) issued by the importer’s bank to its own bank. At the same time, the exporter draws a draft (or bill) on the importer’s bank and gets paid the discounted value of the draft. A banker’s acceptance (BA) is created when the exporter’s bank presents the draft to the importer’s bank which ‘accepts’ it. This BA may be sold (or discounted) as a money market instrument or the exporter may keep it as an asset with himself. BAs are highly standardized negotiable instruments and are available in varying amounts. They permit importers and other users to obtain credit on better terms than simple borrowing.
2. **Euro Commercial Paper (ECP):**

   Euro Commercial Paper is a short-term Euro note issued by corporate on a discount-to-yield basis. Investors in ECP may be money market funds, insurance companies, pension funds and other corporate bodies having short-term cash surpluses. Before ECP came into existence, its domestic version, called simply commercial paper (CP) had been in existence for quite some time. For investors, it represents an attractive short-term investment opportunity, unlike a time deposit with financial institutions. For borrowers, it is a cheap and flexible source of funds, cheaper than bank loans. As mentioned above, a CP or ECP is a discount instrument, purchased at a price below its face value and redeemed at face value on maturity. For example, an ECP issued at $952.4 with a maturity of 180 days will have a face value of $1000, if the discount rate is 10 per cent p.a.

3. **Euro Certificate of Deposit (ECD):**

   A Certificate of Deposit is an evidence of a deposit with a bank. CD is a negotiable or marketable instrument. Unlike a bank term-deposit, a CD can be sold in the secondary market whenever cash is needed. Whoever is holding it at the time of maturity receives its face value in addition to the interest due. Euro CDs are issued by London banks. The interest on floating rate CDs is indexed to LIBOR and Treasury Bill rate, etc. These instruments may be issued in sum like $100000 or more. For fixed rate CDs, usually there is a single period maturity when principal and interest rate paid. As regards floating rate CDs, their time-span is divided into sub-periods of usually six months, when the rates are reset.

4. **Repurchase Obligation (REPO):**

   This is a form of short-term borrowing in which the borrower sells securities to the lender with an agreement to the lender with an agreement to buy them back at a later date. That is why it is called REPO. The repurchase price and selling price are the same. But the original seller has to pay interest while repurchasing the securities. The amount of interest depends on demand-supply conditions. Repos may be overnight repos or of longer maturity.
5. Notes issuance facility (NIF):

In situations where borrowing entity requires resources for the medium term but investors desire to invest on short term basis, the reconciliation is brought about through this. The borrower issues short term notes supported by underwriting from banks. The notes are redeemed on maturity by issue of fresh notes. Shortfalls in subscriptions are covered by the underwriters.

1.14 EURO CURRENCY CENTERS

<table>
<thead>
<tr>
<th>Country</th>
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<tbody>
<tr>
<td>India</td>
<td>Rupee</td>
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<td>United States</td>
<td>Dollar</td>
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<td>Euro Member</td>
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<td>Japan</td>
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<td>Switzerland</td>
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<td>Australia</td>
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Austria
Austrian Schilling

Belgium
Belgian Franc

Netherlands
Dutch Guilder

France
French Franc

Germany
German Mark

Italy
Italian Lira

Portugal
Portuguese Escudo

Spain
Spanish Peseta

1.15 FIVE COUNTRIES RESPONSIBLE FOR THE GROWTH OF
THE EURO-CURRENCY MARKET:

- China (fear that its Fx in USD would be blocked)
- USA (indeed blocked identifiable Fx in USD in 1950, federal Reserve Act, regulation ‘Q’ and ‘M’; control and restrictions on borrowing funds in US in 1965, and introduction of interest equalization tax in 1963)
- Korea (War broke out in 1950)
- Russia (erstwhile USSR) {because of their banking presence in Paris and London}
- UK (policy of not granting sterling loan outside sterling area in 1957)

1.16 GROWTH OF OTHER EURO INSTRUMENTS:

It is obvious that a bank cannot just accept deposits. It has to lend money in the market and has to earn interest. The banks which accepted Eurodeposits started lending in foreign currencies i.e. euro currencies. Thus it was the beginning of EuroCredits or Euroloans. Corporate and merchants started borrowing from the banks in euro currencies for short, medium as well as for long terms.

As it was possible for a corporate to borrow from a bank in euro currency, they also started innovating other euro instruments. They started issuing bonds and
commercial papers in domestic markets but denominated in foreign i.e. euro currencies. This was called as **Eurobonds** and **Euro Commercial Papers**. Very soon, it was possible to issue any instrument in euro currency and was titled accordingly.

Russia was just a visible starting reason. However, market always needed Eurocurrency when it started. Mainly 3 factors are listed below.

### 1.17 FACTORS RESPONSIBLE FOR ORIGINATION AND GROWTH OF EUROCURRENCY MARKETS:

Factors related to the USA:

1. **Less Willingness of countries to hold dollars in USA-Based Banks:**
   The centrally planned economies were reluctant to hold bank deposits in the United States, so they put their dollar earnings on deposit in London. Gradually other European dollar holders did the same, a tendency that was particularly marked when the United States ran large balance of payment deficits.

2. **Regulation Q in the USA:**
   The growth of the Eurocurrency market was also stimulated by certain monetary regulations in the United States. There was a regulation called as ‘Regulation Q’ which had put a ceiling (upper limit) on the interest rates that banks operating in the United States could offer on domestic deposits. So, such depositors were naturally attracted to Eurobanks that were not bound by Regulation Q. In addition, banks in the United States were required to hold non-interest-bearing reserves. By diverting dollar deposits to their offshore branches or subsidiaries, U.S. banks were able to avoid tying up so much of their funds in reserve requirements at a zero rate.

3. **Capital Controls in USA:**
General controls on the movement of capital also helped to boost the Eurocurrency markets. One example was the introduction, in 1965, of the Voluntary Foreign Credit Restraint Program (VFCR) in the United States. The specific goal of the VFCR was to limit the growth of foreign lending by U.S. banks. Instead, their foreign branches—which were not subject to the VFCR—took deposits and lent them outside the ceiling. Between 1964 and 1973 the number of U.S. banks with overseas branches increased from 11 to 125. The number of branches increased from 181 to 699 over the same period.

Factors related to other countries:

4. Restrictions in UK:
   Balance of payments pressures made the United Kingdom government limit British bank’s external use of sterling, so they had a strong incentive to develop business in foreign currencies.

5. Full Capital Account Convertibility adopted by developed countries:
   By the end of 1958 the main industrial countries had restored full convertibility of their currencies. The new freedom produced a surge of international banking business.

6. Growth of offshore banking and tax heaven concept:
   At the end of the 1960s and during the early 1970s the Eurocurrency markets, which had been located in Western Europe (and centered in London), expanded to a number of other ‘‘offshore’’ banking centers. These were typically small territories that had tax, exchange control, and banking laws favorable to international banks. The business was entrepots in nature, with foreign currency funds deposited by one foreign source and then lent to another. Offshore centers have been set up in the Caribbean area, Latin America, the Middle East, and establishment of international banking facilities (IBFS) in the United States designed to bring the locus of American banking business back ‘‘onshore’’.
CHAPTER 2

EUROCURRENCY FINANCES AND LOANS

2.1 EURO CURRENCY SHORT TERM FINANCE: EURO LOANS:

The borrowings in the international capital markets are in the form of Euro Loans which are fundamentally loans from the bank to the companies which require long-term and medium-term funds. The most significant characteristic of the Eurocurrency market is that loans are made on a floating-rate basis. Interest rates on loan to governments and their agencies, Companies, and nonprime banks are set at a fixed margin above London Inter Bank Offered Rates (LIBOR) for the given period and currency chosen. At the end of each, the interest for the next period is calculated at the same fixed margin over the new LIBOR. The margin, or spread between the lending bank’s cost of funds and the interest charged to borrower’s perceived riskiness. These loans are made to the corporations in the required currency by banks. These loans are basically short-term adaptation for periods less than one year. They are mostly provided in euro dollars. The interest rates on these loans are based on the London Inter Bank Offered Rates (LIBOR) for their respective currencies. LIBOR-represents a rate of interest used in interbank transactions in London. The rate for each currency is arrived at as an average of the lending rates charged by six leading London banks in the interbank market. The borrowers of euro-loans are charged on the basis of LIBOR + depending upon the six months floating interest rates is charged. If these loans are for periods beyond six months, the loan is rolled over and interest is charged on the LIBOR prevailing at the time of rollover.

