

Before the Beginning

To 1962

The origins of bond markets can be traced back to governments and their need to borrow, particularly in times of war. In the late Middle Ages, the Republic of Venice was involved in recurring conflicts with neighbouring states. The authorities, concerned about the strains on the state treasury, took to drawing forced loans from their citizens in proportion to their wealth. Such debt paid 5% interest per year and had an indefinite maturity date. Initially regarded with some suspicion, they came to be seen as valuable investments that could be bought and sold. The bond market had begun.

From the medieval Italian city states to warring European powers looking to finance military campaigns, the issuance of interest-bearing debt has enabled them to pursue their ambitions. Much of this debt, like that of Venice, was undated with governments creating a permanent funded debt burden. The amount of debt that could be issued depended on the investor's confidence in the ability and commitment of the issuer to make the required payments under the contract. Unfortunately sovereign issuers were prone to renege on their debts or change the terms substantially, so the investor's preference was originally for short-dated, high interest loans.

During the latter part of the 16th century the Dutch attained an increasingly dominant position in international trade, especially the lucrative spice trade, a position previously occupied by the Portuguese and Spaniards. Amsterdam became the city where merchants and bankers could obtain bills of exchange to settle their trading activity.¹ At the time, it was customary for a trading company to be set up for the duration of a single voyage, financed by a small group of merchants, and to be wound up upon the return of the vessels. Investment in these expeditions was a high-risk venture, not only because of the dangers of sickness, piracy and shipwreck, but also because of changing market conditions for the imported goods. The further a trading expedition ventured, the greater the risks involved, and the greater the number of investors required to finance it. In 1602 the Dutch government sponsored the formation of the Dutch East India Company, which was given a monopoly over Asian trade for a continuous period of 21 years. It was the first company to issue shares and the offering attracted more than a thousand Dutch investors. As the financial outcome of voyages was not known until a particular expedition was completed, the shares varied widely in value and a secondary market soon developed between merchants, investors and speculators. As Asian spices were

imported in bulk to meet the seemingly insatiable appetite in Europe, huge profits accrued to the shareholders.

The Dutch came to dominate trade in Europe. They were favourably positioned at the centre of a network of European trade routes. Dutch traders shipped wine from France and Portugal to the Baltic countries and returned with grain for countries around the Mediterranean. By the 1680s, an average of nearly 1,000 Dutch ships entered the Baltic Sea each year. The Dutch were also able to gain control of much of the trade with the young English colonies in North America.

The accumulation of capital in the enormous amounts generated in this period caused a demand for productive investment opportunities. Wealthy investors with cash balances found that investing in loans and securities was a more portable and flexible way of managing their wealth, rather than relying solely on the revenue from their estates or their trading ventures. So it was among the merchants of Amsterdam that active trading in securities first developed and led to the establishment of the Amsterdam Stock Exchange and the Bank of Amsterdam.

With only a modest domestic government bond market, wealthy Dutch investors became interested in loans issued by foreign governments. Dutch public loans offered yields of only 2–3% whereas foreign government loans offered 4–6% yields. Consequently European states became accustomed to funding part of their budget deficits by selling bonds to wealthy international investors through specialist intermediaries, based in Amsterdam.

Prominent amongst these intermediaries was Hope & Company. The firm was founded in 1762, but members of the Hope family – originating in Scotland and arriving in Amsterdam via Rotterdam – had already been involved in the money and commodity trade since 1720. In the aftermath of the Seven Years War (1756–1763), after Henry Hope had joined the firm, Hope & Co. arranged numerous loans for the governments of Sweden, Russia, Poland, Portugal and Bavaria. Many of these loans were made in exchange for trading privileges. The Portuguese loan was made in return for an exclusive concession to market diamonds from the Portuguese colony of Brazil. Hope & Co. sold the diamonds on the Amsterdam market, and the sale proceeds provided the interest and principal on the loan. This activity contributed to Amsterdam becoming the leading diamond centre of Europe.

The bank floated 10 loans for the Kingdom of Sweden between 1767 and 1787 and 18 loans for Russia from 1788 to 1793.² The first loan to Catherine the Great's Russia was for Fl.3m in 1788 at a rate of 4.5% and many more followed. In return for these loans, Hope & Co. obtained the right to export sugar to Russia, and sell Russian wheat and timber to countries throughout Europe. In fact Hope and Co. remained bankers to the Czars until 1917.³

The bank was also involved in financing plantation owners in the West Indies, taking payment in kind: sugar, coffee or tobacco, which Hopes would then sell on the Amsterdam market. For the majority of these loans, Hope led a syndicate of prominent English and Dutch investors who provided the funds, while Hope & Co. collected a handsome commission of 5–9%.*

*In 1962, with the increasing consolidation of the banking industry, Hope & Co. sought an alliance with R. Mees & Zoonen, initially as a joint venture and then as a fully merged company under the name Mees & Hope, Bankiers. In 1975 Bank Mees & Hope became a wholly owned subsidiary of ABN. It was subsequently sold to Fortis Bank in 1991 but acquired back when Fortis Bank Nederland merged with ABN AMRO in 2010. The private banking business of the combined bank was renamed ABN AMRO MeesPierson.

The securities trading methods and practices established in Amsterdam spread to other financial centres. As markets grew rapidly, speculative booms developed, most notably, the South Sea Bubble in London and the Mississippi Bubble in Paris. The first led to restrictions on joint-stock companies in England while the second led to the French government establishing the first formal stock exchange in Paris in 1724. Paris and London continued to vie with Amsterdam as growing financial centres throughout the 18th century although their focus was on domestic government stock and issuance by domestic joint-stock companies. Amsterdam remained the principal centre for international trading.⁴

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From 1789 to 1815 revolution, then war, spread through Europe with profound consequences for the developing securities markets. The French Revolution of 1789 had a significant impact throughout Europe, with the proclamation of a Republic in 1792 and the execution of King Louis XVI the following year for ‘crimes of tyranny’ against the French people. The outbreak of European wars, originally intended to defend and then spread the influence of the French Revolution, prompted the Republican government in France to renege on a major part of the previous monarchy’s debts.

Napoleon Bonaparte seized power in 1799 after overthrowing the French revolutionary government. There followed a series of wars where French forces battled various coalitions of European nations between 1803 and 1815. French power rose quickly as Napoleon’s armies conquered much of Europe.

But as the conflict spread, other governments also ceased to pay interest on their debts and in some cases even acknowledge their indebtedness, all the more so if such debts were owed to foreign investors. Numerous sovereign defaults ensued and the international securities markets collapsed.

