



USD and Multi-Currency Offshore Portfolios

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Offshore Multi-Currency Portfolios

- US corporations with offshore operations, or an entity that is sold and the proceeds are not repatriated to the US
- Different goals may be
 - Full or partial repatriation of funds
 - Tax deferral
- Diverse international tax structures - no two companies alike
- Offshore portfolios subject to restrictive rules:
 - Subpart F - anti-deferral provision
 - Section 956 - investment in US property
 - “Look through” to underlying securities of fund
- Typically have longer investment horizon
- May require that portfolio manager reside offshore and all meetings conducted offshore



Non-US Source Income



- Carefully craft to not taint income or it may be treated as repatriated funds for principal and interest
 - Entire amount subject to US withholding (30%)
 - Potentially lose tax deferral status
- Criteria for non-US source income not subject to 30% US withholding tax
 - Issuer is domiciled outside the US
 - The security is issued outside the US
 - Security is registered outside the US
 - Interest and principal must be paid by a non-US entity



Domestic US Instruments Exempted From US-Source Income



- Section 956 defines exempted instruments
- Yankee and domestic bank instruments, time deposits, BAs, CDs, (except savings accounts) issued by Federal Reserve member deposit institutions
- OID (original issue date) commercial paper, T-bills 183 days or less
 - Interest bearing not qualify
 - Should limit holdings - recent tax rulings penalized companies with high percentage in OID and domestic bank instruments
- Bearer bonds and registered debt obligations
- US equities that do not pay a dividend, generate capital gains only may qualify



Subpart F Income Tax Rules for Controlled Foreign Corps.



- May apply to offshore money funds
- Generally, foreign corporations are subject to US taxation if they earn income from a business in the US or have US source income
- CFC is any foreign corporation >50% owned by US shareholders
- A foreign corporation's (including US parent of CFC) foreign income is not taxable until the income is distributed to shareholders except:
- "Look through" rules set forth in Subpart F
 - If invested in US securities or US property
 - CFCs invested in such funds could be considered to have repatriated a "deemed dividend" to the US parent
- Avoid Subpart F, invest only in non-US securities, issued offshore, proceeds used offshore, interest payments originating offshore





Tax and Accounting Considerations

- Manage for highest return without incurring US tax or 30% US withholding tax
- Potential investments should be evaluated with regard to any potential impact on US withholding and income taxes
- Foreign investments that are subject to foreign withholding tax should be kept at a minimum and periodically reviewed with the Tax Department
- SFAS 115 impact of longer maturities
- SFAS 133 impact of hedging currency exposure



Multi-Currency Portfolios



- Single Market Portfolios
 - Currencies denominated in one currency
 - Interest rate risk concentrated in one market
- Global Portfolios
 - Securities denominated in multiple currencies
 - Provides diversification of interest rate risk between markets
 - Increases scope of active manager to enhance returns
 - Potential to take limited non-base currency exposure to enhance returns
- Legacy Currency Bonds
 - Bonds in original currencies that now pay in EUR





Economic and Monetary Union Before vs. Today

- Before EMU
 - 11 currencies
 - 11 bond markets
 - 11 central banks
 - 11 yield curves
 - Multiple deposit rates
 - Multiple payment systems
 - Domestic sub-custodians
- Today
 - EUR is single currency
 - Unified money markets
 - European Central Bank
 - Cash reserves can be centralized
 - Portfolios managed as one pool



European Currencies



European Bloc Currencies

- EUR
- UK Sterling
- Swiss Franc
- Danish Kroner
- Swedish Krona
- Norwegian Kroner

Eurozone Member States

- Austria
- Belgium
- Finland
- France
- Germany
- Ireland
- Italy
- Luxembourg
- The Netherlands
- Portugal
- Spain



Eligible Offshore Investments



- Time deposits and CDs
- Bank floating rate notes
- Euro commercial paper
- Euro medium term notes
- Eurobond corporate securities
- Sovereign and supranational notes and bonds
- European Union government-sponsored agencies
- Repurchase agreements with international counterparties and non-US securities collateral
- Asset-backed securities
- Mortgage-backed securities
- Pfandbriefe





Eurodollar Floating Rate Notes

- Eurodollar floating rate notes (Banks)
 - 3- and 6-month refix
 - LIBOR+5 to 40 bps. typically 15-20 bps
 - \$5MM blocks
 - >A rated
 - 5 year maturities
 - Current margin 3-10 bps.