2.2 FEATURES OF EUROLOANS:

1. Swap:
Swap in loans means ‘you pay for my debt and I will pay for your debt’. So, borrowing companies separate out two things in Euroloans viz., getting the loan (sourcing or borrowing) and second is servicing the loan (paying interest and principal amount). They borrow in a currency in which it will be easier and less costly for them to raise money in the prevailing market conditions. Simultaneously, they arrange a swap to transform a debt denominated in one currency into a liability denominated in a different currency. Swap can be interest rate swap or currency swap.

Swaps make the choice of borrowing and servicing of debt very convenient.

2. Syndicated loans:

Many times, Euroloan amount is too large for a single bank to lend. This is specifically so when the loan is to a corporate for the purpose of acquiring another company. Such loans are given by a group of banks which is called as ‘a syndicate’. These Euroloans are called as syndicated loans. One bank undertakes responsibility of forming the syndicate and coordinating them. Such bank is called ‘Lead Manager’ or ‘Lead arranger’. Then there is an underwriting bank which agrees to lend the balance portion of loan after other banks agree to specific
EUROCURRENCY MARKET

amounts. Other banks which lend specific amount or portion are called as participating banks. The lead manager negotiates with the borrower and other banks about terms and conditions of the loan; there might be more than one lead manager in a syndicate. There is also an agent bank that acts on behalf of the syndicate in the administration of the loan: it collects and disburses payments. Depending on the size of its share, a participating bank might have the title of senior manager or manager in the syndicate.

The fees involved in syndicated loan are an establishment fee, legal fees and Administration fee payable to the agent bank. The borrower and the lenders can negotiate a particular principal repayment schedule.

3. **Transferable Loan Certificates:**

Euroloans are given by the banks in the form of Transferable Loan Certificates (TLCs). This certificate enables the lending bank to remain as lender till desires to remain so. Anytime during the tenure of loan, participating bank can sell the TLC to another new bank. Thus the earlier bank gets the loan amount back and the buying (new) bank becomes the new lender. Such sell does not require consent of the borrower. This sell-down provision in the loan agreement allows the lender to take the loan asset off its balance before maturity. The agent bank then registers the buyer as a new lender: a process referred to as ‘secondary syndication’. Trading in syndicated banks turns these illiquid assets on bank balance sheets into liquid ones and, therefore, lowers borrowing rates. At present, it is mostly a banking market, but there is a potential of growing supply of capital form a broader base of financial intuitions, including pension funds and insurance firms. To aid the development of a structured and liquid secondary market for syndicated loans, specialized trading organizations have been established the loan Market Association (LMA) in London, the loan syndication and trading Association (LSTA) in New York and &e Asia Pacific Loan Market Association (APLMA) in Hong Kong (APLMA) has branches in Singapore and Sydney.

4. **Lending Rate:**
Euroloan is a floating-rate loan with an interest rate as Reference Rate (usually LIBOR) plus Lending Margin.

For example, if the interest period of a loan is six months, the references rate is LIBOR and the lending margin is 100bps (100 basis points means 1%), then at the beginning of every six-month period, the lending rate will be recalculated as the current six-month LIBOR for the appropriate Eurocurrency plus 100bps. In some cases, the lending margin is fixed for a particular period of time: say, 75bps for the first year and 60bps for the following years. The precise margin depends on the lender’s credit assessment of the borrower as well as on the condition of the market (demand versus supply of loan able fund). The most common reference rate is LIBOR for the issue’s currency.

It is seen that Eurodeposits get better (higher) interest from banks and Euroloans have a lower interest rate as compared to domestic markets.

2.3 BENEFITS OF EUROLOANS (EUROCREDITS):

Benefits (or motives) of borrowers from Euroloans are shown in the following diagram:
2.4 EURO CURRENCY SHORT TERM FINANCE: EURO COMMERCIAL PAPER (ECP)

Commercial paper refers to short-term securities from seven days to a few years, issued by private companies. Just as euro-bonds are the disintermediated version of long term euro-bank loans, euro commercial paper (ECP) forms the disintermediated counterpart of short-term bank loans. Euro commercial paper is a floating Eurocommercial promissory note. These notes are issued at discount on their face value and such discount represents the profit to the investor. These ESP’s are also issued for less than one year between 7 to 365 days. They offer a high degree of flexibility to the borrower with wide ranging alternative of amounts and maturities. They are thus tailor made to take into account the specific needs of the borrower. It is quite common for an ECP issuer to follow it up with Euro Bond/Equity Issues. ICICI was the first Indian institution to obtain finance through ECP in 1987. ECP markets have existed in an emergent form ever since banks drew promissory notes on their borrowers as a way to confirmed loan agreements. But the market became significant only in the eighties, when, as part of the universal disintermediation movement, large corporations with excellent credit standing started issuing short-or medium-term paper, which is positioned
with institutional investors. The volume of the market remains low comparative to the bond and bank-loan market.

2.5 FEATURES OF EUROCOMMERCIAL PAPER:

1. The market consists of notes, promissory notes, and CD’s. Notes are medium-term paper with maturities from 1 to 7 years, usually paying out coupons. Promissory notes have shorter lives, sometimes as short as 7 days, and are issued on a discount basis, that is, without interim interest payments and with par value.
2. Although an ECP issue can be a one-time affair, many issuers have an ECP-program contact with a syndicate.
3. A bare-bones ECP program just eliminates the botheration of getting a syndicate together each time commercial paper needs to be placed;
4. But many program contracts also offer some form of underwriting commitment. Such a commitment can stipulate the following terms:
   a. A fixed spread (for example 0.5% above LIBOR; this is called a Note Issuing Facility (NIF).
   b. A capped spread; this is called a Revolving Underwritten Facility (RUF).

2.6 EURO MEDIUM TERM FINANCE:

1. **Syndicate Loans:**
   As the size of the individual loans increased, individual banks found it difficult to take the risk single handed. Regulatory authorities in most countries also limit the size of the individual exposures. Hence the risk was required to be shared by a group of banks termed ‘syndicate’.

   A loan syndicate refers to the negotiation where borrowers and lenders sit across the table to discuss about the terms and conditions of lending. Syndication works on the principle of risk spreading and benefits the lenders as borrowers.

   These are loans given by syndicates of banks to the borrowers. They bear a variable rate of interest LIBOR. They are attached to specific project in case of corporations. Government can also borrow syndicate loans. But such loans are not attached to definite projects. They can be even used to meet balance of payment difficulties.
PROCESS OF LOAN SYNDICATION:

2. Revolving Underwriting Facility (RUF):
   A RUF is a provision in which a borrower issues on a revolving basis bearer notes, which are sold to investors either by placing with an agent or through tenders. The investors in RUF undertake to make available a certain amount of funds to the borrowers up to a certain date. The borrower is free to draw down repay and redraw the funds after giving due notice. The London branch of the State Bank of India provided the first RUF in 1984 to an Indian borrower.

3. Euro-Medium Term Notes (MTNs):
   The medium term notes have maturity from 9 months to 20 years. There is no secondary trading for MTNs. Liquidity is provided by the commitments from dealers to buy back before maturity at prices, which assure them of their spreads. These are issued just like Euro-commercial paper. The issuer enjoys the possibility of issuing them for different maturity periods. Companies use these notes. The sums involved vary between $2 & $5 million.

2.7 EURO LONG TERM FINANCE:

Two kinds of bonds are floated in international bond market.
1. **Euro-bonds** underwritten by an international syndicate and placed on the market of countries other than that of the currency in which the issue is made.

2. **Foreign bonds** issued on the market of a country and bought by non-resident in the currency of that country.