In 1803 Britain declared war on France and, aided by its island status and naval supremacy, remained at war until 1815. The British government, in addition, paid out large sums of money to other European states, so that they would remain at war with France. But the cost of war drained Britain’s resources, and ran up a considerable national debt. The British government was borrowing heavily, not only to build up her own forces, but also to subsidise her European allies whose capital markets were no longer operating.

Between 1810 and 1814, the Netherlands was annexed to France and the French franc circulated in place of the ‘gulden’. International trading links broke down. As the Amsterdam market suffered, so that of London prospered. International trade increasingly gravitated towards British merchants.

Yet during this period of turbulence a landmark bond transaction took place involving for the first time on a major scale, cooperation between the financial markets. This was ‘the Louisiana Purchase’. Spain had secretly granted the Territory of Louisiana, in North America, to France in 1801. The territory stretched across the entire Mississippi Valley, to the Rockies in the west, to Canada in the north and southwards to the Gulf of Mexico. An area roughly equivalent to a third of the United States today, encompassing all or part of 15 US states. Louisiana was of diminishing strategic importance to France and Napoleon believed that it could be a liability in any future war with Britain. When approached to sell it to the US government, he agreed.

The sum needed for the purchase was beyond the means of the US government and so help was sought from the two leading merchant banks at the time, Hope & Co. of Amsterdam

and Barings of London. Barings had well-established connections with both the US and France, and Hopes were the leading issuer of sovereign loans, and the banks themselves were linked through family connections. Negotiations were conducted during a brief period of peace between Britain and France. The size of the transaction was unprecedented, as France demanded FF100m for the territory. The parties agreed that the financing could only be achieved by the issue of US government bonds and the price finally agreed was FF80m (equivalent to \$15m). After the American bonds had been issued, the French government then sold them on to Hopes and Barings at a discount of $\$87\frac{1}{2}$ per \$100. The bonds were issued in 1804, and rank among the first US securities issued in the international markets. The coupon of 6% was payable half yearly in Amsterdam, London or Paris. In fact Napoleon was so desperate for funds that the bankers advanced FF10m of the funds ahead of the bond issue. The issue was an evident success for the underwriters with all bonds placed at or above par.⁵

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A rapidly expanding industrial economy and the success of the new income tax (introduced to finance the war against France) meant the London market was growing as the fortunes of the international securities markets waned. For foreign investors at a time of widespread sovereign default, British government debt was viewed as a safe haven. Bankers and brokers from other financial centres moved to London as the only centre still operating normally. One noteworthy immigrant was Nathan Rothschild.

Mayer Amschel Rothschild founded the house of M.A. Rothschild in Frankfurt in the 1790s. Starting out as a coin and bill dealership, his business developed into offering financial services to wealthy German clients and Prussian nobility. 'Court Jews' as they were known, were opportunists operating on the principle that courtly patronage would lead to a range of advantageous state and commercial benefits. In 1816 Amschel advised his brother 'Business transactions with royalties always end in a profitable way. Please do not let the smallest business go by.'⁶

In the early 19th century the five sons of Mayer Amschel Rothschild set out from their home in Frankfurt to establish businesses in Europe's principal financial centres: London, Paris, Frankfurt, Naples and Vienna. His third son, Nathan, at the age of 21, left Frankfurt for England. After 10 years working as a textile merchant in Manchester, he took a small office near the Bank of England in London, where, with a large sum of money given to him by his father, he set up a banking house. His brothers followed his example and in time they had established a family network of banks in Europe's financial centres.

By 1811 Nathan Rothschild had begun to involve himself in British war finance. The British government used the Rothschild family network to relay funds to troops in the field and subsidy payments to Britain's European allies.

After the peace of 1815 the first big international financial transaction was an 1817 loan to France, however Rothschild was excluded from the deal. It was a loan to allow France to pay war indemnities and so facilitate the evacuation of foreign troops and was arranged by the experienced partnership of Barings and Hope & Co.

When the British wartime subsidies ran out as the conflict ended, so her allies, particularly Austria, Prussia and Russia, the so-called 'Holy Alliance', found themselves in financial straits. The post-war Prussian deficit amounted to Thaler 188 million (£32 million). Their own continental markets were not capable of raising sufficient finance so it needed to be raised in London. In fact the idea for a London loan came from the Prussian Seehandlung Bank in

London, but they had proposed it be raised in Prussian Thaler.⁷ Nathan Rothschild took a different view.

The end of the Napoleonic Wars found English merchants and aristocracy with substantial sums to invest. As the financial momentum had swung towards London so Nathan Rothschild decided that future foreign government borrowings should be denominated in sterling to attract these investors. Heavy domestic government issuance had crowded out foreign issuance in the past. Interest would be payable in sterling in London rather than in Prussian Thaler in Berlin. Seehandlung Bank would be responsible for ensuring the necessary payments were transferred to Rothschilds in London. He insisted the bonds should be in bearer form rather than in the registered form favoured by some European governments and included a British style sinking fund to ensure the amortisation of the loan.⁸ These features would attract British investors, along with the bond providing a more attractive yield than the 3% available on British 'Consols' (Consolidated government stock) at the time.

The new loan was not just offered in London but throughout Europe via the Rothschild network of offices. Despite the initial opposition in Berlin, particularly from the German bankers, the £5 million Prussian loan of 1818 was an outstanding success attracting both British investors and major European financiers. With this initial success Nathan was able to raise a further Prussian loan in 1822.

Despite the obvious success of the sterling loans not all governments were enthusiastic about following the Prussian example. Cash-strapped Russia favoured a rouble transaction. Rothschild came up with a sterling loan similar to the Prussian loan but with the option to pay interest in sterling in London or roubles in St Petersburg with the exchange rate fixed at the outset.⁹ Before long, the overwhelming majority of sovereign issuance was launched in sterling via London; either as a straight sterling loan targeted at British investors or with the ability to pay interest in foreign currency to attract both domestic and foreign investors. These bond issues of 1818 and 1822 became the template for sovereign bond issuance for more than a century. The economic historian Niall Ferguson declares these Prussian and Russian loans to be among the first, if not *the* first, Eurobonds.¹⁰

Between 1822 and 1825 British merchant banks issued 20 foreign loans totalling £40 million. Of these, 12 were for new Latin American Republics, largely building on the template Rothschild had set. Many featured a syndicate of European merchant banks looking to attract subscriptions from as wide an investor base as possible. To accommodate trading in the new loans the London Stock Exchange established a 'Foreign Funds' market which was absorbed into the main market in the 1830s.¹¹ In England it became the custom to underwrite issues at fixed prices by having banks enter into purchase contracts with issuers, thereby assuming the market risk of success or failure. The need for syndication was expressed by Nathan Rothschild to London colleagues in 1865: 'I think you will not only require your friend Baring, but likewise some of the joint-stock banks to unite with you, and however disagreeable it may be to have such partners, if it is the means of making the affair go down, you ought not to mind it.'¹²

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The dominance of government issuance in the securities markets came under threat as the 19th century progressed. From the middle of the 18th century, British industry increased rapidly because canals provided the means for the movement of raw materials and manufactured goods. The needs of the new industrial age required development and infrastructure projects necessitating substantial up-front investments. The canal companies had sought capital before

1800 but now they were joined by the needs of gas and water network projects and by the railway 'mania' of the 1840s.

