Birth of the Euromarkets

The reason why London became the offshore destination for US borrowing was the presence of a growing stock of homeless dollars deposited there. The origin of these deposits is still a matter of debate: some people trace them to the Suez crisis when Washington froze the US-based assets of the combatant Arabs, French

and British – which had the effect of frightening away foreign depositors and driving dollars out of the US. Others trace them to countries which, for political reasons, preferred to bank their dollars outside the US, like the Soviet Union. There was also "leakage" of dollars from international transactions which needed to be kept away from the eyes of the US authorities. Another factor was a US regulation which capped the amount of interest that domestic banks could pay on deposits. Offshore banks escaped this regulation and could pay more to attract funds.

At the time the IET was introduced, there was $20bn deposited in Europe, mostly in London. These dollars acquired the name Eurodollars and the markets in which they were traded came to be called the Euromarkets. Five years later, in 1968, the volume of Eurodollars had doubled to $40bn, and what began as an unintended consequence of US credit control was turning into a major new business for London, drawing droves of international borrowers, banks and offshore dollars into the City. It was an enormously significant development which created an environment ripe for exploitation by ambitious bankers: huge sums of homeless money, surging demand from borrowers for credit, and very little regulatory control.

Three types of market developed. The first was for deposits where banks needing Eurodollars could buy them from banks which had a surplus. This market evolved around 1960, and existed mainly to finance trade-related activities.

The second was the market for bonds denominated in Eurodollars which replaced the now too-expensive Yankee market. These were known as Eurobonds and were typically issued by international companies to raise long-term capital. In the early days, this market was set to establish itself in Switzerland because of the huge demand for bonds among wealthy Geneva- and Zurich-based investors. But the Swiss decided to tax foreign bond trading to protect their currency. At the same time, the UK authorities, spotting an opportunity, halved stamp duty on securities transactions from two per cent to one per cent, and allowed bonds to be traded in bearer form[11]. These developments ensured that the market switched to London, where it has remained.

The birth of the dollar-denominated Eurobond market is usually dated to 1963 when Autostrade, the Italian state-owned motorway company, floated a $15m 15-year bond. Although this budding market was the brainchild of British

[11] *A bearer bond is an unregistered, negotiable bond on which interest and principal are payable to whoever possesses it, regardless of whom it was originally issued to. This makes for a much more liquid market than one in registered bonds.*

merchant banks and a few Continental banks, it soon also became a destination for US banks keen to tap it for their own clients. An important consideration for them was that London lay beyond the reach of US banking law which barred commercial banks from underwriting bonds. By forming London subsidiaries incorporated under English law, they were able not only to enter the Euromarkets, but open up lucrative new lines of business as well.

The third was the market for bank loans denominated in Eurodollars. This was slower to get going for reasons we shall come to in a moment.

In Rome, Minos was watching all these developments with interest. Although he had a huge market to cover, and was succeeding in building up a useful business for Manufacturers, he could also see the shortcomings. For one thing, Manufacturers, which merged with Hanover Trust in 1961, needed a much stronger presence in Europe if it was to match its competitors, Citibank, Chase Manhattan and Morgan Guaranty, which were all gaining footholds in the new Euromarkets. For another it was clear that there were gaps in the market that Minos felt he could fill, though not necessarily from the rather limited market in Rome. At a personal level, Minos was also keen to spread his wings.

The question was, how? Manufacturers Hanover Trust, or Manny Hanny as it was known, was less experienced in international banking than its competitors, despite being the fourth largest bank in the US. It was primarily a domestic bank whose Manufacturers arm financed small New York businesses, while Hanover Trust looked after the money of upmarket New Yorkers. But pressure to expand internationally was growing inside the bank, not least from Minos who saw an opportunity to create a major new business for Manny Hanny.

For some years, Minos had seen his core business – trade finance – being whittled away by new competitors and sources of credit. As early as 1960, he sent a memo to John Waage in New York stressing the need for "more and diversified activities which can bring new income to replace diminishing earnings from the traditional business." Minos reckoned that total loan demand in Europe was as big as the US': acquisitions, joint ventures, public sector finance, infrastructure projects. But there was still a rooted view that the job of US banks overseas was to support American corporations' foreign activities rather than fund non-US businesses. Minos thought it was time for those banks to pursue opportunities that were profitable rather than just patriotic, like lending to companies in Europe. With developments such as the Common Market, barriers were coming down, and companies which previously looked to domestic sources of finance were beginning to explore international markets. Minos could foresee an era of

"free cross-border capital movements, including savings [opening up the way] not only for more medium-term but also for internationally-generated longer term capital to finance a wide range of activities." But to achieve these ends, Manny Hanny's new banking venture would have to be more than a conventional offshoot; it would need the remit and skills to operate in a wide range of markets, including commercial (loans) and investment (securities) activities.

Minos began to give serious thought to a new idea: how to construct a product that would meet the rapidly growing demand for medium term bank finance. The product would have to consist of very large unsecured loans – hundreds of millions of dollars – on terms of up to seven years. But they would have to be put together in a market where the bias was for short-term, bilateral, self-liquidating loans backed by hard assets such as tradable goods or industrial plant. The challenge lay in bridging that gap.

Minos explored all the wrinkles and put together a proposal for Manny Hanny for a new type of bank offering a new type of product. Not surprisingly, given its novelty, it drew a hostile reaction. Minos "must have gone crazy", it was "too risky" and had "never been done before". Nonetheless, his bosses left the door open by suggesting that he take advice more widely. Minos decided to talk to the Swiss banks which were, at the time, the most sophisticated in Europe. In particular he went to see Hans Baer, the burly and genial boss of the family bank which bore his name. He also called on White Weld, the Wall Street firm which was at the forefront of the Eurodollar market. In London, he talked to Rothschilds, the leading merchant bank at the time, where he forged a good relationship with Jacob, the joint senior partner with Evelyn, and the more ambitious of the two. He also made a point of talking to central banks because the product he had in mind had implications not just for the banking business, but also for cross-border capital flows and therefore for monetary control. He returned from these meetings greatly encouraged. The discussions had convinced him not only that there was a market but that the authorities would go along with his idea, at least for a trial period.