A Eurobond is distinguished from a foreign bond as it is denominated in a currency other than the currency of the country in which it is issued. Eurobonds are sold to international borrowers in several markets simultaneously by international group of banks. The same causes, which led to the growth of Eurocurrency market, have also contributed to the development of Eurobond market. But the size and growth rate of this market are modest compared to Euromarkets. In spite of that, it has established itself as a major source of financing for multinational corporations. In addition MNCs, private enterprises, financial institutions, government and central banks and international financial institutions like the World Bank are the principal borrowers. They issue these bonds. Institutional investors such as insurance companies, mutual funds, pension funds etc are the principal buyers/investors. Leading multinational banks and brokerage house also act as lenders. Since it is free from regulations that characterize the US market, MNCs exploits the control-free environment. An international syndicate representing major European banks and European does underwriting of bond issue and foreign branches of US banks with participation from banks in other financial centers in Asia, the Middle East, and the Caribbean’s as well as large international securities firms.
### 2.8 DISTINCTION BETWEEN EUROBOND AND EUROCREDIT:

<table>
<thead>
<tr>
<th></th>
<th>Eurobonds</th>
<th>Eurocredit (Eurocurrency loans)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Cost of Borrowing:</strong></td>
<td>Eurobonds are issued in both fixed and floating rate forms. Fixed rate bonds are attractive exposure management tool since known long term currency inflows can be offset with known long-term outflows in the same currency.</td>
<td>Interest rate on Eurocredit is variable. It is better hedge for non-contractual currency exposures.</td>
</tr>
<tr>
<td><strong>2. Maturity:</strong></td>
<td>Longer maturities</td>
<td>Relatively shorter maturities</td>
</tr>
<tr>
<td><strong>3. Size of Issue:</strong></td>
<td>Till 1983, Eurocredit market was far bigger than Eurobonds. As corporate started realizing saving of cost in issue process of bonds, the size expanded dramatically.</td>
<td>Now, it’s a size competition between the two markets.</td>
</tr>
</tbody>
</table>
4. Flexibility:
   Funds must be drawn down in one sum on a fixed date.
   Funds can be repaid according to a fixed schedule. Prepayment can be with substantial penalty.

   | Draw down for Eurocredit can be staggered to suit borrower’s needs |
   | Can be prepaid in full or in part often without penalty |

5. Speed:
   Eurobonds take more time to issue because of procedures. This difference is vanishing very fast.
   This difference is vanishing very fast.

   | Internationally known borrowers can raise funds in Eurocurrency market very quickly, often within two or three weeks of the first request |

CHAPTER 3
INTERNATIONAL BOND MARKETS

3.1 INTRODUCTION:
Before discussing Eurobonds, it would be appropriate to understand what is bond, in general.

Term loans are borrowed by corporate from banks. Banks are intermediaries. General public deposits their money to the bank. Bank pays some interest to them. Banks lend the same money to corporate at a higher rate on interest. In this process depositors earn less interest and corporate pay higher interest to banks. This is because the bank makes the differential profit.
The alternative way to corporate is to borrow directly from public. Public would withdraw its money from bank and lend it to corporate directly. Companies (corporate) offer higher interest to depositors as compared to banks. However, the interest paid is less than what corporate pays to bank to loans. This is a win-win situation for both: banks and depositors. As a receipt of loan given by public, corporate issue a certificate to each individual investor which is called as ‘Bond Certificate’ or just ‘Bond’. Bond is a confirmation that the corporate has borrowed money from you and will pay specified interest to you. It will also return the principal amount after defined period of some years. These bonds are listed on the stock exchanges. In case any person does not want to keep
his investment for so many years, he can sell it to someone else on the stock exchange. The corporate would pay interest to the next (buyer) person.

As a comparison, bonds carry better rate of interest than bank-loan. Bonds are issued to public and loans are borrowed from bank. Bonds are traded on exchange whereas loans are traded within bank’s network.

Indian market does not have matured market corporate bonds. Indian investors are more familiar with Debentures. Debentures are similar to bonds, issued to public. Tenure of bonds is much longer than debentures. More often bonds are secured as compared to debentures.

Bonds are issued domestically and also abroad. Bonds can be issued in home currency or even in foreign currency. Based on this, bonds are classified as follows:

<table>
<thead>
<tr>
<th>Name of Bond</th>
<th>Currency</th>
<th>Issuer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic Bond</td>
<td>Home</td>
<td>Home Resident Corporate or government body</td>
</tr>
<tr>
<td>Foreign Bond</td>
<td>Home</td>
<td>Foreign Entity</td>
</tr>
<tr>
<td>Euro Bond</td>
<td>Foreign</td>
<td>Home Resident or Foreign, Either (If issued by a domestic entity, they are also called as <strong>External Bonds</strong>)</td>
</tr>
</tbody>
</table>

1. **Domestic Bonds:**

   They are issued locally by a domestic borrower and are usually denominated in the local currency.

   **For e.g.** Amoco Canada issues a bond in Canada for placement in the Canadian domestic market, i.e. with investor resident in Canada.

   The issue is underwritten by a syndicate of Canadian securities houses. The issue is denominated in the currency of the intended investors, i.e. CAD.

2. **Foreign Bonds:**
They are issued on a local market by a foreign borrower and are usually denominated in the local currency. Foreign bond issues and trading are under the supervision of local market authorities. For e.g. Amoco Canada, a foreign corporation, issues bonds in the U.S. for placement in the U.S. market alone. The issue is underwritten by a syndicate of U.S. securities houses. The issue is denominated in the currency of the intended investors, i.e. USD.

3. **Eurobonds:**

They are underwritten by a multinational syndicate of banks and placed mainly in countries other than the one in whose currency the bond is denominated. These bonds are not traded on a specific national bond market. For e.g. Amoco Canada, a foreign corporation, issues bonds, in a major international financial center, to be placed internationally. The issue is underwritten by an international syndicate of securities houses. The issue is denominated in any currency, including even the currency of the borrower’s country of incorporation, i.e. CAD.

Foreign Bonds have some exotic names depending on the country in which it is issued.

3.2 **EUROBOND:**

**Definition:** A bond underwritten by an international syndicate of banks and marketed internationally in countries other than the country of the currency in which it is denominated. The issue is thus not subject to national restrictions.

Euro bonds are similar in many respects to the normal domestic bonds. Eurobond market is almost free of official regulation. It is however, self-regulated by the Association of International Bond dealers.

For each currency, the bond markets can be divided into two parts: **the markets within the country of the currency**, namely the domestic and foreign bond markets, and **the markets outside of direct jurisdiction of the country**, that is the Eurobond market. As we have seen, Eurobonds can be denominated in any of the several different currencies. These different markets are linked to one another through the currency swap
market. Swap market provides contracts for future exchange of interest and principal in two different currencies, or alternatively through the long dated forward-exchange market.

3.3 FEATURES OF EUROBONDS:

Eurobonds have several distinguishing features:

1. **Face Value/Par Value:**
   
The face value (also known as the par value or principal) is the amount of money a holder (investor, who is generally a common citizen) will get back once a bond matures. Bond in most cases, is issued at par. A newly issued bond usually sells at the par value. Par value is not the price of the bond. A bond’s price (on stock exchange) fluctuates throughout its life in response to a number of variables. When a bond trades at a price above the face value, it is said to be selling at a premium. When a bond sells below face value, it is said to be selling at a discount.

2. **Coupon (The Interest Rate):**
   
The coupon is the amount the bondholder will receive as interest payments. It’s called a “coupon” because in early days there were physical coupons attached to the bond certificate (which was paper printed in those days, and now are in demat form). The investor had to tear off the yearly coupon and give it to company-office to get interest.

   Most Eurobonds pay interest annually, whereas domestic and foreign bonds pay interest every 6 months. **The coupon is expressed as a percentage of the par value.** Another possibility is an adjustable interest payment, known as a floating-rate bond. In this case the interest rate is tied to market rates through an index, such as the rate on Treasury bills. More often bonds are with fixed rate of interest.

