

ADDRESS : CANADIAN CLUB OF TORONTO

Monday, 6th December, 1965

MERCHANT BANKING TO-DAY

Mr. Chairman, Gentlemen:

I would like to thank you for giving me the opportunity to speak to you this afternoon, and I hope that in the time available I shall be able to touch on the various roles as played by the modern Merchant Bank.

Merchant banking - as known in London - traditionally and historically has carried out the job of financing world trade for centuries. Although to-day the term "merchant bank" is often misused, I would like - in my initial remarks this afternoon - to comment on the function of the merchant bank as it has been in the old days.

When large parts of the world were still unexplored, a merchant would send an agent to a little-known part of the world. This agent would take with him, or have shipped to him, manufactured goods produced in the home country, particularly say, for example, cotton and other piece goods, which the inhabitants of that country were expected, or wanted, to buy. And at the same time, the merchant would buy the products of that country and ship them home. For this money had to be remitted from one country to another and the bill of exchange - an instrument that had been in existence throughout Europe for a long time - came to be more and more used, and the Bill of Exchange on London became the means of financing the trade of

practically the whole world.

The Bill of Exchange Act 1882 has an admirable clarity and has defined a bill of exchange as an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the addressee to pay on demand, or at a determined future time a sum in money to, or to the order of a specified person, or to bearer. It is a very simple and effective document with a fixed sum, a definite due date, and an unconditional liability to pay, and it is hardly surprising that it was found very convenient to use.

THIS WAS MERCHANTING AND THIS BECAME BANKERS.

This was the origin of Acceptance Credits, and through this medium the merchants also accumulated deposits and even went so far as to finance local industries in those areas where their agents were trading. Trading companies were formed and investments began to take place.

It is well known to this audience that in the development of this country, the United States, and other similar trading nations, the merchant banker from London played a considerable part in commencing the initial step ~~of trade~~. Confidence and trust and the relationship of the City of London to its far flung trading routes was the key of the merchant bankers' success.

In the early part of this century, this trade - which was stimulated from London - continued at a faster rate. Investment in industry and the

development of communications resulted in new enterprises being started up. Up until the beginning of the first World War the London Merchant Banker was a key person in organising the development of the railways of the CANADA & the United States, the shipping and port development, and in investment in heavy industry which developed in places such as Toronto, ^{HERE} Montreal and the United States. All these originally started with trading concerns and slowly grew into permanent capital and investment on a much greater scale.

There is no need for me to trace the history of the Merchant Bank between the wars; the resultant up-and-down period through economic difficulties and the commencement of the second World War. To-day, I am going to try and give you a few points as to the modern merchant bank with its resultant flexibility and change of attitude in the modern scene.

In London after 1945 austerity continued for a number of years; the merchant banker picked up the threads of peaceful existence. Regulations still existed. There were restrictions and considerable difficulty in arranging international trade as the breakdown in communication, trust and understanding had to be re-studied and this required all the skill of the London merchant banker to reinstate his position in the world of banking. His capital had been considerably reduced in many cases, through taxation, and this led to a new and different outlook.

Just after the war the need for credit to those countries which had

been devastated and to which trade was their life's blood, was just as essential as when the acceptance credit first began. London merchant bankers were the first people to help re-establish trading and financing of obligations on the Continent of Europe, as well as the possibility of helping the under-developed and developing nations in Africa, Asia, South America, and the Far East.

But with all this, a "new look" and a new attitude was being built up. People had hitherto been rather slow to realise the possibility of development in one's own home market. The merchant banker - and please do not get me wrong - although fundamentally based on international trade, had not, and still did not, realise the other aspects of the domestic market.

In this particular context, I meant the financial advice and help that he could give to his clients in the United Kingdom, for such things as financing medium-and-long-term credit, re-arranging capital structures, rationalising industries, merging companies, and general financial advice. It soon became apparent after the war that industry and commerce in the United Kingdom was going to have to change and adapt itself to the modern industrial era if it was going to survive, particularly in relation to the United States and other industrial nations. New staff was taken on - specialists in the field of taxation, issues - those who probably had had training in commerce and industry ^{they} soon adapted themselves to the London

merchant banking scene and very quickly showed the way to new arrangements for companies. It is not easy to generalise over the last ten years without mentioning specific names, but I do not think that this is what you want to hear. It is well known through the medium of the financial press that one can follow the ups and downs and the various changes that have taken place in banking circles on the London scene. Companies have emerged stronger and more efficient, often due to the advice that a merchant bank has given.

