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BOOK REVIEW

THE LAW AND REGULATION OF INTERNATIONAL FINANCE. By Ravi C. Tennekoon. Butterworth Legal Publishers, Salem, NH: 1992. Pp. 500. $125.

Reviewed by Ian F.G. Baxter*

The Law of International Finance, as its opening states, revolves around "the law and regulation affecting the raising of finance in the international financial markets."[1] Thus, the book is about a very specialized area of finance and law—an area that has come into prominence, or even existence, only during the last two decades. As a solicitor in a large London firm that does substantial work related to financial business in the London international capital markets, Ravi Tennekoon has had considerable practical experience in legal work related to Eurobond issues and transactions and international syndications. London is, of course, the main center of the so-called Euro-currency markets. Most Eurobonds are issued in the London market, and the bonds normally contain a clause selecting English law as the applicable law.

As an academic lawyer, who has not had professional practice with Eurobonds or international syndications, my knowledge of these topics is derived from reading. Thus, I am qualified only to evaluate generally the author's detailed examination of the law, regulation, and practice of raising capital in the Eurobond and syndicated loan markets. To evaluate the book from a professional viewpoint would require a lawyer experienced in these areas.

With that caveat, *The Law of International Finance*, within its chosen boundaries as to the subject matter, is a very useful text. Tennekoon has put into the book the results of his professional knowledge and ex-

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1. RAVI C. TENNEKOON, THE LAW OF INTERNATIONAL FINANCE 1 (1992).

pertise about Eurobonds, syndications, and related matters in the London markets, and utilizes an approach that is analytical yet practical. Statutes, regulations, case law, and practice are examined and explained with regard to their possible impact on the relevant topic and legal practice. For example, the reader quickly can discern the potential impact of legislative and judicial changes on the many aspects of a Eurobond issue in the London market. Tennekoon does not provide basic criticisms of the law or thoughts about the social effects of international lending and borrowing.

Because borrowing money by issuing Eurobonds is not a universally available capital raising method, *The Law of International Finance* targets a very specific audience. Borrowers are generally governments and governmental bodies, international organizations or supranationals, banks, and industrial and commercial corporations.[2] Moreover, access to the Eurobond markets "is, generally speaking, restricted to corporations and other entities which have at least a single A assigned to their credit rating by credit-rating agencies such as Standard & Poor's and Moody's."[3]

The introduction of floating rate notes (FRNs) into the Eurobond market in 1970 has led to a rapidly accelerating use of bond swaps by these institutions. "Bond swaps, both currency and interest rate, are the fastest growing sector of the Eurobond market. Their significant increase in importance during the 1980s has had a radical and probably lasting impact on the market."[4] FRNs are medium and long-term international bonds with interest payable at a variable rate. Floating rate international bonds were introduced because, when the first FRN issue was made, a significant difference existed between the maturities for bank loans and bonds. FRNs gave industrial borrowers longer maturities than both syn-

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2. In the period between 1984-1987,

> [s]o strong was the recovery in corporate borrowing . . ., that Eurobonds were split 60/40 in favour of the private sector. Again, straight debt offering led the pack, representing nearly 34% of total issuing volume. FRNs also rebounded to exceed the past peak achieved during 1978-80. Commercial banks were major issuers during this period as they endeavoured to improve their balance sheet ratios by raising more long-term capital. Although the public sector as a whole was reduced in percentage terms, governments did return to the markets in greater numbers accounting for [13.5% of new issues. Their performance tended to overshadow the offering record of the other categories of sovereign borrowers.

FREDERICK G. FISHER III, EUROBONDS 61 (1988).

3. TENNEKOON, *supra* note 1, at 146.

4. During the mid-1980s, approximately 70% of all Eurobonds were tied to some form of swap. *Id.* at 187.

dicated loans and the floating rates often received from bank lenders.[5]

The choice between fixed and floating interest rates is a question of major importance in medium-term and long-term financing since the preferences of borrowers and lending banks likely will differ. For example, a borrower may prefer fixed rate financing because this will assist it in making long-range plans, but a lending bank may prefer an interest rate that floats in relation to a market variable, such as the London Interbank Offered Rate (LIBOR). The interest rate and currency swap market provides a means of alleviating the concerns of banks and lenders. A lending bank might issue fixed rate bonds to match loan commitments. The bank then might negotiate with a swap dealer (probably another bank) to swap the bond liability for an agreed liability in respect of floating rate debt. A swap is essentially a counter-trade in currency or interest obligations. For example, if fixed-interest obligations owned by A are swapped for floating-interest obligations owed by B, then A will provide the funds to pay the floating-interest obligations, and B will provide the funds to pay the fixed-interest obligations. In practice, a swap dealer (bank) will intermediate.