3. **Maturity:**
   
The maturity date is the date in the future on which the investor’s principal will be repaid. Maturities can range generally from 10 years to as long
as 30 years (in some cases bonds of 100 years have been issued). 15 years maturity is more used in case of Eurobonds.

4. **Issuer:**
   Eurobonds are mostly issued by corporate (large MNCs). Other borrowers are governments, international organizations such as World Bank.

5. **Denominations (Currency):**
   Various currencies are commonly used. The U.S. dollar is used the most, denoting 70 to 75% of Eurobonds. Many other Eurobonds are denominated in Euros. The Japanese yen has been used by some firms to denominated debt recently because of its extremely low interest rates.

6. **Secondary Market:**
   Eurobonds have a secondary market. It is different from common stock exchange. The market makers (facilitators to buy and sell) are in many cases the same underwriters who sell the primary issues. A technological advancement called **Euro-clear** helps to inform all traders about outstanding issues for sale, thus allowing a more active secondary market.

7. **Rating:**
   The bond rating system helps investors determine a company’s credit risk. Think of a bond rating as the report card for a company’s credit rating. Blue-chip firms, which are safer investments, have a high rating, while risky companies have a low rating.

   While ratings are available for most Eurobond issues; there has been a tendency of the purchasers to ignore ratings in favour of a well-known name.

8. **Taxation:**
   Eurobonds are not subject to tax and largely free from government regulation.

3.4 **EURO BOND MARKET:**
The Eurobond market consists of several layers of participants. First there is the issuer, or borrower, that needs to raise funds by selling bonds. The borrower, which could be a bank, a business, an international organization, or a government, approaches a bank and asks for help in issuing its bonds. This bank is known as the lead manager and may ask other banks to join it to form a managing group that will negotiate the terms of the bonds and manage issuing the bonds.

The managing group will then sell the bonds to an underwriter or directly to a selling group. The three levels-managers, underwriters, and sellers-are known collectively as the syndicate. The underwriter will actually purchase the bonds at a minimum price and assume the risk that it may not be possible to sell them on the market at a higher price. The underwriter sells the bonds to a selling group that then places bonds with investors. The syndicate companies and their investor clients are considered the primary market for Eurobonds; once they are resold to general investors, the bonds enter the secondary market. Participants in the market are organized under the International Primary Market Association (IPMA) of London and the Zurich-based International Security Market Association (ISMA).

After the bonds are issued, a bank acting as a principal paying agent has the responsibility of collecting interest and principal from the borrower and disbursing the interest to the investors. Often the paying agent will also act as fiscal agent, that is, on the behalf of the borrower. If, however, a paying agent acts as a trustee, on behalf of the investors, then there will also be a separate bank acting as fiscal agent on behalf of the borrower appointed.

3.5 FEATURES OF EURO BOND MARKET:

A Eurobond is an international debt security. Basic characteristics are:

1. Eurobond is transferable.
2. Eurobond are usually bearer securities.
3. Eurobond is intended to be traded.
4. Eurobond is a medium – to long – term debt security.
5. Eurobond is generally launched through a public offering.
6. Eurobond is generally listed on a stock exchange.
3.6 REASONS FOR GROWTH OF EUROBOND MARKET:

1. **Avoidance of legal expenses:**
   As borrowers are generally of good credit standing, euro bonds tend to be unsecured, so that legal costs as well as the expenses of bonding and monitoring are avoided.

2. **Disintermediation movement:**
   Another impetus for the growth of the euro-securities market came from the general disintermediation movement since the mid-70’s.

3. **Income tax evasion:**
   Euro bonds being anonymous bearer bonds make it easier to evade income taxes. Withholding taxes can be avoided by issuing the bonds in tax heavens; and most OECD countries have recently waived withholding taxes for non-residents.

4. **Private placement:**
   Swift and efficient private placement.

5. **Regulations:** Fewer regulations for off-shore public issues because monetary authorities and capital market regulations are less concerned with issues that do not involve their own currency and are not (or not primarily) targeted at local investors

6. **Size:**
   Issues below USD 100 million are rare. The relatively large size of these issues allows low issuing costs.

3.7 THE ADVANTAGES OF THE EUROBOND MARKET TO BORROWERS (CORPORATE):

The Eurobond markets possess a number of advantages for borrowers. These include the following:

a. **Large amounts:**
   Quantum of Money involved in international market is huge. Corporate can successfully issue bonds amounting to big amounts, frequently.

b. **Fewer restrictions:**
The Eurobond market has a freedom and flexibility not found in domestic markets. The issuing techniques make it possible to bypass restrictions, such as requirements of official authorization, queuing arrangements, formal disclosure, exchange listing obligations and so forth, which govern the issue of securities by domestic as well as foreign borrowers in the individual national markets.

c. **Low cost:**

The cost of issue of Eurobonds, around 2.5 per cent of the face value of the issue, is relatively low.

d. **Lower interest paid:**

Interest costs on dollar Eurobond are competitive with those in New York often US multinationals have been able to raise funds at a slightly lower cost in the Eurobond market than in the US domestic market.

e. **Longer Maturities:**

Maturities in the Eurobond market are suited to long-term funding requirements. Maturities may reach thirty years, but fifteen-year Eurobonds are more common. In the medium-term Eurodollar loans. But the longer maturities provide the assurance of funds availability at a know rate.

f. **Sound institutional framework:**

A key features of the Eurobond market is the development of a sound institutional framework for underwriting, distribution and placing of securities.

### 3.8 ADVANTAGES OF EUROBONDS MARKET TO INVESTORS:

There are a number of special characteristics of the Eurobond market which make it particularly attractive to investors. These include the following:

a. **Less tax:**

Eurobonds are issued in such a form that interest can be paid free of income-tax or withholding taxes of the borrowing countries. Also, the bonds are issued in bearer form and are held outside the country of the investor, enabling the investor to evade domestic income tax.

b. **No risk of losing money (creditworthiness is high):**

Issuers of Eurobonds have, on the whole, an excellent reputation for creditworthiness. Most of the borrowers governments, international organizations
or large multinational companies have first-class reputations, the market is very much a name market.

c. **Attractive types of bonds:**
   A special advantages to borrowers as well as lenders is provided by convertible and exchangeable Eurobonds.

d. **Active secondary market:**
   The Eurobond market is active both as a primary and as a secondary market. The secondary market expanded in the late 1960s and early 1970s. Just as telecommunications linkages have integrated foreign exchange markets, so they have integrated the secondary market in Eurobonds. Since 1968 international trading in Eurobonds has been greatly facilitated by a clearing house arrangement formed by Morgan Guaranty Trust Company in Brussels and called Euro clear. This provides liquidity to the investor.

### 3.9 TYPES OF EUROBONDS:

Eurobonds are mostly bearer bonds and are generally denominated in U.S. dollar, issued in the denominations of U.S. dollar 10,000/- The bonds are issued for a period of about 5 to 7 years though in some cases they are issued for a longer duration. The following are the types of bonds.

1. **Straight Bond:**
   It is a fixed income bond. It has annual (or sometimes 6 monthly) payment of coupon interest to the investor. It is issued at par (or at a nominal discount to attract investors). Principal amount is redeemed (repaid) to the investor on maturity (after the complete tenure gets over). Straight bonds are attractive because of known (fixed) periodic income.
2. **Zero Coupon Bonds “Zeros”:**
   Zero coupon bond does not pay any interest during its tenure. The interest is compounded and paid at the end of the tenure, along with principal amount. Most zero coupon bonds are in the form of deep discount bonds. They mature at par and are issued at a discounted price. These bonds are ideal financing instruments for the issuer (company) if the proposed project is not likely to generate good cash flow in the initial years. However, for the investor, they are riskier as compared to straight bonds because no interest is received till maturity.
3. **Partly-paid bonds:**
   These are standard straight bonds. However, the initial payment of principal amount by investors is limited to maximum 33% of the principal amount. The balance (67% or more) is paid six months later. These bonds are popular with issuers who can tailor the second payment to their cash flow requirements.