Largest ECP Multi-Currency Programs

903 programs, \$230 B outstanding

Issuer or Group	US\$ MM	%Share
Kreditanstalt fur Wiederaufbau	6,566.38	2.8
Rolo Banca 1473 SpA	5,369.36	2.3
Landesbank Baden-Wuerttemberg	5,262.82	2.3
Abbey National Treasury Services plc	4,625.59	2.0
DePfa-Bank Europe plc	4,142.73	1.8
Republic of Austria	3,656.48	1.6
Citibank Ltd	3,411.60	1.5
British Telecommunications plc	3,150.59	1.4
Landesbank Schleswig-Holstein Girozentrale (Lux)	2,981.71	1.3
Landwirtschaftliche Rentenbank	2,969.74	1.3
Bank Austria AG	2,917.01	1.3
Commerzbank AG	2,766.99	1.2
BSCH International Ltd	2,765.82	1.2
ABN Amro Australia Ltd	2,650.46	1.1
DaimlerChrysler AG	2,522.30	1.1
National Australia Bank Ltd	2,491.25	1.1
DaimlerChrysler Co-ordination Center SA	2,462.96	1.1
DaimlerChrysler UK Holding plc	2,462.96	1.1
FCE Bank plc	2,381.73	1.0
GMAC (UK) Finance plc	2,377.68	1.0
GMAC International Finance BV	2,377.68	1.0
Opel Bank GmbH	2,377.68	1.0





Euro Medium Term Note Market

- Broad selection of issuers
- 693 Issues rated >A, < 2 years, USD pay bonds
- Similar to US MTN market but issued in Eurobond market by foreign issuers
 - Often registered in Luxembourg, Cayman, Netherlands
 - Multi-billion shelf registration, issued over time at different maturities, rated by S&P or Moody's
 - Over 500 issues with 3-5 year maturities
 - Issuers: corporates (fastest growing sector), regional banks, local governments (growing), supranationals
 - 30 Currencies: 40% USD, Yen, GBP, EUR, DM, A\$, CA\$ (7% each historically)
 - Dominated by AAA (42%), AA (30%), and A (19%)



USD Eurobond Market Intermediate Maturities



- USD denominated issues US\$3.1 trillion*
- Rated by S&P and Moody's
- Recent trend for “mega deals” up to US\$ 3 billion
- US Agencies issue “reference notes” that trade similar to Eurobonds may attract US source income, trade on 3 Cent spread
- Eurobonds are issued on a fixed price re-offer basis a lead managers build book of interest
- Issues are valued on a spread basis relative to swap rates and measured by investors with both swap rates and spreads to the US curve
- Large sized issues of >AA rating trade on a 10 Cent bid offer spread

Source: Merrill Lynch 1998

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Mechanics of the Eurobond Market



- Size
- Bid-Offer spreads
- Liquidity
- How market operates, competitive, negotiated
- League tables for major underwriters
- Settlement, clearing
- Need for a custodian, global or domestic
- Where is the money wired





USD Eurobonds Issued 7/99-6/00

Source:Capital Data Bondware

Issuer or Group	US\$MM	Issues	%Share
European Investment Bank	26,488.43	101	3.1
Kreditanstalt fur Wiederaufbau	16,279.83	81	1.9
General Electric Co	16,117.98	63	1.9
Commerzbank AG	16,094.48	186	1.9
Bayerische Landesbank Girozen.	14,058.32	39	1.6
Bank of Scotland	9,981.72	44	1.2
HypoVereinsbank	9,315.08	47	1.1
Abbey National plc	8,657.02	26	1.0
Koninklijke KPN NV	8,589.54	8	1.0
World Bank	8,566.15	54	1.0
Deutsche Bank AG	8,289.19	81	1.0
Banco Bilbao Vizcaya	8,207.15	17	1.0
Landwirtschaftliche Rentenbank	8,070.99	25	0.9
Dexia SA	7,819.82	45	0.9
Credit Foncier de France	7,777.64	6	0.9



Globalization of Eurobond Market



- Globalization of Eurobond market bringing megadeals issued in multiple markets and currencies
- Deutsche Telekom in August, 2000
 - Largest global issue to date
 - Denominated in USD, Euro, Sterling, and Yen
 - Issuer domiciled in Germany
 - Issue registered in Netherlands
 - Sold worldwide to foreign investors in different markets
 - Denominated in USD, Euro, Sterling, and Yen



Asset Backed and Mortgage Backed Securities



- Emergence of ABS
 - AAA-rated issues in EUR market
 - LIBOR + 10 bps. or higher
 - 2-3 year average lives/maturities
- If collateral is US property (receivables), security may be subject to US withholding tax
- A foreign finance company with foreign collateral would avoid US withholding



Reference Notes



- Typical issuers of reference notes through Dutch Antilles entity include:
 - Federal Home Loan Mortgage Corporation (FHLMC)
 - Federal National Mortgage Association (FNMA)
 - Guaranteed National Mortgage Association (GNMA)
- May be held in pooled or mutual fund and may not be considered non-US source income
- Cannot hold individual securities outright because source of interest and principal payment from US Agencies



Offshore Money Funds Ireland Domiciled



- Ireland is an attractive location for domiciling funds and fund management operations
 - IFSC (International Financial Services Center) Dublin
- Irish Government's progressive attitude toward financial services
 - Economic and political stability
 - Proactive legal regime in financial markets and desire to accommodate needs of financial institutions
 - Well developed professional and technological infrastructure
- Regulatory and operationally, fiscal, legal and structural environment is positive for the corporate investor