I. The Syndications Process

A. *The Lead Manager*

In chapter three, Tennekoon examines the role and functions of the lead manager—usually a major international bank. The prudent choice of a lead bank is important for the borrower. This choice may be influenced by the professional standing and reputation of the lead manager, its facilities and resources, its ability to organize a suitable syndicated group of banks, and its commitment to the whole operation.[6]

Chapter three also discusses the legal implication of a term sheet or offering document—the document by which the borrower mandates the bank to be lead manager and to organize a syndicate. Upon receiving a term sheet, the lead manager will attempt to interest other banks and

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5. The FRN combines "characteristics of a long-term international bond with a medium-term syndicated bank loan." *Id.* at 171.

6.

> Inherent in the scope of professional execution is the ability of a lead manager to underwrite a portion of the deal and then work well with competing institutions when the mandate has been granted. The ability of commercial banks to underwrite the transaction led to the eventual retreat of the U.K./U.S. merchant and investment banks from positions as lead managers or arrangers, as they had neither the ability nor willingness to commit capital to a given deal.

Robert P. McDonald, International Syndicated Loans 63 (1982).

financial institutions to become participants and members of a syndicate. Sometimes, in this connection, an information memorandum is circulated to provide information about both the proposed loan and the borrower. This information memorandum must be absolutely accurate and may not contain misleading information.[7] In fact, given that both the lead manager[8] and the borrower may be held liable for inaccuracies in the information memorandum, it may be better to omit the information memorandum, and instead provide that each potential syndicate member should conduct its own risk assessment. Potential bank members of international syndications usually have a network of branches and correspondents and access to a wide range of financial intelligence, and, thus normally should be capable of making their own assessment of the proposed borrower.

Tennekoon, in chapter four, addresses the interesting issue of whether a bank may be a fiduciary when it acts as an agent for other members of an international loan syndicate, when it provides them with advice or information, when it fails to transmit information, or when it reports, or fails to report, on the status of collateral security of the debtor.[9] If ever, only very compelling circumstances ought transform a lead or agent bank into a fiduciary. A participating bank almost certainly will be a major institution, with adequate legal resources and experience in international lending.[10] The relationship between a lead manager and a syndicate bank "is not fundamentally different from the relationship between IBM and the purchaser of a large computer system "because the members of a syndicate are 'buying' a product developed, marketed and serviced by the [lead] manager."[11]

B. *The Loan Agreement*

In chapter five, the author addresses the structure and contents of a syndicated loan agreement. Tennekoon's analysis in chapter five is substantial and indubitably will prove very useful to lawyers who are faced with the task of drafting or revising such a document, or who otherwise are asked to provide an opinion with regard to some aspect of a syndicated loan agreement. A draft of the loan agreement normally is pre-

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7. TENNEKOON, *supra* note 1, at 46.

8. Re Colocatronis Tanker Securities Litigation, 420 F. Supp. 998 (J.P.M.L. 1976).

9. See, UBAF v. European American Banking Corp., [1984] Q.B. 713, (C.A.).

10. TENNEKOON, *supra* note 1, at 67.

11. Leo L. Clarke and Stanley F. Farrar, *Defining Rights and Duties of Managing and Agent Banks to Co-Lenders* 117, 119, in SOVEREIGN LENDING: MANAGING LEGAL RISK (M. Gruson and R. Reisner, eds., 1984).

pared by outside lawyers instructed by the lead manager.

The amount of documentation involved in a major syndication can be prodigious.

> The typical 15-page Eurocurrency contract from the 1968-72 era had mushroomed into 60 pages or more by 1982. The difference between the two documents can be found in the explicit treatment of the operational and mechanical features surrounding deposit-taking functions of a dollar-only agreement, the selection and amount of optional currencies in multi-currency contracts, expanded clauses catering for alternative ways of quoting rates (the Eurodollar disaster clause), the changes of law paragraphs (illegality clause) and the wholesale conversion of the agency provision.[12]

The loan agreement will be a binding contract under its proper law and can form a basis for the discussion of any difference that may arise between the parties.

II. Risk Reduction and Issue Strategies

Clearly, international syndicated lending has not enjoyed unbridled success. For example, this method has produced a variety of problem loans, including third-world sovereign loans.[13] Subsequently, many international banks have attempted to reduce the risky assets appearing on their balance sheets. One method of risk reduction is the transfer, or selling, of high risk loans—probably at a discount. Another method involves the development of markets for the discount sales of risky loan assets. Chapter six discusses various interesting legal points about the effective transfer of these assets, essentially with reference to English law.