4. **Bonds with Options:**
   Bonds have long tenures. An option is given to the investor and/or to the issuing company to redeem and close the bond before the tenure. There are two types of bonds in this category, namely, callable and puttable bonds. Option to the issuing company to call back bonds and pay the dues is called as call option. It is a callable bond. Conversely, a puttable bond allows the investor to sell back the bond to the issuer before the date of maturity.

5. **Convertible bonds:**
   A convertible bond is a bond that can usually be exchanged or converted (at the option of the holder-investor) into equity shares or any such security at a fixed conversion rate. Conversion rate is set at the time of issue of bond. Issuers benefit from (1) the lower funding costs relative to short-term money markets and (2) the possibility of no repaying the principal if the conversion right is exercised. Investors benefit because they receive the benefit of regular coupon payments plus the option of converting to equity or any such attractive instrument.

6. **Bonds with warrants:**
   To attract investors to the bond issue, bonds carry a detachable warrant which assures allotment of equity issue for this purpose is indicated at the time of issue of bond. Convertible bonds simply get converted to equity. Warrants are attached to the application of equity, and investors have to pay for it, may be at a lower price.

7. **Dual-currency bonds:**
   Dual-currency bonds are bonds that are purchased in terms of one currency but pay coupons or repay principal at maturity in terms of a second currency. Japanese firms have frequently issued CHF-denominated bonds.
convertible into common shares of a Japanese company. A foreign investor can benefit from purchasing this bond in any one of three situations:

a. A drop in the market interest rate on CHF bonds (as on any straight CHF bond).
b. A rise in the price of the company’s stock (because the bond is convertible into stocks).
c. A rise in the JPY relative to the CHF (because the bond is convertible into a JPY asset).

8. **Composite currency bonds:**
   Are denominated in a currency basket, such as SDRs or ECUs, instead of a single currency. They are frequently called currency cocktail bonds. They are typically straight fixed-rate bonds. The currency composite is a portfolio of currencies: when some currencies are depreciating others may be appreciating, thus yielding lower variability overall.

9. **Parallel Bonds:** In some cases, a firm may issue a variety of bonds in various countries (more or less simultaneously). The currency denoting each type of bond is determined by the country where it is sold. These foreign bonds are sometimes specifically referred to as **parallel bonds**.

10. **Floating Rate Notes (FRN):**

    Bonds having varying interest rates or coupon rates over their life are called as floating rate notes. They are issued with maturity period varying from 5 – 7 years and their rates are linked to six months LIBOR rates. There are four different types of Floating Rate Notes (FRNs) as follows.

    - **Flip Flop FRNs:** The investors have the option to convert into flat interest paying instrument at the end of particular period.
    - **Mix – Match FRNs:** These notes have semi – annual interest payments though the actual rates are fixed monthly. This enables investors to benefit from arbitrage arising out of differential interest rates.
EUROCURRENCY MARKET

- **Mini – Match FRNs:** These notes include both maximum and minimum coupons. The investor will earn a minimum as well as maximum rates on these notes.
- **Capped FRNs:** An interest rate capped is given, over which the borrower is not required to service the notes even if LIBOR moves above that level.

11. **Sinking Fund Bonds:**
These bonds provide for repayment of the principal in installments during the lifetime of the bond. Such bonds are issued by companies with average credit rating. The repayment in installments assured the investors about the solvency and credit worthiness of the issuer. It also helps to progressively reduce the liability of the issuer.

12. **Junk Bonds:**
Companies with very poor credit rating or entering into high risk business ventures issue such bonds. These bonds carry coupon rates of at least 3 – 4% above the normal rates. A characteristic feature of these bonds is the high turnover of investors. Such bonds are used by corporate entities and individuals to make short term gains on temporary surplus liquidity.

13. **Deep Discount Bonds:**
These bonds are also issued at discount and redeemed at the face value, difference in values being the cumulative interest earned by investors at specified rate of interest.

3.10 **FOREIGN BONDS:**
These are bonds issued by borrowers outside their home capital market underwritten by a firm that is situated in the foreign market. These bonds are denominated in the legal tender of the market in which they are issued. At times they may be denominated in another currency. Thus a foreign bond is issued by foreign borrowers and is denominated in the currency of the country in which it is
issued. U.S.A., Japan, Switzerland, Germany and U.K. allow foreign borrowers to raise money from their residents through the issue of foreign bonds.

A foreign bond is underwritten by a syndicate composed of members from a single country, sold principally within that country, and denominated in the currency of that country. The issuer, however, is from another country. A bond issued by a Swedish corporation, denominated in dollars, and sold in the U.S. to U.S. investors by U.S. investment bankers, would be a foreign bond.

Immediately after the Second World War, USA was the primary market for foreign bonds. Due to Interest Equalization Tax imposed in 1963, much of the dollar denominated bonds moved to the Eurobond market. The market trend is that borrowers prefer Euro market rather than the U.S. market. Foreign organizations other than U.S. have extensively floated dollar bonds in the United States taking advantage of the well-developed capital market. US multinational raised substantial amounts capital during 1970s by issuing bonds denominated in D-mark in Germany and bonds denominated in Swiss Francs in Switzerland.

Foreign bonds are referred to as traditional international bonds because they existed long before Eurobonds. Yankee bonds are foreign bonds issued in the United States. Foreign bonds issued in U.K. are called Bulldog bonds. Those issued in Japan are called Samurai bonds.

3.11 TYPES OF FOREIGN BONDS:

1. **Yankee Bonds:**
   These are dollar denominated bonds issued in US market by foreign (non-American) borrowers, with no restriction on size of the issue and maturity.

2. **Bulldog Bonds:**
   Pound denominated bonds issued in the United Kingdom domestic markets by the foreign (non – UK) companies are known as Bull Dog bonds. The
tenure ranges between five to twenty five years. These bonds are subscribed by long term institutional investors such as Pension funds, Life Insurance Corporation of India. They have redemption on bullet basis.

3. Samurai Bonds:
   Yen denominated bond issued in the Japanese domestic markets by the non – Japanese companies are known as Samurai Bonds. The borrowers have a minimum investments grade rating (Grade A). The maturities range between three to twenty years. Since this instrument is for public and the arrangements have to be made for underwriting and selling involving documentation, its issuing costs are the highest.

4. Shibosai Bonds:
   These are yen denominated private placement bonds, limited to financial institutions. Private placement means they are not by general advertisement. They are issued to known groups, which trust the issuing corporate.

5. Kangaroo Bonds:
   A type of foreign bond that is issued in the Australian market by foreign (non – Australian) companies and is denominated in Australian currency. The bond is subject to Australian laws and regulations. These bonds are alternatively known as “Matilda Bond”.

6. Maple Bonds:
   A type of bond that is issued in the Canadian market by foreign (non – Canadian) Companies and is sold by foreign financial institutions and companies. The Maple bond provides an opportunity to domestic (Canadian) investors to invest in foreign companies without worrying about effects of currency exchange fluctuations. Foreign companies can use Maple bonds to raise Canadian Dollars for setting up operations in Canada.

7. Panda Bonds:
   A Panda bond is a Chinese renminbi – denominated bond from a non – Chinese user, sold in China. It was agreed eventually, that funds cannot be repatriated from China.
8. **Rembrandt Bonds:**

   A foreign bond denominated in Euros and traded in the Netherlands is known as Rembrandt bond. A non-Dutch company can choose to sell this bond to raise capital from Dutch investors.

9. **Matador Bonds:**

   A term used to identify a foreign bond issued in Spain by a company that is not domiciled in Spain. Matador bonds were bonds denominated in Pesetas and were usually corporate bonds. The name matador originated from bull fighters in Spain. Spain followed a systematic approach when accepting new foreign issuers. Spain initially allowed only AAA rated super nationals to issue Matador bonds. After a few years sub AAA multinational were allowed access to Spain’s debt market and eventually, allowed non-investment sovereigns to issue bonds.

10. **Matrioshka Bonds:**

    Matrioshka bond, a Russian Rouble denominated bond issues in the Russian Federation by non-Russian entities. The name derives from Russian wooden dolls popular with overseas visitors to Russia.