Central Bank of Ireland



- Regulatory authority on investments
 - Controls credit supply
 - Regulates banks, building societies, futures and options exchanges
- Three specific roles
 - Regulates UCITS, unit trusts and investment companies
 - Supervisory authority for authorization and regulation of investment service providers that give investment advice, custodial services and handle securities transactions
 - General regulator of IFSC (International Financial Services Center) Dublin



UCITs



- Undertakings for Collective Investment in Transferable Securities
- UCITs are similar to mutual funds
- Normally listed securities as
 - Unit trusts or
 - Public limited investment companies with fixed or variable share capital
- UCITs monitored by Central Bank of Ireland
 - Bi-annual review meeting with investment company management and trustee/custodian
 - Investment company must maintain sufficient financial resources to meet liabilities
 - Monthly reporting to CB



Questions to Ask About UCITs



- Fund Manager and Sub-Advisor
- Custody and Trustee of Assets
- Legal Counsel
- Master Distributor
- Accounting
- Listed on Dublin Stock Exchange
- Taxation to Non-Irish residents
 - Generally NO Irish taxes due on income, unrealized or realized capital gains, withholding on dividends
 - However, capital gains, dividends and interest received by investor may be subject to foreign withholding taxes



Pfandbrief Market AAA-Rated



- The largest non-government asset class in Europe
 - EUR246 billion 1Q99
- 50% of bonds secured by mortgages & balance by public sector loans
- German Pfandbriefe (70%) of total mortgage & public sector debt market
- Favorable regulatory treatment and requirements
 - Issuer must be credit institution domiciled in EU
 - Issuer country supervision to protect investors through trustees, collateral checks and special valuation rules
 - Proceeds of bond issuance must cover principal & interest
 - In case of issuer's bankruptcy:
 - Assets repay principal and interest
 - Bond holders have preferential claim on issuing institution
 - Traditional Pfandbriefe issued bearer or registered form
 - Structured, floater, zero coupon



Jumbo Pfandbrief Market



- Advent of EUR brought larger issues increased liquidity
- Straight bullet, bearer bond, minimum EUR 500MM, 3 market-makers; up to 10 year maturities; active repo market, listed on German stock market
- Over 250 Jumbo Pfandbriefe issues with
 - Average size EUR 1 billion
- Represent 35% of total Pfandbrief market
- 90% of Jumbo Pfandbriefe are AAA-rated
- All Jumbos were redenominated in Euros in 1999



Jumbo Pfandbrief Market



- Restrictive collateral requirements:
 - Hypotheken-Pfandbriefe collateralized by pool of first mortgages on residential and commercial property
 - Eligible mortgages <60% loan to lending value (lending value is 85-90% of market value)
 - Collateral assets for bond holders only
- Maturities range from 2-5 years (up to 10 years)



Criteria for Offshore Manager



- Specialist managers with full resources of global investment
- Tailored portfolios to meet unique tax needs
- Disciplined investment style exploits market inefficiencies
- Market presence generates economies of scale
- Team of credit analysts
- Independent compliance staff and risk management team
- Track record





Global Fixed Income Investment

- Bond and currency markets not as efficient as US
- Currency decisions should be managed independently and be constrained in low risk portfolios
- Credit risk beyond high grade investments should be avoided
- Decisions should be made on market sensitive basis (gain/loss constraints)
- Typical performance benchmarks
 - 3 month LIBID
 - JPM Global Short-Term Index
 - JPM Global Bond Index



Euroclear System



- Transnational settlement and depository system for banks, brokers, and market makers
- Settlements in EUR and convertible currencies
- Established 1968, owned by ECSplc, 122 shareholders
- Operated by Morgan Guaranty Trust Company (Brussels)
- Over 2300 banks, brokers and investment professionals participate
- Regulated by the Belgian Banking Commission, Federal Reserve Bank, State of NY Banking Dept., UK Securities and Investment Board
- Audited by Price Waterhouse
- Securities held in book-entry or physical form



Cedel Bank, SA



- Transnational depository
- Established 1970, owned by 98 major banks and securities companies
- Securities:
 - Euro-instruments, foreign bonds, US foreign-targeted bonds, government and corporate bonds, money markets, equities
 - Safekeeping varies depending on type of security
- Regulated by Luxembourg Monetary Institute under Minister of the Treasury
- Audited by KPMG Audit



Euro-Denominated Investments



- Issuers
 - European governments and other sovereign issuers
 - Local government agencies, authorities, municipalities, provinces
 - Supranational organizations (World Bank, Asian Development Bank, African Development Bank, IMF, United Nations)
 - European and foreign corporations
 - European Union Government Treasury bills and notes
 - European Union Government sponsored agencies
 - Repurchase agreements
 - Euro commercial paper

