
CURRENT DEVELOPMENTS IN EUROMARKETS

JOHN EDWARDS

Linklaters & Paines
London, UK

I am delighted to be here and to see so many friends, many of whom have been in London and visited my firm.

I have been asked to talk about recent developments in the Euromarkets. There are far too many questions, let alone answers, for this topic to be dealt with comprehensively or indeed in some sort of broad, logical order. However, I do hope to bring out some of the concerns, and some of the trends which have concerned the Euromarkets in 1988, and are likely to have an effect in 1989, and well beyond into the final decade of this century.

I must apologise for the paucity of the material relating to my presentation in your folders - perhaps you are thoroughly delighted - but I have only produced one and a half pages. It is extremely difficult, in the midst of a fairly busy practice life, to write speeches about subjects as topical as this, particularly when they themselves are changing almost week by week. I do not exaggerate when I say that the expression "current" in the context of the title Current Developments in the Euromarkets means astonishingly fast moving.

My first contact with Australia, and I have had the pleasure of coming here on a number of occasions, was in London, when I had the privilege of being asked to a lunch at which the principal speaker was the then Chairman of your largest insurance society, AMP. His topic was "The Economy of Australia - and the Future". He said something like: "Forgive me if I start my topic, namely Australia and the future, by talking to you for twenty minutes about the economy of Japan. It is not possible to understand what the Australian economy is about if you do not know what our relationship is with Japan and how Japan affects our future." I am not of course an economist, and I do not propose to try and emulate that marvellous speech, but I do want to go about it in the same way, because the Euromarkets are nowadays so heavily dominated by Japan, that it is almost impossible to start any meaningful discussion on what is happening without focusing on a few facts and figures relating to Japan.

Fifteen years ago it would have been virtually unheard of for a Japanese securities house to lead manage a securities issue for a Japanese corporate borrower in the Euromarkets. Today, it would be inconceivable for anybody other than a Japanese securities house to lead manage an issue for a Japanese corporate borrower. In addition Japanese securities houses are now very active in the Euro-yen market, arranging yen documented transactions for non-Japanese borrowers. Most recently, Japanese securities houses have begun to place equity, by way of Euro-equity offerings, for non-Japanese corporates.

A look at the latest tables which are available in the International Finance Review show that on a rolling league table basis in the period March 1988 to March 1989, the first four lead managers were Nomura, CSFB Deutsche Bank, Daiwa. The next two were Nikko and Yamaichi. So among the first six, the four big Japanese houses featured prominently, and the only two non-Japanese houses in the top six in the first quarter 1988 were CSFB and Deutsche Bank. If you look at the same quarter in 1989, the first four are Nomura, Nikko, Daiwa, Yamaichi. CSFB is fifth and Deutsche is sixth. If you look at the figures for the first quarter of 1989, Nomura lists 10.7 billion dollars of issues led. Nikko, Daiwa and Yamaichi all come between 3, 4, and 5 billion. It is quite clear that Nomura is becoming one of the biggest financial services organisations in the world.

The biggest financial services organisation in the world means not only securities; you are of course all aware that Japan, like the United States still has a split between commercial banking and securities underwriting, in Japan known as Article 65 (equivalent to the Glass Steagall Act in the United States). The Japanese securities houses are working hard at changing Article 65; it can only be a question of time before those barriers are broken down. Furthermore, all of the four major Japanese securities houses have banks with full authorisation in the United Kingdom.

A danger which threatens the Euromarkets is the danger of repatriation. By that I mean that the most lucrative area of securities underwriting in the Euromarkets, which is the bond warrant market for Japanese corporates, denominated in Eurodollars, launched, signed and closed in London, but largely sold back to Japan, will be repatriated to Japan. The word is not quite accurate, because of course it never started there, so it will be, so to speak, transferred. But everybody talks about repatriation. If this very lucrative market transfers back to Tokyo, syndication of Eurocurrency securities deals will start out of Tokyo; once that happens, the London based Eurodollar market will lose one of its most profitable sectors.

I think it is not an exaggeration to say that the majority of all issues in the last twelve months launched in the London Eurodollar market have been bond warrant issues for Japanese corporations. In this calendar year alone, we have had no less

than five issues of either one billion dollars or more, the latest being Mitsubishi Corporation for 1.5 billion dollars, amounts absolutely unheard of five years ago.

Here is a quote from a recent Financial Times article:

"Japanese banks are edging closer to victory in their long-running battle for greater access to domestic securities markets. Securities companies are slowly being forced to accept that they will have to drop their outright opposition to banks and to compromise. There are several signs that the Japanese Minister of Finance, the ultimate arbiter of financial deregulation, is growing increasingly keen to break down the barriers created by Article 65 of the securities and exchange law, the Japanese equivalent to the Glass Steagall Act. Rather ominously, in addition, piecemeal deregulation which has been going on for years, has lowered the lines between banks and securities companies in many areas making it increasingly complex for each side to do business. Some securities companies' executives believe it might be better to settle the future once and for all rather than fight countless individual battles over territory."

Another element which is holding up a complete liberalisation of the financial services system in Japan is the Commission Bank system. This may not be familiar to you. It is the equivalent, or at least the nearest equivalent, of the Anglo-American or the Anglo-Saxon concept of trusteeship. However, the Commission Bank is not a genuine trustee as we know him to be. In other words, he is not clothed with rights and has not impressed upon him the obligations which put him into a genuine fiduciary role vis-a-vis bondholders. In the Japanese domestic yen market the Commission Bank is in effect the agent - he is really close to a fiscal agent of the issuer, and negotiates, usually on behalf of the issuing corporations, with the securities houses distributing the issue.