A particular section which I would like to point out to you is the Investment Advisory and Portfolio supervision service, plus Trust Departments, WHICH WERE ~~that have been~~ set up by merchant banks. Up until - and just after the last war - it was not usually the practice of merchant banks to advise a great many clients outside the tight circle of friends or family in which they may have been involved. It was also not the custom of many institutions, pension funds and the like, to seek advice, as most of their securities were gilt edge and trustee securities. Therefore, the advent of an increased interest in the equity market began, and new departments were set up in merchant banks with particular importance in advising in this field. This required experience, judgement, and a considerable amount of instinct.

Investment advice - in general - is an art, and not a science, and therefore, for quite some time there was speculation and judgement passed on the various qualities of the various houses that took part in this specialised job. Clients, for the first time, saw the opportunities which this field could

bring them. At the same time, it was not uncommon practice for clients to move from one merchant bank to another. These departments - in some measure - suffered from lack of experience, as there had been very few people staffing these new departments who had experienced the ups and downs of the twenties and thirties. Stockbrokers still carried the burden of the work, and still do. The merchant bank has assumed a more important role and it is yet to be seen whether this particular field will continue to be one in which the merchant bank plays an important part. It is probably more than likely that in advising institutions, pension funds and large charitable organisation, the merchant bank may be useful. There is, through the medium of savings, nationalised industries and other accumulations of wealth, the need for expertise, which these organisations may not have at their finger-tips. Therefore, they are willing to pay fees and rely on merchant banks for guidance.

All this, as well, has resulted in the Stock Exchange making public companies more aware of their shareholders. Half-yearly statements are compulsory, and as you well know, generally the attitude towards investors is moving much closer towards that which you have in this country and the United States.

But I do not think it would be appropriate for me to-day to dwell much longer on this section of the modern merchant bank. These two main sections of the bank are something which in Toronto, I believe, bankers

are not able to do under one roof in quite the same manner. I know you have your Trust Companies, Trading Banks, and stockbrokers, but we in London are able to do and carry out a function which perhaps is still unique - and this is cover every section of a financial transaction in the banking community. But it does lead me to another point, and that is the question of long term financing in international trade and for international concerns.

Key Point
Time Available

As I mentioned previously, the need for rehabilitating the devastation of the last war and the continuing need for capital in the under-developed and developing countries, has required the acumen of the financial capitals of the world to be put to work. London which was, and is in some measure, an important financial centre, realised in the last few years the importance of this need. In the United Kingdom itself, companies require financing and this is done under normal practice of debt in ratio to equity in short and medium term obligations, whether for export or internal trade. This is the normal practice which, I believe, is also in existence in Canada.

However, in the long term financing for corporations and international institutions - and even nations - the capital market of the free world has been centered on New York until relatively recently. It is well known that the supply of capital available outside the United States, had been limited by the difficulties which resulted from war, taxation, and economic disturbance. However, due to the advent of the equalisation tax in 1963, the London capital

market for international borrowing began. The initial impetus to London was given by the United States Treasury's dissatisfaction to the growing volume of foreign borrowing in New York. At a time when the United States payments balance was in disequilibrium, and Europe was gaining reserves, it seemed paradoxical that, for example, the European Coal and Steel community itself should be forced by the inadequacies of European capital markets to resort to borrowing in the United States.

In May 1962 Mr. Dillon, Secretary to the Treasury, speaking in Rome to the American Bankers Association, drew public attention to the shortcomings and fragmentation of European markets and the unfair burden that was being thrown on the United States balance of payments. As I have mentioned, this dissatisfaction became embodied in the announcement of the interest equalisation tax in July 1963 designed to impose a graduated capital tax on Americans who bought foreign securities. The equalisation tax was finally enacted in September 1964, having already effected a slow-down on foreign borrowing by its threat alone.