The British railway network, the oldest in the world, was developed in a piecemeal fashion by small private railway companies. In 1825 the government had repealed the Bubble Act, brought in after the South Sea Bubble fiasco, which restricted new business ventures and had limited joint-stock companies to a maximum of five investors. With these limits removed the newly emerging middle class could invest their savings in new industries and railway companies presented an exciting opportunity. During the railway boom of the 1840s the proliferation of competing small railway companies were linked up to form a national network.

The new railways reduced the cost of shipping by carriage by 60–70%, so it was not long before railway 'fever' spread to other countries. Large numbers of bond issues were launched for British and foreign railways from the United States, China, France and other countries throughout the 1840s and 1850s. In the United States new 'railroads' developed swiftly across the vast continent and European banking firms forged alliances with US securities firms to participate in the business.¹³ In 1860 Henry Varnum Poor, a financial analyst, published a *History of Railroads and Canals in the United States*. This book was an attempt to compile comprehensive information about the financial and operational state of US railroad companies and was annually updated. This would evolve into the financial analysis company and rating agency Standard & Poor's.

So by the middle of the century corporate securities were beginning to challenge the dominance of government debt. While the railways led the way, they were closely followed by other public services. In addition the growth of the banking and insurance industries bolstered the securities markets. But key to the development of the international securities markets was the development of international communications.

In 1832 Samuel F.B. Morse, among others, worked on the idea for an electromechanical telegraph. The flow of electricity through a wire was interrupted for shorter or longer periods by holding down the key of the device. The resulting sequences of dots or dashes enabled messages to be transmitted. The first commercial telegraph lines were completed between Washington, Philadelphia and New York in the spring of 1846. This enabled links between stock exchanges on the US east coast. The *New York Herald* of 3 March 1846 records 'certain parties in New York and Philadelphia were employing the telegraph for speculating in stocks.'¹⁴ At this time other telegraph systems based on rival technologies were being built. Amsterdam and Rotterdam were connected by telegraph in 1847 and Berlin and Frankfurt linked in 1849.¹⁵ With messaging between markets now taking minutes rather than days, national markets became increasingly internationally connected via telegraph. A trans-Atlantic cable was successfully completed in July 1866 and four days later the *New York Evening Post* published price quotations from the London Stock Exchange.¹⁶

Throughout the second half of the 19th century, London and Paris were the principal financial centres in which large foreign bond markets existed.¹⁷ One of Rothschild's principal rivals in France, and similarly well-connected with foreign governments, were the Paris-based bankers, Erlanger et Cie. They played a major role in channeling French capital into railroads and land development in the southern states of the US during and after the American Civil War. Baron Frederic Emile d'Erlanger was married to Matilde Slidell, the daughter of Louisiana merchant, lawyer and politician, John Slidell. Slidell was the Ambassador of the Confederate States of America at the court of Emperor Napoleon III. The Confederate States had relied heavily on import tariffs and taxes on exports to finance their war effort. However

they introduced a trade embargo on cotton exports in 1861 in an attempt to starve Europe of cotton and thereby try to force international diplomatic recognition of the Confederacy. Meanwhile the Union Navy blockaded southern ports. With dwindling revenues from exports, the Confederate government raised taxes and increasingly printed money.

Foreign debt finance was an alternative, but the Confederate currency was considered worthless in Europe. Moreover the principal merchant banks in London were reluctant to be seen as supporting the Confederacy, particularly as they were suffering repeated defeats in the conflict. The Confederate government therefore entered into an arrangement with Emile Erlanger et Cie. for the so-called Erlanger Loan or 'Cotton Bonds'.

The loan for £3m or FF75m was issued in five European cities, London, Liverpool, Paris, Amsterdam and Frankfurt with a fixed coupon of 7%. *The Times* of London commented on 18 March 1863:

One of its peculiar features is that the bonds are to be exchangeable against cotton, the latter being taken at the fixed price of 6d per pound. This arrangement is of course designed by way of attraction to the speculative appetite; for supposing it were possible to get the cotton away and sell it at Liverpool at 12d per pound (which is less than half the present price,) the holder of a bond which has cost £90 might get from £180 to £200. In every respect this is a very remarkable operation ... As a matter of course, the security of the bondholders will depend entirely upon the ability of the South to maintain its independence.

The bond issue was allegedly over-subscribed five times with even the British Chancellor of the Exchequer at the time, William Gladstone, a willing investor. All this, despite the fact that cotton shipments would need to be collected in the blockaded southern ports.

Erlanger did very well out of the issue which they had purchased at a face value of £77 to offer at £90 plus taking a 5% fee for their efforts. In addition they established the European Trading Company, a shipping company targeted at evading Union ships and breaking the blockade in the Gulf of Mexico. For a significant fee, cotton would be delivered to Bermuda, the Bahamas or Cuba for transport onwards to anxious European bondholders. After the Confederate forces defeat at Gettysburg, the bond price collapsed. Some commentators claim these 'Cotton bonds' as the first true Eurobonds.

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As international markets became more connected what could be done about foreign exchange risk? From the earliest times, gold and silver had provided a common medium of exchange with goods being exchanged for gold and silver coins. If the coins were unfamiliar, then a merchant simply weighed the coins, assessed or rather 'assayed' their purity, then calculated what weight of pure gold or silver they represented. In Britain, the Anglo-Saxons introduced silver pennies or 'sterlings' and 240 of these weighed exactly one pound weight. As trade proliferated it became unwieldy to carry around vast quantities of coins or bullion so bankers began to issue paper notes representing a particular quantity of gold or silver. Goldsmiths had issued bank notes – promises to pay set against gold deposits – from the 16th century. In 1717 Britain fixed £1 to 113grains (7.32g) of fine gold, rather than its original silver. This so-called 'gold standard' fixed the value of money by allowing it to be converted into a certain amount of gold. People could now have faith in 'paper money'. In the 1870s Germany joined Britain on the gold standard and by the end of the 1870s nearly the whole world was on

the gold standard. As a result exchange rates only moved after an agreed adjustment which largely removed foreign exchange risk. Trade expanded rapidly under the gold standard, as did international capital markets.