Chapter eighteen, dealing with the subject of stabilization, provides some interesting insights into issue strategies in the international bond markets. Tennekoon defines stablization as:

> a complex and sophisticated transactional process . . . [that] is an impor-

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12. McDonald, *supra* note 6, at 234.

13. In the 1970s,

> [t]he syndicate market was then a free-form, unstructured and undisciplined financial laboratory, prone to publicity and notoriety and an obvious fast track for career-minded bankers. To maintain momentum and growth, however, an innovative marketplace must nurture and sustain a high level of confidence. At the height of the market's free-form phase in early 1974, 18-20 maturities for certain European sovereign borrowers were in the discussion stage. Ten months later, the same quality borrowers were limited to a five-year final maturity and an average life not exceeding three.'

McDonald, *supra* note 6. at 39.

> tant function of the lead manager in ensuring that an international bond issue is a success. In essence, a lead manager will effect stabilisation by buying and selling Eurobonds in the open market for the account of the syndicate during the issue period by placing bids on screens used by dealers in the market in such a manner as to provide a price support mechanism for the bonds.[14]

The chapter, however, also points out:

> Stabilisation can also be used to create demand in such a way as to drive up the price of the bonds well above their issue price. In the case of Eurobonds which are convertible into shares (or in the case of Eurobonds issued with warrants to subscribe shares), it is also possible to 'ramp' or drive up the price of the underlying equity securities prior to the launch of the bond issue in order to make the convertible Eurobond (or the Eurobond with warrants) an extremely attractive investment despite its low coupon.[15]

Tennekoon also notes that a more common practice is for a lead manager to over-allot bonds to members of the underwriting syndicate during the issue phase, and then later stabilize the price via "buy back" purchases. Still another practice involves a lead manager under-alloting bonds "to a managing underwriter (or selling group member) which has established a short position in the bonds by over-selling or dumping bonds on the market prior to allotment."[16] This practice is referred to as "squeezing the shorts," and the author comments that " 'squeezing the shorts' also can be effected after allotment by purchasing bonds in the open market so as to make it expensive for short sellers to close their position."[17] The various stabilization practices raise questions about their legality,[18] and these are discussed in some detail in the chapter.

III. UNITED STATES SECURITIES REGULATIONS

In Part V, Tennekoon investigates the impact of the confusing maze of United States securities laws on international bond issues. This alone is a valuable piece of research, especially for those who are not United States securities lawyers or otherwise do not already have a specialized

14. TENNEKOON, *supra* note 1, at 340.
15. *Id.*
16. *Id.* at 341.
17. *Id.*
18. For example, section 47(2) of the Financial Services Act 1986 (U.K.) creates a statutory offense of market manipulation. A "safe harbour," however, is apparently provided by section 47(7) for stabilization conducted in accordance with stabilization rules made by the Securities and Investments Board.

knowledge of United States securities law. The author, in chapter nineteen, maintains that the reason for undertaking this formidable task is that: "(a) a large number of issuers in the international markets are U.S. corporations; (b) many of the lead managers and key underwriters of international bond issues are U.S. investment banks; and (c) over half the international bond issues are denominated in U.S. dollars."[19]

One of the questions raised in this part of the book—who is the owner of a bearer bond placed in a depository (such as Euroclear or CEDEL)?—may have wide implications. The usual rule, of course, is that the owner of a bearer instrument is the person in possession of it. On an issue of Eurobonds, however, the practice is different because a temporary global instrument is placed in a depository and exchanged later for definitive bonds. The global instrument is a bearer instrument, and until the exchange, stands in the place of the definitive bonds and contains appropriate obligations in favor of the purchasers. Trading in bonds is recorded in accounts with Euroclear or CEDEL and may take place before the definitives are available. Bonds are not sold by serial numbers, but are traded in fungible amounts between banks or dealers who are members of the system. Thus, banks in continental Europe may buy Eurobonds to the credit of their depositary accounts and subsequently credit amounts to customers wishing to invest.

Trading in Euro-instruments is electronic between dealers, without the trading of physical instruments. Indeed, in regard to some short-term Euromarket instruments, such as Euro-commercial paper, usually no definitive instrument exists. Therefore, the general process is analogized to the bank term-deposit (substituting bond deposit data for money deposit data) and should probably be analyzed on that basis.