11. **Arirang Bonds:**

    It is a Won denominated bond issued in South Korea named after a Korean folk song. The market is very small. The Asian Development Bank was the first to issue Arirang seven-year bonds in 1995 for Won 80 billion.

12. **Kauri Bonds:**

    A similar bond but issued in New Zealand in 2004 named after trees and denominated in NZ dollars. It may be noted that bonds can be issued not only by corporate, but also by government and government bodies such as municipalities. Eurobonds are denominated in foreign currency as like any other euro instrument.

**3.12 EUROBONDS V/S FOREIGN BONDS:**
The two segments of the international bond market are: foreign bonds and Eurobonds. Eurobond is a publicly traded bond that is sold exclusively in countries other than the country in whose currency the issue is denominated. For example, a Eurobond issue will be issued by Airbus (France) of a $-denominated bonds. In Japan Foreign bonds are bonds sold in country of denominated currency, however issuer is from another country. For example, if British Airways offers bond in the United States priced in US$, that would be a foreign bond. Yet another example of a foreign bond is the Yankee bond- these are foreign bonds that are sold in the US.
<table>
<thead>
<tr>
<th>Eurobonds</th>
<th>Foreign Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eurobond is a security issued in external (international, offshore) bond market.</td>
<td>Foreign bonds are bonds issued in the domestic market of another country.</td>
</tr>
<tr>
<td>International syndicated act as the underwriters; underwritten by the underwriters of multinationality.</td>
<td>The bond is issued by a foreign entity (such as a government, municipality or corporation); underwritten by the underwriters of the country where they are issued.</td>
</tr>
<tr>
<td>Euro bonds are simultaneously placed with investors from different countries.</td>
<td>The bond is traded on a foreign financial market.</td>
</tr>
<tr>
<td>Bonds are issued outside the jurisdiction of any specific country and do not have to be registered and are free from regulations.</td>
<td>Subject to government rules and regulations.</td>
</tr>
<tr>
<td>Eurobonds are tailored to the needs of multinational investors.</td>
<td>Foreign bonds is determined keeping in mind the investors of a particular country.</td>
</tr>
<tr>
<td>Securities issued both in the domestic and external markets are called global bonds.</td>
<td>Issuers of the foreign bond: Market is not officially registered in the country, where the bond is issued and traded.</td>
</tr>
<tr>
<td>A Eurobond is a bond that is issued by an international borrower and sold to investors in countries with currencies other than the currency in which the bond is denominated.</td>
<td>A foreign bond is a bond issued in a host country’s financial market, in the host country’s currency, by a foreign borrower.</td>
</tr>
<tr>
<td>Bonds denominated in one currency but issued in a country that is not the home of that currency. For example, a bond denominated in $ can be issued in London is a Eurobond.</td>
<td>The bond is denominated in a foreign currency. Bonds issued in a bond market by a foreign company. For example, a Japanese firm issuing a U.S. dollar denominated bond in the U.S. is issuing a foreign bond.</td>
</tr>
<tr>
<td>Most countries have a very few regulations governing the issuance of</td>
<td>Because foreign bonds are simply a part of the domestic bond market, the only real</td>
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CHAPTER 4

INTERNATIONAL COMMERCIAL BORROWINGS

4.1 EXTERNAL COMMERCIAL BORROWINGS (ECBs):

Introduction

External Commercial Borrowing (ECBs) is a key component of India’s overall debt. Policy on External commercial Borrowings (ECB) is framed by the Government of India in consultation with RBI. For the convenience of investors and borrowers, Government brings out the consolidated ECB Guidelines in the form of a brochure.

External commercial borrowing is a complicated process. It is not the loan agreement alone that is sufficient. It involves a number of other documents. The exact kind and number of documents to be executed in an external commercial borrowing depend on various factors including the nature of the lenders, that is, whether it is an international financial institution, a financial institution of a country, an export import bank, a commercial bank or a syndicate of such banks. The extent and the period for which the funds are required by the borrower also play an important role in the process. The purpose of the borrowing is also significant.

The important aspect of ECB policy is to provide flexibility in borrowings by Indian Corporates, at the same time maintaining prudent limits for total external borrowings. The guiding principles of ECB policy are to keep borrowing maturities long, costs low, and encourage infrastructure and export sector financing which are crucial for overall growth of the economy.

Government has been streamlining / liberalizing ECB procedures in order to enable Indian Corporates, to have greater access to international financial markets.
Government has now empowered Reserve Bank of India to give ECB approvals in accordance with the guidelines brought out by the RB.

ECB includes commercial bank loans, buyers’ credit, suppliers’ credit, securitized instruments such as floating rate notes and fixed rate bonds etc., credit from official export credit agencies and commercial borrowings from the private sector window of multilateral financial institutions.

ECBs can be used for any purpose (rupee-related expenditure as well as imports) except for investment in stock market and speculation in real estate. They are a source of finance for Indian corporate for expansion of existing capacity as well as for fresh investment.

ECBs provide an additional source of funds to the companies, allowing them to supplement domestically available resources and to take advantage of lower international interest rates.

4.2 ADVANTAGES OF EXTERNAL COMMERCIAL BORROWING:

a) **Lower interest rate** – First, the foreign currency loan is offered in the international markets frequently against the guarantee from a bank. Therefore the borrower should add against the guarantee fee payable by him to his bank to the cost of raising the foreign currency loan. The interest rate the guarantee commission and other incidental costs should aggregate to less than the cost of funds in the domestic market.

b) The availability of the funds from the International market is huge as compared to domestic market and corporate can raise large amount of funds depending on the risk perception of the International market.

c) **Non-encumbrance on assets** - The third advantage is that since specific assets are usually not charged for funds raised abroad, the borrowing capacity in the domestic company is not affected.

d) **Freedom from exchange risk** - The exchange loss on conversion can be avoided provided the purpose for which the loan is raised can be paid for in the currency of the loan and the source of repayment is also in the same currency. For instance,
the loan is raised to pay in dollars for raw materials imported and export proceeds are also received in US dollars. If the sources of repayment are in a currency other than the currency of loan, the borrower will be facing exchange risk. Forward cover may arrange, but this should be added to the cost of borrowing. Further, hedging exposures for longer periods is costly.

4.3 DISADVANTAGES OF EXTERNAL COMMERCIAL BORROWING

a) **Interest Rate Risk:** As ECB’s are issued for a longer period of time and in this Mean while if the interest rate in domestic country goes down, it can convert ECB in an expensive source of financing.

b) **Exchange Rate Risk:** If the domestic currency gets depreciated at the time of payment of ECB, then borrower will have to pay extra rupee because of the domestic currency depreciation.

c) **Leverage:** ECB is a debt instrument, and if it is raised beyond a limit, it can increase the country’s dependence on the Lender’s country. As they will be in a condition to impose their decision on borrowing country.

4.4 BITCOINS:

Bitcoin is a new currency that was created in 2009 by an unknown person using the alias Satoshi Nakamoto. Transactions are made with no middle men – meaning, no banks! There are no transaction fees and no need to give your real name. More merchants are beginning to accept them: You can buy webhosting services, pizza or even services.

Bitcoin is a new kind of money. It’s the first decentralized electronic currency not controlled by a single organization or government. It’s an open source project, and it is used by more than 100,000 people. All over the world people every day with no middle man and no credit card companies. It’s startup currency which has never happened before.
Bitcoin is the first digital currency that is completely distributed. The network is made up of users like yourself so no bank or payment processor is required between you and whoever you’re trading with. This decentralization is the basis for Bitcoin’s security and freedom.

Email helps us send letters for free, anywhere in the world. Skype lets us make phone and video calls for free, anywhere in the world. Now there’s bitcoin. Bitcoin lets you send money to anyone online, anywhere in the world for less than a cent per transaction! Bitcoin is a community run system not controlled by any bank or government.

Bitcoin is perhaps the biggest opportunity for innovation that the world has seen since the industrial revolution. An idea whose time has come.