There is a further ominous reference to this in the Japan Times of April 7. A Ministry of Finance official called the Commission Bank system a stumbling block to the healthy development of the straight bond market because trustee fees are much higher in Japan than in overseas markets. That is one of the reasons why the Japanese came to the Eurodollar market in the first place, the other reason being that the Japanese corporations could come unsecured, whereas all Japanese domestic issues have to be secured.

"Banks are becoming aware that their trustee role should be reduced although they oppose it now." So that force is still at work and has not yet been resolved.

Last but not least a curious problem, what I call the Japanese law problem - the applicable law of a bond issue or for that matter any other form of loan documentation, is, subject to a few

minor legal constraints, a question of freedom of choice as between the parties. It has never been suggested that there are major stumbling blocks to the choice of English law, German law, Swiss law, French law or New York law, all of which have been successfully used over many years for international issuing by corporations from those jurisdictions, and particularly in the case of English law, by corporations from jurisdictions other than from England.

However, Japanese law, despite the fact that it is a sophisticated and mature civil law system, suffers from the fact that it is thought not to be supported by a well developed commercial court system. Getting a case through the Japanese courts is liable to take time, and the Japanese judges are apparently not, at least until now, used to handling a commercial case in the same way as the courts in the UK or the USA.

The next area which I would like to focus on is swings between syndicated loans and international securities issues. I think it is common knowledge that in the early 70s, syndicated loans dominated international finance and securities issues represented a small portion of the total market. Then came the LDC crisis, and banks suddenly became aware that participations in loans were illiquid, or at least very difficult to dispose of without legal difficulty. For many years, certainly until about 1987, the ratio between securities and syndicated loans changed in favour of securities issues.

We are now seeing a resurgence of the syndicated loan, both the straight unsecured syndicated loan and the secured syndicated loan which may take the form of a syndicated loan with security over assets (aircraft, ships), but also structured financing, which means project financing. Takeover finance, which will be addressed later on in this Conference, also gives rise to syndicated loans with conditions attached.

What has happened recently in the market in terms of the players and the volume? I have already mentioned that the volume is up, but I should also mention that profitability is down, certainly profitability in every realm other than the realm of issues of Japanese bonds with warrants to subscribe shares of common stock. There are too many players chasing too few mandates, a situation no doubt not unknown to some of you. Therefore borrowers are playing off bankers against each other. We are seeing a shake out of the smaller players who cannot compete, because they have not got the capital to absorb the large positions; the result is that some of these smaller players are ceasing to be in business. Even the not so small players are suffering. You will have read about respectable medium to major sized domestic UK houses who in years gone by have ranked as among the most important and prestigious merchant banks, all of whom have suffered losses, principally through competing in fields outside their traditional areas of activities.

I must mention new offering methods, primarily of equity. These methods encompass offers to the public and international equity offers to professionals at the same time. We are seeing more and more of this largely because of the growth of privatisation, not just in England but also in other jurisdictions. The question of multi-jurisdictional public offers is in itself a question of enormous interest and complexity being looked at by a variety of bodies both nationally and internationally, and you may expect a number of pronouncements to come out in the months to come on this subject.

I must also mention regulation and harmonisation, because we have had a veritable spate of regulation and harmonisation attempts both domestically - our Financial Services Act, various EEC directives which have been incorporated into our own legislation - and internationally; the EEC is busily producing no less than 300 directives by 1992, some of which will impact on financial services, ie. banking and investment services.

The other development which I must mention is commercial paper. What I was not aware of until very recently was just how lively it was in Japan, where the daily amount in issue is now approaching 100 billion US dollars equivalent. This is a market which five years ago hardly existed.

Legal developments are relatively slender, compared to market developments. The two Libyan cases, the Bankers Trust and the Manufacturers Hanover cases, which were heard recently, are of interest to any banking lawyer not least because they managed to establish what we in England had always felt should be the case, namely that foreign law should not have automatic extra-territorial effect.

We continue to suffer from an extraordinary lack of jurisprudence in the Euromarkets both on the securities side, and on the syndicated loan side; thus, practitioners to some extent work in a vacuum, always hoping that the basic building blocks of our trade - contract, tort, equity and private international law, will continue to hold good. I believe they will, myself. I find myself more comfortable being a common lawyer than being a regulator or statutory lawyer.

The growth of takeover financing raises with me the question: is there a conflict between a duty as custodian of its depositors' assets on the one hand, and on the other hand its activities as an entrepreneurial business? I am sure that it should be a custodian of its depositors' assets, but I am less comfortable about a bank initiating or supporting takeovers which could not otherwise even get off the ground.

I would like to mention the emergence of rating agencies as a force in the market. From a legal point of view I do not regard the activities of a rating agency as absolving a practising lawyer or merchant banking client from the duty to exercise due

diligence in relation to whatever loan he is making to a company which happens to either have a rating or be in the process of obtaining a rating. I have never yet heard of a case in any jurisdiction being argued on those grounds but I have no doubt it will come sooner or later.

I must sign off by leaving you with the thought that I started with, namely Japan. The Euromarkets are by no means a settled entity. There has been much talk about the Common Market destroying them, everybody rushing off to Switzerland, everybody rushing off to Luxembourg etc. I personally believe that we will see two things happen side by side. We will see a continued strength in the global international capital markets but at the same time I also believe we shall see regional markets of considerable strength emerging. Thank you very much.