But there was a down side to the gold standard in that it would transmit economic cycles and financial crises around the world as fast as the telegraph could carry them. Governments faced with the need to fund high levels of expenditure, but with limited sources of tax revenue, suspended convertibility of currency into gold on a number of occasions in the 19th century. The British government suspended convertibility during the Napoleonic wars and the US government during the US Civil War. In both cases, convertibility was resumed after the war.

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By the dawn of the 20th century national stock exchanges proliferated but they were no longer confined by their national boundaries. The international securities markets had become a significant source of corporate financing for developed economies. With an absence of major conflicts, government borrowing declined while corporate issuances grew. In general by 1914 corporate stocks and bonds had overtaken government debt in importance, with around 60% of the securities in existence having been issued by companies, compared to only 40% by government.¹⁸

Before the First World War the British pound sterling was the most important international currency, and the City of London was the world's most important financial centre. More than 60% of global trade was financed, invoiced and settled in sterling, and the largest proportion of official reserves, apart from gold, was held in sterling. The City of London was the undisputed centre of international finance with 387 loans issued for 54 different sovereign borrowers in the period from 1866 to 1914. The London market was attractive because interest rates were generally lower than elsewhere, and restrictions on foreign loans were less in London than in competing financial centres.¹⁹

However the period before the First World War was one of increasing political tension among the European powers. From 1815 onwards the major European nations had gone to considerable lengths to maintain a balance of power throughout Europe, resulting by 1900 in a complicated network of political and military alliances across the continent. But with a host of unresolved territorial disputes, a mood of growing nationalism and increasing militarism was developing. On 28 June 1914, the Archduke Franz Ferdinand, heir to the Austrian throne, was shot and killed by a Serb terrorist, while visiting Sarajevo. Austria was already hostile towards Serbia, and now it decided on retaliation. On 28 July 1914, Austria declared war on Serbia.

Now the alliance system swung into play. On 30 July, Russia started mobilisation in support of Serbia. In reaction, Germany, in support of Austria, declared war against Russia on 1 August. Germany declared war on France, and demanded free passage across Belgium. Britain was a particularly reluctant participant in the growing tensions, more concerned with the troubles in Northern Ireland. Nonetheless Britain pledged to support Belgium and on 4 August a British ultimatum to Germany was refused. Britain therefore declared war on Germany, while Germany declared war on Belgium, and launched an invasion of the country. Finally, on 5 August, Austria declared war on Russia. The horrors of the First World War were about to unfold.

A government can finance a war in only three ways: it can raise taxes, it can borrow or it can print money. Increasing taxes is the most painful and unpopular, while opportunities for debt financing may be limited and put pressure on interest rates. Printing money, however, makes war seem costless to the average person. The economic situation in Europe when war

broke out led many to believe an extended conflict would be ruinously expensive and therefore the war would be over in weeks or months at worst. Unfortunately ways were found to fund the fighting.

In August 1914 the gold reserves of the Bank of England amounted to nine million pounds (at the time £1 = US\$4.85). The banks feared the declaration of war would trigger a run on the banks, so the Chancellor, David Lloyd George, extended the August bank holiday for three days to allow time for the passing of the Currency and Bank Notes Act, by which Britain left the gold standard. Most belligerent countries followed the UK in leaving the gold standard during the war, and as a result suffered significant inflation.

The international securities markets were not prepared for a major European war and it came as a considerable shock. Markets collapsed as investors panicked and looked to sell whatever securities they could. In response, to avoid a meltdown, authorities closed down stock exchanges around the world. Only the New York Stock Exchange remained open and only the US dollar remained convertible into gold.

But while markets for corporate stocks remained subdued, the supply of government bonds in national markets exploded, as authorities looked to tap domestic savings to finance the war effort. The international securities market shrank and gravitated to New York as domestic government paper swamped investors. Investors were either enticed or forced to sell foreign investments and support the home war effort. American investors purchased more than \$3bn of US securities previously held in Europe. Between 1917 and 1919 they were also called on to absorb \$17bn of US Liberty Loans and a victory loan of \$4.5bn.²⁰ And it was to the US market that Britain and her allies looked to for much needed funds. In the period August 1914 to April 1917 Britain borrowed \$1,250m, France \$640m and Russia \$107m.²¹

Before the First World War the US was a substantial debtor country and its growth was financed in large part by European capital. When the war began the US economy was in recession. But the war stimulated the US economy, increased employment and raised the profitability of US industry as the demand for US materials in Europe escalated. Steel production reached twice its pre-war level by 1917. US farmers enjoyed boom years as agricultural prices rose and the international market for their products expanded. Annual incomes rose steadily, from \$580 in 1914 to more than \$1,300 by 1920. Now US citizens had money to invest. By the 1920s the US found itself as the world's largest creditor nation, being owed significant sums of money by most of the combatant nations involved in the First World War. After the war the US began investing large amounts overseas, particularly in Latin America, taking a role previously played by London.

Following Germany's defeat, reparations were set by the Allied victors at the Treaty of Versailles in 1919 – as compensation and punishment for the 1914–18 war. Most of the money was intended to go to Belgium and France, who had suffered the greatest devastation from the war, and to repay the Allies some of their war expenditure.

The victors in 1919 were in no mood to be charitable, and the initial sum agreed upon for war damages was 226 billion gold marks, the equivalent of around 100,000 tonnes of pure gold. This 100,000 tonnes of gold was clearly beyond the means of the Germans to pay. Consequently their only way of paying back the debt was in foreign currency, but attempts to purchase foreign currency with the devalued paper Marks in circulation led to hyperinflation.

The principal representative of the British Treasury at the Paris Peace Conference, John Maynard Keynes, resigned from the Treasury in June 1919 in protest at the scale of the reparations demands, and subsequently protested publicly in the best-selling book *The Economic Consequences of the Peace* (1919). Keynes exposed the folly of imposing on Germany a debt of more than three times its pre-war annual GDP, which was to be repaid over a period of

decades. He warned that the reparations threatened to destabilise the German economy, and German politics: 'If we aim deliberately at the impoverishment of Central Europe, vengeance, I dare predict, will not limp.' The 1924 Dawes Plan modified Germany's reparation payments and in May 1929, the Young Plan reduced the payments further to 112 billion gold marks.

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The United States was now a financial superpower eclipsing that of Britain. Yet after the war Britain sought to return to its former pre-eminence, ignoring the consequences of the war. Winston Churchill returned sterling to the gold standard in 1925 at the pre-war rate of £4.86 to the dollar. This rate of exchange for sterling had been unchanged since Sir Isaac Newton, Master of the Mint, set it in the 18th century, and now was seriously overvalued. The dollar's growing dominance was reducing sterling's importance as a reserve currency.