IV. Concluding Remarks

The Law of International Finance does not deal with all forms of international financial transactions. Its parameters are the primary markets for international debt securities and international syndicated loans. This means, of course, that various important aspects of international banking and financial business, such as foreign exchange markets, are not included in the book. Foreign exchange markets are very large. According to a 1990 survey, the average daily volumes of the main centers are: London - 187 billion (U.S.) dollars; New York - 129 billion (U.S.)

19. Tennekoon, *supra* note 1, at 361 (citing *The Euromarket in Figures* (June 1989 supp.)).

dollars; Tokyo - 115 billion (U.S.) dollars.[20] Over ninety percent of the global volume consists of inter-bank trading. Other topices not covered in the book include: "baskets of currencies," such as the Special Drawing Right of the International Monetary Fund (SDR) or the European Currency Unit (ECU); futures and options markets and contracts; banking and other financial aspects of export trade, such as letters of credit or the financing of exports; and the various uses of bills and notes including forfeiting in relation to exports.

The author does not address the advantages or disadvantages of different ways of attempting to settle disputes, if and when they arise. This can be quite a large subject on its own, when account is taken not only of the basic range of resolution methods including negotiation, arbitration, and litigation, but also the differences in the laws of different states. The author highlights the prevailing practice of putting choice-of-law clauses into Euro-instruments, such as Eurobonds and syndication agreements. Using a wider set of topic parameters, however, might not allow for the current trend of heavy reliance on English or New York choice-of-law or choice-of-jurisdiction clauses.

The chosen subject area of *The Law of International Finance* is, in fact, part of a wider area of development involving the greater internationalization of financial business and of the activities of banks and other financial institutions. Lawyers who are involved, or may be involved, in some areas of international finance should have at least a general understanding of current markets, techniques, and developments. Knowledge of the domestic legal system alone is not adequate for a lawyer who may be involved with the financial aspects of the globalized business world. Students and others interested in international business must also have access to information on the whole spectrum of financial globalization.

We often tend to think of Euro-transactions, foreign exchange transactions, syndicated bank lending, and other international financial business, as being confined to one of the three first-line market centers—London, New York and Tokyo. These are centers of great power and strength, with sophisticated banks and operators. It is true that these are the three primary deal-making centers—with perhaps the addition of Hong Kong and Singapore. While these are the main places for negotiations, the deals may be "booked" elsewhere—such as in the Cayman Islands or another tax haven to reduce taxes. Consequently, a rather peculiar situation develops whereby few large and important deal-making locations are able to serve as possible booking places.

20. The *1990 Foreign Exchange Directory*, INSTITUTIONAL INVESTOR, Feb. 1990, at 239.

Communications technology has enabled the building of high-speed, electronic systems as global networks, or as wide-area networks connecting other networks, with widely dispersed elements in different parts of the world. This technology provides for the free flow of financial information between locations at electronic speed. If an international bank is to be truly competitive, financial information must be fast and global. The computerized systems that deliver information keep growing in number, complexity, and size. Banks, of course, have their own networks for transferring funds internationally. Indeed, the whole edifice of international finance rests on globalized information technology, with linked computers, transmitting, receiving, and storing data at electronic speeds.

The nature of these developments can raise questions about effective regulation of international financial business. States have employed different approaches to financial regulation with varying degrees of effectiveness. Some are mainly of interest as tax havens or as convenient parking-places for money. Another problem for regulation is that most large banks have subsidiaries or branches in states other than their head-office state—a problem demonstrated by the example of the Bank of Credit and Commerce International (BCCI). Thus, a variety of regulatory agencies, perhaps all in different states, may be involved. These agencies are likely to have different policies with different effectiveness, and varying concern about regulation. Is the whole array of international banking, trading and investment—now spread across the globe—becoming so complex that even vigilant national regulators may be unable to detect improper transactions and wrong-doing, or to devise adequate general rules which will have international effect? Information carried by a computer network can bypass national boundaries. Computer networks can be used for illegal, as well as legal, purposes, and money can be quickly moved into and out of accounts held in many locations.

The Law of International Finance seems, to this reviewer, to provide very useful assistance to lawyers concerned with preparing documents, giving opinions, and advising on matters related to Eurobonds and syndicated bank lending. The book also could function as an effective reference work for those who are studying international finance and might wish to access Tennekoon's detailed information on Eurobonds and syndicated loans.

Ultimately, however, it should not be overlooked that the law and processing of Eurobonds and syndicated bank loans (mainly in the London markets and in relation to English law) represents only a part of the modern spectrum of developments in the globalization of finance.

These developments have many ramifications and have a potential for problems, as well as benefits.