Bitcoin can be used to buy merchandise anonymously. In addition, international payments are easy and cheap because bitcoins are not tied to any country or subject to regulation. Small businesses may like them because there are no credit card fees. Some people just buy bitcoins as an investment, hoping that they’ll go up in value.

4.5 CHARACTERISTICS OF BITCOINS:

1. **Acquiring Bitcoins:**
   
   **Buy on an Exchange:** Several marketplaces called “bitcoin exchanges” allow people to buy or sell bitcoins using different currencies. Mt. Gox is the largest bitcoin exchange.

2. **Transfers:**
   
   People can send bitcoin each other using mobile apps or their computers. It’s similar to sending cash digitally.

3. **Mining:**
   
   People compete to “mine” bitcoins using computers to solve complex math puzzles. This is how bitcoins are created. Currently, a winner is rewarded with 25 bitcoins roughly every 10 minutes.

4. **Owning Bitcoins:**
Bitcoins are stored in a “digital wallet,” which exists either in the cloud or on a user’s computer. The wallet is a kind of virtual bank account that allows users to send or receive bitcoins, pay for goods or save their money. Unlike bank accounts, bitcoin wallet are not insured by the FDIC.

5. **Anonymity:**
   Though each bitcoin transaction is recorded in a public log, names of buyers and sellers are never revealed – only their wallet IDs. While that keeps bitcoin user’s transactions private, it also them buy or sell anything without easily tracing it back to them. That’s why it has become the currency of choice for people online buying drugs or other illicit activities.

6. **Uncertain future:**
   No one knows what will become of bitcoin. It is mostly unregulated, but that could change. Governments are concerned about taxation and their lack of control over the currency.

4.5 **EURO-DEPOSITS:**

![Diagram of Euro-deposits]

Although the deposit is held in the account of a London bank the money doesn’t actually leave Japan; rather it is held in the account of a London based bank in Japan and becomes an asset of that bank. The depositor’s (investor’s) claim is with the London Bank. The Euro market has its origins in the deposits – whereby cash was held in a banking system outside the country of that currency’s origin.

Historically there was a demand for dollars to held in time deposits outside the US, specifically in Europe, thus they came to be called Eurodollars.
Dollars later came to be held in South-East Asia and the Middle Eastern banking system, but they are still called Eurodollars. The market subsequently widened to include a range of currencies held in time deposits outside their country of origin – Euro deutschmarks, Euroyen and so on.

Euro time deposits generally range from 7 days to 6 months. Banks receiving Eurocurrencies use them to make loans to international and supranational financial institutions, governments, companies and to each other. Bank borrowing in Eurocurrency markets is an alternative to borrowing in domestic interbank market. A Euro placement is an alternative to selling reserve in the domestic interbank market.

With the exception of overnight funds, domestic and euro rates track each other closely. The euro rate tends to be slightly higher because of the higher risk attached to holding currency in a foreign country.

These risks include the possibility that the Central Authority where the euro deposit is held may interfere in the movement of interest or principal. Another risk is that the Central Bank may not act as “the lender of last resort” to bail out a Eurobank (the bank where the deposit is held) which gets into trouble.

The risks of holding euro-deposits are accentuated by the fact that, on average, euro-deposits tend to have shorter maturities than euro-loans. Euro-deposits are free from reserve requirements and most other national regulations, and as their attractiveness for hedgers and speculators moves funds into the market, Central Bank control of financial intermediaries decline.

Example of Eurocurrency deposit (Eurodollar deposit):

German firm sells medical equipment to institutional buyer in the US. It receives a US$ check drawn on Citicorp, NY. Initially this check is deposited in a checking account for dollar working capital use. But to earn a high return (or rate of interest) on the $1 million the German firm decides to place the funds in a time deposit with a bank in London, UK.
One million Eurodollars have thus been created by substituting a dollar account in a London bank for the dollar account held in NY. Notice that no US $ left NY but ownership of the US deposit has moved from a foreign corporation to a foreign bank. The London bank would not like to leave the funds idle in NY account. If a government or commercial borrower is unavailable, the London bank will place the $ 1 million in the London interbank market. The interest rate at which such interbank loans are made is called the London interbank offer rate (LIBOR).

CHAPTER 5
EURO BANKING

5.1 INTRODUCTION TO EUROBANKING:
Eurobanking offers many key advantages to the various stakeholders. Depositors escape from the tax-net of their own country of domicile. Borrowers get liquid money for working capital as well as for capital investments at a highly competitive interest rate.

To grab this kind of business, banks offer banking services to non-residents. Depositors would deposit their own home currency or US Dollar and thus Eurodollar deposit or Eurocurrency deposit is created. This is then lent to an appropriate borrower by the bank.

This example demonstrates that the Eurocurrency market is a chain of deposits and a chain of borrowers and lenders. The majority of Eurocurrency transactions involve transferring control of deposits from one Eurobank to another Eurobank. Loans to non-Eurobank borrowers account for less than half of all Eurocurrency loans.

The Eurocurrency market operates like any other finance market, but for the absence of government regulations on loans that can be made and interest rates that can be charged.

The preferred location of Eurobanking would be the one which provides the least regulatory restrictions. In early 20th century, traders from UK used to deposit their money in Channel Islands (Jersey, Guernsey and Isle of Man); which were offshore to Britain; to escape from British regulations. This was termed as offshore banking. Thus offshore banking is just a convenience term used for Eurobanking.

5.2 OFFSHORE FINANCIAL CENTERS:

Offshore Financial Center (OFC) usually refers to low-tax, lightly regulated jurisdictions which specialize in providing the corporate and commercial infrastructure to facilitate the use of those jurisdictions for the formation of offshore companies.

The IMF considers the following to be characteristics of an Offshore Financial Centre:

- Jurisdiction that have relatively large numbers of financial institutions engaged primarily in business with non-residents;
EUROCURRENCY MARKET

- Financial systems with external assets and liabilities out of proportion to domestic financial intermediation designed to finance domestic economies; and
- Centers which provide some or all of the following services: low or zero taxation; moderate or light financial regulation; banking secrecy and anonymity.

The advantages of offshore financial centers (OFCs) to offshore banking typically include:

- Strong privacy
- Less restrictive legal regulation
- Low or not taxation (i.e. tax heavens)
- Easy access to deposits (at least in terms of regulations)
- Protection against local political or financial instability

Offshore banking is an important part of the international financial system. Experts believe that as much as half the world’s capital flows through offshore centers. Tax heavens have 1.2% of the world’s population and hold 26% of the world’s wealth, including 31% of the net profits of United States multinationals. According to Merrill Lynch and Gemini Consulting’s “World Wealth Report” for 2000, one third of the wealth of the world’s “high net-worth individuals” – nearly $6 trillion out of $17.5 trillion – may now be held by international business companies (IBCs) and trusts.

The offshore activities give capitalism new dynamism and generated additional profits, but also leave major social scars. They do not enable elected governments to eradicate poverty, fight environment degradation, finance education, healthcare, pensions and much needed social infrastructure.

5.3 ADVANTAGES OF OFFSHORE BANKING:

1. Access to stable jurisdictions to park funds:

Offshore banks provide access to politically and economically stable jurisdictions. This may be an advantage for those residents in areas where there is
a risk of political turmoil, who fear their assets may be frozen, seized or disappear.

2. **Better interest on deposits:**
   Some offshore banks may operate with a lower cost base and can provide higher interest rates than the legal rate in the home country due to lower overheads and a lack of government intervention. Also in most of the popular offshore banking centers, interest rate is not controlled. Banks are free to decide their interest rates. This is a great advantage for the banks.

3. **Tax Evasion:**
   Interest is generally paid by offshore banks without tax deducted. This is an advantage to individuals who do not pay tax on worldwide income, or who do not pay tax until the tax return is agreed, or who feel that they can illegally evade tax by hiding the interest income. In popular offshore banking centers, banks also save on their own direct taxes.

4. **Non – conventional Facilities:**
   Some offshore banks offer banking services that may not be available from domestic banks such as anonymous bank accounts, higher or lower rate loans based on risk and investment opportunities not available elsewhere.