The financial imbalance between the US and Europe was growing and the Federal Reserve maintained a low interest rate policy to support the dollar sterling exchange rate. Encouraged by the low US rates foreign borrowers were attracted to the New York market. It is estimated that US investors absorbed US\$3.6bn in European securities between 1921 and 1926 for both sovereign and corporate borrowers.²² Much of the debt offered in the foreign bond market during the 1920s and early 1930s defaulted during the Second World War. Investors in new issues like the First Bohemian Glass Works (of Czechoslovakia) 7.5% due 1957 issued in 1927 or the City of Warsaw 7% 30-year bonds issued in 1928 could not imagine the devastation that was to be wrought on those countries in the subsequent conflict.²³

The US was now enjoying a great sense of confidence, optimism and prosperity. By the mid-1920s the economic boom was fuelling a speculative frenzy on Wall Street. US investors were being tempted by the increasing returns available on the New York Stock Exchange. A significant number of them were borrowing money, at the prevailing low rates, to buy more stocks. By August 1929, brokers were routinely lending small investors more than two-thirds of the face value of the stocks they were buying. Over \$8.5bn was out on loan, more than the entire amount of currency circulating in the US at the time. From 1921 to 1929 the Dow Jones rose from 60 to almost 400.

Because of margin buying, investors stood to lose large sums of money if the market turned down – or even failed to advance quickly enough. On 24 October 1929, with the Dow just past its 3 September peak of 381.17, the market finally turned down, and panic selling started. The falls in share prices on 24 and 29 October 1929 prompted panic and price falls in all major markets. During November alone the Dow Jones collapsed from close to 400 to 145. The 1929 Wall Street crash brought the 'Roaring Twenties' to a grinding halt.

The decline in stock prices caused bankruptcies and severe economic difficulties including contraction of credit, business closures and redundancies. Banks began to fail as debtors defaulted and depositors attempted to withdraw their deposits en masse, triggering multiple bank runs. Bank failures multiplied as desperate bankers called in loans which the borrowers did not have time or money to repay. With future profits looking poor, capital investment and construction slowed or completely ceased. The liquidation of debt could not keep up with the fall of prices which it caused; eventually turning a recession into a depression.

One response to shore up the ailing US economy was the protectionist Smoot Hawley Tariff Act of 1930, which raised US tariffs on over 20,000 imported goods to record levels. This Act prompted retaliatory measures by other countries and is often considered as marking

the beginning of the Great Depression when international trade plunged by 50 % and where, by 1932, US unemployment reached 25%.

It was the longest, most widespread, and deepest depression of the 20th century, leading to mass unemployment and mass poverty. The majority of countries set up relief programmes, and most underwent some sort of political upheaval, pushing them to the left or right. In Germany the emergence of the National Socialist Party, out of the chaos of hyperinflation, would set the stage for the Second World War in 1939.

Many believed that the depression was spread around the globe by the rigidities of the gold standard. Accordingly every major currency left the gold standard during the Great Depression as countries tried to stimulate domestic demand by devaluing their currencies. Exchange controls were introduced, isolating one economy from another. The liberal global securities market of 1914 was now replaced by a series of restrictive compartmentalised markets under domestic government supervision.

When sterling left the gold standard in 1931, many other currencies – about half the world's total – chose to leave with it and many countries opted to remain pegged to sterling. This gave rise to the 'sterling bloc', which during and after the Second World War would evolve into the sterling area.

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Crisis always brings regulation in its wake. In reaction to the Wall Street crash and the ensuing depression, and at President Franklin Roosevelt's instigation, Congress set out to enact laws that would prevent further speculative securities frenzies. After a series of hearings that brought to light the severity of the abuses leading to the crash, Congress enacted the Securities Act of 1933 (the 'Securities Act') governing the issue of securities, and the Securities Exchange Act of 1934 (the 'Exchange Act') which regulated the trading of securities. The key theme of the new federal securities law was the need to give investors access to information about the securities they buy and the companies that issue securities. Federal securities laws primarily accomplished this by putting the burden on companies to disclose information about themselves and the securities they issue and the adoption of GAAP (Generally Accepted Accounting Principles). Companies looking to issue securities publicly must disclose important financial information through the registration of securities. These disclosure requirements are backed up by broad liability for fraud under the Securities Act and the Exchange Act for both issuers and sellers of securities.

The 1933 Act was the first major federal legislation to regulate the offer and sale of securities. Prior to the Act, regulation of securities was chiefly governed by state laws, commonly referred to as 'blue sky' laws. In addition, the Exchange Act created the Securities and Exchange Commission (SEC), a federal agency that had the authority to enforce federal law and its own rules. The SEC also regulates the securities business. Under the Exchange Act, the SEC has the authority to register, regulate and discipline broker-dealers, regulate the securities exchanges, and review actions of the securities exchanges' self-regulatory organisations (SROs).

In addition to the new securities laws, new banking laws came into force to reform the banking system and control speculative activity. The Banking Act of 1933 sometimes referred to as the Glass-Steagall Act (although only four sections directly relate to Glass-Steagall), prohibited commercial banks from engaging in the investment business. It protected bank depositors from the additional risks associated with security transactions. It was enacted as an emergency

response to the failure of nearly 5,000 banks during the Great Depression. It gave tighter regulation of national banks to the Federal Reserve System; prohibited bank sales of securities; and created the Federal Deposit Insurance Corporation (FDIC), which insures bank deposits.

Banks were given a year to decide on whether they would specialise in commercial or in investment banking. Only 10% of commercial banks' total income could stem from securities. As a result banks such as J.P. Morgan decided to remain as a commercial bank but with a group of managers leaving to set up a securities business as Morgan Stanley. First National Bank of Boston decided to go down the commercial banking route while setting up a separate securities company, First Boston Corporation, in conjunction with Mellon Securities Corporation.

Another development at this time which would have considerable long-term effects on the debt markets was that bank regulators, eager to encourage banks to invest in only safe bonds, issued a set of regulations culminating in a 1936 decree that prohibited banks from investing in 'speculative investment securities' as determined by 'recognised rating manuals'. This put the rating agencies at the heart of investment decision making in the US.

* * *

Unlike the First World War, the Second World War was widely expected in Europe. Indeed the armaments expansion ahead of the anticipated conflict went some way to drag countries out of their economic depression. When war finally arrived, securities markets did not experience panic as they had in 1914. Domestic securities markets were now managed by national authorities with little exposure to international markets. Any foreign securities that still commanded a value had been sold if buyers could be found. As in the First World War there was some evidence of a flight of capital to New York during the war but the evidence suggests that much of this was put on deposit with US banks rather than invested in the securities markets.²⁴

The Second World War had put an end to any sense of a global securities market. Governments controlled their domestic markets and any foreign assets had been sold.

Yet in 1944, while still at war, 730 delegates from 44 allied nations met in the US resort of Bretton Woods, looking to rebuild the global financial system when the conflict ended. While 44 countries participated, negotiations were largely driven by the US and the UK. The Bretton Woods Agreement sought to regulate international finance and foreign exchange trading to prevent economic collapses like the 1930s Depression. The principal architect of the agreement, the celebrated economist, John Maynard Keynes, argued that capital controls were necessary to preserve and protect industry and society. He advocated the use of fiscal and monetary measures to reduce the effects of economic recessions and depressions. Similarly he stressed that no economy was independent of other economies and argued for a world currency and a world central bank. Two new institutions, later known as the World Bank and International Monetary Fund (IMF), were founded as a compromise to Keynes's plans, reflecting the more conservative American vision.

An attempt was made to return to a system of fixed exchange rates. The chief features of the monetary system agreement were an obligation for each country to adopt a monetary policy that maintained the exchange rate by tying its currency to the US dollar, with the IMF offering short-term help to avoid devaluation. The fixing of exchange values or parities permitted only a 1% appreciation or depreciation from the exchange value agreed. The United States agreed separately to establish and maintain the international value of the dollar at \$35 per ounce of gold, making the system a modified form of gold standard. Foreign nations would use the dollar as an intervention currency, and would keep their reserves in dollars as well as gold.

At the conference's farewell dinner, Keynes told the assembled delegates that thanks to their work 'the brotherhood of man will ... become more than a phrase'.

The Bretton Woods conference in 1944 effectively marked the end of sterling's predominance in international trade, and its replacement by the US dollar. While the agreement defined both the dollar and the pound as reserve currencies, given the UK's very large balance of payment deficit caused by the war, this was more 'a sop to British pride rather than a reflection of the truth'.²⁵ By September 1949 the UK's balance of payments deficit finally proved untenable and the pound was devalued by 30%.

As devaluation pressures were most prevalent, European countries were incentivised to build up significant dollar reserves which could be used, if necessary, to support the external value of their currencies. Exchange control regimes were extensively introduced by countries either during the Second World War or put in place in the immediate post-war period. Many of these capital controls persisted throughout the 1950s and beyond.

After the war the allied nations desperately needed US assistance to rebuild their war-torn economies. The United States at the time was running huge balance of trade surpluses, and the US reserves were substantial and growing. In response the United States set up the European Recovery Program (popularly known as 'the Marshall Plan') to provide large-scale financial and economic aid for rebuilding Europe. From 1948 to 1954 the United States provided 16 Western European countries with \$17 bn in grants and a further \$4.4bn to Japan. Between 1947 and 1958, the US deliberately encouraged an outflow of dollars, and, from 1950 on, the United States ran a balance of payments deficit with the intent of providing liquidity for the international economy. These deficits were exacerbated by the strong international demand for dollars, which kept the exchange rate high, thereby making US exports less competitive.

Over time the quantity of US dollars outside the United States increased significantly, as a result both of the Marshall Plan and US imports. Consequently, large sums of US dollars were in the custody of foreign banks outside the United States. The surplus dollars were mostly kept on deposit by European banks, which in turn held this currency in their New York branches, subsidiaries or correspondent banks.

As Cold War tensions increased, particularly after the invasion of Hungary in 1956, the Soviet and East European countries transferred much of their dollar holdings to Paris and London from New York. This was to prevent the US government confiscating or freezing those deposits. The first transfer by the Soviet Union of a dollar account to a European Bank was to the Banque Commerciale pour l'Europe du Nord, whose telegraphic address was Eurobank. It is suggested that this was the first time in which 'euro' was used in a financial market, and in time a dollar deposit held in Europe became known as a 'Euro-dollar' deposit.²⁶

There were more than enough of these Eurodollars for the banks receiving them to lend them on, or redeposit them with other financial institutions. There were no US reserve requirements for Eurodollar deposits. In addition they were outside the jurisdiction of the Federal Reserve Board's Regulation Q, which controlled the rate of interest that could be paid on domestic dollar deposits. From 1935 to 1956 the maximum rate payable in the US on 30-day deposits was 1%, and 2.5% on three-month deposits. With no such restrictions in Europe, banks bid competitively for dollar deposits and the Eurodollar market flourished.²⁷ US bank expansion overseas naturally followed the rise in offshore dollar activity.

When UK interest rates rose above US rates in mid-1955, Midland Bank decided to offer non-UK residents dollar deposit facilities. Midland offered $1\frac{7}{8}\%$ interest for 30-day dollar deposits, which was $\frac{7}{8}\%$ more than the maximum rate payable in the US according to Regulation Q. Midland then sold the dollars spot for sterling and bought them back in the

forward market paying a premium of $2\frac{1}{8}\%$. The net result was they acquired sterling funding at 4% at a time when the Bank Rate was fixed at 4.5%.²⁸ The Bank of England appeared to reluctantly tolerate this development so other banks, including US banks in London, followed Midland's lead. This attracted new customers with more US dollars to the UK. By the late 1950s the growing pool of externally held dollars had encouraged the development of a market between banks lending money to each other in the form of dollar deposits at competitive rates of interest, i.e. the 'interbank market'.

Meanwhile US multinational companies were expanding and making sizeable overseas investments. Between 1950 and 1957 US deficits were modest but from 1958 to 1962 US deficits reached levels of between \$2.5bn and \$3.8bn.²⁹ By 1961 the Federal Reserve was expressing concerns about the Eurodollar market's growth suggesting it may 'constitute a danger to stability', whereas the Bank of England felt the market had value in developing international trade.³⁰ A key supporter of these developments at the Bank of England was Sir George Bolton. He lobbied tirelessly for the abolition of exchange controls in Europe and the promotion of London as an international financial centre. By 1963 the Bank for International Settlements estimated the overall size of the Eurocurrency market to be US\$12.4bn, of which \$9.3bn were US dollars.³¹

In the post-war period foreign borrowers naturally turned to New York in search of much needed funds. The US was the leading centre of wealth creation and the US dollar was the pre-eminent international currency for trade and finance. During most of the depression and the Second World War there had been very little activity for foreign bond issuers in the New York market. The first international bond issue after the war was issued in 1947 on behalf of the World Bank. It took time for such issues to develop but according to an estimate in Salomon Brothers' International Bond Manual some \$14bn of capital was raised in 'foreign dollar bonds' in the years 1946 to 1963. The market was almost entirely a public sector market. The issuers were largely governments, government agencies and municipalities: Australia, Belgium, New Zealand, Denmark, the Japan Development Bank, the European Coal and Steel Community, and entities of the Italian and French governments. Naturally such issues had to be compliant with the Securities Act of 1933 and registered with the SEC. In addition, offering these foreign dollar bonds in New York required using a US investment banking house as lead manager and a US domestic underwriting syndicate. The lead managers included Kuhn Loeb, First Boston, Lazard Freres and Morgan Stanley.³²