5. **Other advantages to the banks:**
   In most offshore banking centers; banks get exemption from reserve requirements, entry is easy to establish a branch, license fees are low etc.

5.4 **DISADVANTAGES OF OFFSHORE BANKING:**

1. **Crime and illegal activities:**
   Offshore banking has been associated with the undergone economy and organized crime, through money laundering. Following September 11, 2001, offshore banks and tax heavens, along with clearing houses, have been accused of helping various organized crime gangs, terrorist groups, and other state or non – state actors.

2. **Tax loss to Governments:**
The existence of offshore banking encourages tax evasion, by providing tax evaders with an attractive place to deposit their hidden income.

3. **Capital outflow and volatility:**
   Developing countries can suffer due to the speed at which money can be transferred in and out of their economy.

4. **Widens rich – poor gap:**
   Offshore banking is usually more accessible to those on higher incomes, because of the costs of establishing and maintaining offshore accounts. The tax burden in developed countries thus falls disproportionately on middle-income groups. Offshore Banking centers cause tax loss to other countries and they also influence currency value variation. Switzerland is one of the largely criticized centers. Swiss banks were referred to as Gnomes of Zurich by some finance ministers across the world.

5.5 **LIST OF POPULAT OFFSHORE BAKING CENTERS:**

   London, Switzerland, Singapore, Hong Kong, The Cayman Islands, The Bahamas, Bahrain, Bermuda, British Virgin Islands BVI, Guernsey, Jersey, Isle of Man, Luxemburg, Liechtenstein, Monaco, Panama, Uruguay and some more.

**CHAPTER 6**

**FLOATING RATE NOTES**

6.1 **FLOATING RATE NOTES (FRNS):**

   The floating-rate note is an instrument whose interest rate floats with prevailing market rates. It pays a three-month or six-month interest rate linked to LIBOR such as “LIBOR + 1%”. This interest rate is reset every three or six months to a new level based on the prevailing LIBOR level at the reset date. The framework we use places pricing at the center of what defines an instrument, and FRNs are priced in part like money-market instruments and in part like conventional fixed-rate bonds.
The floating-rate note has grown up with the Euromarket as a whole. The instrument was introduced in the early 1970s after many investors had gotten their finger burned by dabbling in the fixed-rate Eurobond market, in which prices fell as inflation drove interest rates up to historically high levels.

**6.2 BANKS ARE MAJOR INVESTORS IN FRNs:**

Investment banker through that they would have a ready demand for floating-rate notes among that investor who wanted longer maturity instruments than bank deposits, ones that would maintain their value in the face of higher interest rates. It turned out that the biggest buyers of floating rate notes were not banks customers, but banks themselves. Some saw them as another trading instrument buy today, sell later at a profit. Most, however, bought them as medium-term substitutes for loans. Other banks preferred them to bank loans because they were treated by the regulators as securities, a treatment that improved the liquidity of the bank’s asset portfolio. Whatever the reason, the bulk of FRNs are today held by financial institution 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.

**6.3 FEATURES OF FRNs:**

All floating-rate notes have a coupon that is reset at fixed intervals in accordance with some preset formula, but there are many variations on this theme. Most FRNs can be characterized by the following features:

1. **The reference rate:**
   
   The reference rate is the interest rate to which the coupon payment is linked. This is normally a short-term rate, so that some see FRNs as a substitute for money-market instruments. In the Euromarkets, the reference rate is usually LIBOR, although a few FRNs have used other reference rates (such as LIBID, LIMEAN, or the U.S.-Treasury-bill rate). The rate is normally reset at the beginning of each coupon period, and interest is paid.
2. **The margin:**

   The margin is the spread between the coupon payment and LIBOR. For instance, in case it is “LIBOR + 1%”, then 1% is called as margin. In fact it is called as basis points (bps); 100 bps = 1%. This depends on the risk rating of the issuer.

3. **The reference-rate period:**

   The reference-rate period is the maturity of the security to which the FRN’s coupon is linked, such as three- or six-month Eurodollar deposits. An FRN coupon is quoted as the LIBOR-period rate and the margin for example, six-month LIBOR plus 3/16 percent.

4. **Frequency of reset:**

   Reset frequency is the period between coupon-reset dates, and normally coincides with the reference-rate period.

5. **Coupon-payment frequency:**

   This is the interval between coupon payments, and normally coincides with the coupon-rest periods.

6. **Maturity:**

   The date on which the principal on an FRN will be redeemed is the maturity date. Many FRNs have call features—that is, the issuer may, at its option, redeem the FRN at certain prespecified dates prior to maturity.

6.4 ADVANTAGES OF FLOATING RATE NOTES:

   The specific advantages in investing in Floating Rate Notes include:

   1. known return over LIBOR;
   2. known quarterly cash flow – coupon resets typically every 90 days in line with interest rate movements;
   3. Tradeable on secondary market in normal market conditions;
   4. Provide protection against rising interest rates;
   5. Minimal administration as the coupon is automatically paid and reset every quarter (typically) until maturity;
   6. Principal is repaid in full upon maturity (subject to the issuer remaining solvent until maturity); and
   7. No ongoing fees.
6.5 EUROBONDS V/S FRNs

<table>
<thead>
<tr>
<th></th>
<th>Eurobonds</th>
<th>FRNs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tenure</strong></td>
<td>Longer (10 to 30 years is common)</td>
<td>Medium Term (3 to 10 years is common)</td>
</tr>
<tr>
<td><strong>Coupon Rate</strong></td>
<td>Fixed percent on face value</td>
<td>Floats based on its linkage with reference. Common Reference is LIBOR</td>
</tr>
<tr>
<td><strong>Type of Instrument</strong></td>
<td>Capital Market instrument</td>
<td>Mix of capital and money market. Legally, money market instrument.</td>
</tr>
<tr>
<td><strong>Preferred when</strong></td>
<td>Interest rates are falling</td>
<td>Interest rates are rising</td>
</tr>
<tr>
<td><strong>Main investors</strong></td>
<td>Corporate, Individuals</td>
<td>Banks</td>
</tr>
<tr>
<td><strong>Interest payment Frequency</strong></td>
<td>Yearly and 6-monthly</td>
<td>Quarterly</td>
</tr>
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</table>

**CONCLUSION**

The creation and growth of the Eurocurrency market has been an important side effect of the increase of international economic activity over the past few decades. The market has expanded largely as a means of avoiding the regulatory costs involved in dollar-denominated financial. Due to the size and importance of the foreign exchange market, it remains largely unregulated. There is no international organization to look over it or any institutions that sets rules. The name Eurocurrency market is given to any bank deposits in any country held in a different country’s currency. An example of this is United States dollar depositing in a British bank. These banks are called Euro banks. The emergence of eurobanks has facilitated trade and investment between countries. A Eurocurrency is any currency that is deposited outside of the home country. Since approximately two thirds of Eurocurrency is U.S. dollars, central banks and regulators are concerned about Eurocurrency because they are stateless money. Eurocurrency market has very little regulations, such as taxes, restrictions on capital movements and exchange controls. Thus, the market attracts more investors. It is easier for banks around the world to use the Eurocurrency market to move and store funds more profitably than they could in many countries. Since the market is relatively free of regulation, Eurodollar market must operate on narrower margins than banks in the United States. The Eurocurrency market gives investors the opportunity to hold short-term claims on commercial banks,
which also act as intermediaries to transform these deposits into long-term claims on final borrowers. Not only does Eurocurrency market allow for more convenient borrowing, it also improves the international flow of capital for trade between countries and companies. This market also attracts domestic deposits because it offers a higher interest rate. The largest Eurocurrency markets are located in London, New York, and Tokyo.

One of the factors that make the Eurocurrency Market unique compared to many other money market accounts is the fact that it is largely unregulated by government entities, it is difficult for domestic governments to intervene, particularly in the United States. However, with the establishment of the flexible exchange rate system in 1973, the Federal Reserve System was given powers to stabilize lending currencies in the event of a crisis situation.

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