These foreign dollar bond issues (later to attract the title 'Yankee bonds') were targeted at US domestic investors but US underwriters had little interest in trying to distribute such paper as foreign issuance was insignificant compared to the mainstream mass of domestic offerings. In addition two key groups of institutional investors were limited in their ability to buy foreign bonds. Many US public pension funds could buy no foreign securities at all, while US insurance companies were also limited in the amount of overseas investments they could make. Increasingly these securities were purchased by European investors attracted by dollar-denominated investments for familiar names. By the late 1950s more than 75% of those New York issues were being placed in Europe. They were taken up by 'discretionary accounts managed by Swiss, Dutch or Benelux banks, or London brokers'.³³ Increasingly New York issues were also listed in Paris, Brussels and Luxemburg reflecting European investor interests. By 1958 the European Coal and Steel Community were undertaking multiple listings.³⁴

These European intermediaries found it particularly galling that the US underwriters earned most of the new issue fees while the distribution was largely handled by a European

selling group. Over time European distributors would seek ways to handle the entire new issue process themselves. As distribution increasingly took place in Europe so did secondary market trading activity.

Most notable among these early participants in the foreign bond markets were White Weld and Strauss Turnbull.

White, Weld & Co. was founded in Boston in the 19th century, as a family office for the White and Weld families. Having taken on a wide circle of friends as clients, it moved to New York and became an NYSE firm before the First World War. White Weld had formed a close relationship with J.P. Morgan – which gave it a privileged position in Morgan Stanley foreign dollar bond issues after the Second World War.

White Weld had formed a foreign department in 1929 and was the first American house to re-establish an overseas presence after the Second World War– in Venezuela and Zurich. They set up an office in Zurich (rather than the more usual Geneva) in the 1950s – courtesy of a long relationship with *Crédit Suisse*, a relationship which would later develop into the successful joint venture, *Crédit Suisse White Weld (CSWW)*, in the 1960s. Robert Genillard, a partner since 1958, moved from Caracas to Zurich as Chairman and Chief Executive of the new joint venture. Genillard is regarded as one of the main architects and developers of the Eurobond market in which the firm he led played a dominant role. ‘White Weld wasn’t one of those elite firms in New York doing foreign dollar bond business. White Weld started out in the secondary market in New York. It learnt who bought the bonds. It first just got a selling concession, then became a member of the underwriting group and ultimately manager.’³⁵

Genillard gathered around him a formidable set of young bankers who would become key figures in the development of the Eurobond market. Stanislas Yassukovich joined White Weld in Zurich in 1961. His father, Dimitri Yassukovich, had been one of White Weld’s partners and opened an office in London in 1933, first as a joint venture with Old Broad Street Securities, and then as a branch of New York: ‘In those days, nepotism was not only rife, but okay’ remarked Yassukovitch.³⁶ He was key in moving the market’s focus to London. Yassukovich would become Deputy Chairman and CEO of the European Banking Company and a highly regarded Chairman of the Association of International Bond Dealers (AIBD). He would move on to become Deputy Chairman of Merrill Lynch Europe Ltd, Deputy Chairman of the London Stock Exchange and Chairman of the Securities Association, the forerunner to the FCA.

Another White Weld alumnus was David Mulford, Managing Director and head of International Finance. He went on to become senior advisor to the Saudi Arabian Monetary Agency in its key formative years. He served as Under-Secretary for Finance at the US Treasury presiding over the Brady Plan and in his later career served as US Ambassador to India.

White Weld’s Zurich office was the leading distributor of foreign bonds – indeed White Weld produced the best known annual register of outstanding foreign dollar bonds – most having been issued in the 20s and 30s, and many in default. ‘White Weld had a very privileged position in (foreign bond) syndicates and had a much higher retention than their underwriting always.’³⁷ ‘The dominant takers of bonds in those very early days were the big three Swiss Banks for their own private clients, and at that time they were happy to be treated as simply sales agents and not seek to underwrite or certainly not manage issues.’³⁸

White Weld also came to dominate secondary US bond trading in Europe. Yassukovitch explains: ‘When we were trading in Zurich in the early days, the book would be handed back to New York for their opening, and they would trade it and then hand it back overnight.’³⁹

The move of White Weld's trading from Zurich to London under Walter Koller was a critical event in the history of the market. White Weld, and others, believed foreign dollar bonds were exempt from Swiss stamp, not because the book moved to New York in the afternoon, but because all deals struck in Zurich in the morning were confirmed by head office in New York. However when the volume had increased enormously, concern grew that this would be seen as an artificial construct. Bob Genillard wanted to move the trading to our Paris office. But Stancliffe and I had a young tax advisor in London who took us to see a senior Inland Revenue official. He pointed out that the UK tax code included a provision to facilitate inter-Empire trade (e.g. between South Africa and India) arranged through a London representative office but not involving a UK resident counterparty. The dollar premium rules at the time, excluded UK resident investment counterparties making foreign currency investments, however the official opined we could engage in foreign security market making in London, between non-resident counterparties, and continue to be taxed, as are all branches of overseas firms in the UK, on an expenses basis. The move to London of our market making brought the overwhelming bulk of the secondary market in foreign dollar bonds to London.⁴⁰

Walter Koller was White Weld's celebrated trader: 'If Walter came on, you better be sure you had the right price or he would smack you.'⁴¹ The story is recounted of a Cr dit Foncier de France deal in December 1959 where Koller noticed in the documentation that French investors could not buy the issue until January 1960. The deal had been issued at 95½. So Koller bought up a significant holding in the issue and on 1 January deluged French investors with telexes offering paper at 100 or better which was eagerly taken up.⁴²

The London stockbroking firm of Strauss, Turnbull & Co. was founded by Julius Strauss with his cousins Robert and Ronald in 1938. Strauss was born in Frankfurt but moved to England in 1933. Before the war Strauss had traded and distributed foreign dollar bonds, as he recalled:

[I]n the pre-war days we talked about foreign bonds, the principal issues being dollar obligations of countries like Australia, New Zealand, some Scandinavian countries, Argentina, Brazil, Chile and Mexico. They were issued and underwritten in New York, but the main investors were the British composite insurance companies. When I worked for a year in New York in 1934, I interested the banks in, what was then Palestine, in these bonds for investment purposes and carried on regular business for many years. I also discovered that some of the Canadian insurance companies were interested in the same market, and we began working the sinking funds actively, particularly in the few Japanese names then outstanding ... During the war years, UK residents were allowed to deal amongst themselves in Commonwealth foreign bonds denominated in dollars which proved very valuable investments, particularly with the eventual advent of the dollar Premium. During those years my firm was also privileged to re-purchase Norwegian dollar bonds for the Norwegian government in exile throughout the world thus putting their large shipping revenues to good use.⁴³

Strauss continues:

After World War II, and once Marshall Aid was tailing off, very large amounts of funds were required to make good the ravages of war in the western world. Sterling was losing its role as a reserve currency and in those early days practically all borrowing was effected in US dollars through New York houses. With the increasing amount of Eurodollars in circulation, the majority of these bonds were eventually placed in Europe. A few selected European houses were invited by the American managers to join the selling groups but the allocations were very

restricted and most of the bonds could be obtained only less $\frac{1}{2}$ % reallowance. The appetite grew, mainly through the intermediary of London, where a few of us spent a great deal of time and effort popularising this form of investment.⁴⁴

Strauss maintained these activities at Strauss Turnbull although this over-the-counter (OTC) market was very much outside the activities of traditional London brokers. Strauss was considered something of an outsider in the broking community, only gaining Stock Exchange membership after a period of many years.⁴⁵ Strauss proved to be a born trader and assembled fellow natural traders around him such as Paul Sherwood and Stanley Ross.

Ross, a bus conductor's son, left school at 15 and after a short time with the RAF headed for the City in 1951. In 1963 the young Stanley Ross was sitting in Strauss's office reading a translation of Proust's *A la Recherche du Temps Perdu*, volume four, recalls Ross, when Julius Strauss was making one of his routine tours of inspection. Strauss was so impressed by this display of intellect that he promoted him to Strauss Turnbull's equity trading department. From there, Ross moved to Eurobond trading from where he would go on to have a sparkling, if sometimes controversial, career, first at Kidder Peabody, and then at his own firm, Ross & Partners and finally as a Managing Director of Deutsche Bank.

* * *

But New York was not the only foreign bond market. The Swiss foreign bond market opened in 1947 and by 1963 totalled the equivalent of \$790m – slightly more than that for European borrowers in the New York market.⁴⁶ The Swiss foreign bond market was particularly attractive to issuers because of the low Swiss interest rates. Eugene Rotberg, Treasurer of the World Bank, and a substantial issuer in the Swiss franc market, would later quip of the Swiss market 'the only place where the underwriting commission that was paid to the underwriters was higher than the interest rate for the bond itself'.⁴⁷ The German and Dutch capital markets were open to foreign issuers as long as they joined the central bank queue, and in the deutschemark market, also agreed to convert the issue proceeds into other currencies.⁴⁸

In the wake of the Suez crisis in 1956 and the resultant severe foreign exchange pressures, the UK prohibited the use of sterling in third country financing and tightened exchange controls. So why then did the foreign bond market gravitate towards London?

Switzerland was the market's natural home as the majority of early issues were placed there. Switzerland, along with Germany, imposed a 35% withholding tax on domestic issues for non-residents, but not on foreign issues. In addition Swiss Federal issue tax of 1.2% discouraged Swiss banks from underwriting and managing issues in Switzerland themselves. But the killer stroke to the long-term development of the market in Switzerland was the Swiss authorities' refusal to exempt bond trading from Swiss stamp tax.⁴⁹

US banks originally favoured Paris for tax reasons. Morgan Guaranty established Morgan et Cie with Morgan Stanley in Paris to undertake underwriting business. In the 1960s Morgan et Cie was second only to Deutsche Bank in the league tables. Dillon Read opted for Paris and Merrill Lynch initially set up their European headquarters there.

The UK was not an obvious candidate for a developing foreign securities market. John Craven, then of Warburgs, remembers: 'London was a pretty miserable place to be, beset with post-war gloom, exchange controls and the narrow parochial attitude of the City.'⁵⁰ The UK retained exchange controls from September 1939 until December 1979. During much of this time UK investors looking to purchase foreign investments had to go through a special pool of

investment currency – or ‘premium dollars’ which traded at a large premium to the commercial rate (15% by 1965), and violators of the law were subject to criminal penalties. As a result, UK institutional investment abroad was typically less than 5% of total assets.

It was not possible to issue a prospectus in the UK or raise any money without the permission of the Treasury under the Control of Borrowing Order and the Capital Issues Committee.⁵¹ In addition new domestic issues attracted a stamp duty of 4% and if issues were listed in London, the Stock Exchange ruled that 15% must be given to the jobbers – who had no placing power.

But, in its favour, the City of London shared a common language with the US, and its merchant banks had considerable experience and expertise in international corporate finance and syndication. The Bank of England was skilled at ensuring that exchange controls did not hinder the City of London’s role as an international financial centre. White Weld’s Yassukovitch explains ‘Paradoxically it was because there was exchange control. As a result of the Exchange Control Act the Bank could allow traffic in foreign currency securities on its capital market, and activity in foreign currencies, because it was completely isolated from the management of the domestic currency mass.’⁵² The UK Treasury and the Bank of England had created a highly regulated onshore domestic economy, but by tolerating the growth of the Eurodollar and subsequently the Eurobond markets they helped create a deregulated offshore market, with the City of London at its centre.

Other European countries were more fearful of the rapidly expanding stateless pool of Eurodollars and imposed restrictions on its growth. In the early 1960s Switzerland, France, Germany and Italy all took measures to restrict Eurodollar growth in their jurisdictions – principally by prohibiting interest payments on foreign deposits.⁵³ Herman Abs, the head of Deutsche Bank, warned the UK authorities that the Eurodollar market was not under any central bank supervision and urged great caution.⁵⁴

Because of the heavy concentration of banks in London holding Eurodollar deposits the possibility of using Eurodollars for loans to foreign governments began to be discussed at the end of 1962. The Governor of the Bank of England declared at the Lord Mayor’s Banquet in October 1962:

*The time has come when the City once again might well provide an international capital market where the foreigner cannot only borrow long term capital but where, equally important, he will once again wish to place his long-term investment capital. This entrepôt business in capital, if I may so describe it, would not only serve this country well but would fill a vacant role in Europe in mobilising foreign capital for world economic development.*⁵⁵

In mid-December the UK Treasury outlined the plan for a foreign currency loan, utilising the City of London’s financing expertise and involving ‘some of the very volatile Eurodollars at present in London’.⁵⁶ Belgium was looking for a \$50m loan as were a group of Austrian public utilities and Norway was speaking with banks to place \$15–20m in Europe.

Who would arrange London’s first foreign currency loan?

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