Quebec Hydro
RESTRICTION *

SOME HAVE RECENTLY
CHANGED

*
Apart from Canada and the less-developed countries who are on the exempt list, the majority of the capital hungry and credit worthy countries were just barred from the American market by a tax which, ranging from 10.3% on 15-year bonds, to 12.5% on 20-year bonds, had the effect of increasing the cost of servicing a long term loan by rather more than 1% per annum.

Before the equalisation tax, a large proportion of the foreign dollar bonds issued in New York were bought by European subscribers. Thus, the ready-made market already existed, and there was no intrinsic reason why New York bankers should not continue to do the business themselves ~~to~~ ^{By} ~~SELLING~~ ^{SELLING} outside the United States, and relying on their existing distribution networks overseas. However, this possibility was not immediately apparent.

Meanwhile, it was for Europe to fill the vacuum. Swiss bankers had been raising long term francs for foreigners in amounts equivalent to about \$150 million a year, and no more could be done without disrupting the domestic Swiss market. The Dutch market was feeling the strain of heavy capital demand and the French and Italian markets were subject to numerous controls. In Germany, Belgium and the United Kingdom bankers were exploring new ways of mobilising capital.

Under the leadership ~~of~~ of the Deutsche Bank, the Germans set about enlarging the market in Deutsche Mark Loans for foreign borrowers, and ^{THEY} ~~he~~ developed his idea of parallel loans whereby borrowers would issue at the same time, identical loans in different countries, and denominated in local currencies in yields tailored to meet the growing interest rate in each place of issue. The Belgian bankers, Banque Lambert, and ^{KREDIT BANK} ~~the~~ canvassed ~~with~~ their new Unit of Account Loans, whereby issues would be

denominated not in individual currencies, but in a composite unit based on the accounting system in the European payments union and protected from fluctuations in exchange rates by a rather complicated formula. The Bank of England, prevented by our own balance of payments problem from allowing a major relaxation, nevertheless extended the access to the London market to the EFTA nations.

While these schemes were designed to create a genuine broadening of the European market, the London merchant bankers were restive at the restrictions imposed on them by the dollar premium, the still limited access to the London market, and the high rates for sterling loans. They, therefore, offered themselves as the new centre for dollar bonds. In this they were helped by the actions of the Government of the day in allowing the issue of bearer securities and reducing stamp duty, but their greatest asset was an expertise which rivalled that of Wall Street.

The City of London machinery of solicitors, accountants, stock exchange and banker were already adaptable to the organisation, design and quotation of dollar bonds and this old skill which had been fostered in the years after the First War were put again to work. The most difficult part of the whole operation was that of marketing overseas. By this, I mean the re-education and learning that goes into finding good and efficient markets for these bonds. This is taking place, and will continue to take place for some considerable time, as due to the World War and taxation, markets have changed considerably.

It must not be forgotten that on the Continent of Europe generally, the availability of funds for long-term investment are very few. In general the main availability of these funds is in tax havens, and although nominated in the currency in which the haven exists, it is more than often that the origin of the fund is far away. (MIDDLE EAST OIL MONEY IN SWITZERLAND)

Soon the pattern of the London capital market began to emerge.

The efforts of ^{THE GERMANS} ~~THE GERMANS~~ resulted in an increasing volume of Deutsche Mark Loans. The Unit of Account - frowned on by central banks, complicated for investors and borrowers - made little headway. The dollar, gaining in strength, came to be regarded as the best hedge against exchange fluctuations, and London proved itself to be a centre of growing skill. Merchant bankers who, at first, had simply relied on their normal overseas banking correspondents to distribute these dollar bonds, were now learning to discriminate between those who placed the issues firmly, and those who did not. Mechanics for marketing were improved and the range of contacts for investors broadened. However, the rediscovery of the European Dollar Market by the Americans now meant that the borrowers had a choice between London and New York as a centre of issue.

It has recently been stated that the European Capital Market is not fulfilling its function. This, in my view, is mainly due to the United States companies who ~~accessed~~ ^{have access to} a large resources at home using this market mainly as a gesture towards the United States Government policy designed to correct the balance of payments. This, however, means that European and other borrowers outside the United States will find it increasingly difficult to raise capital in the European market. I must confess that as the European Dollar Market was largely set up at the prompting of the United States Treasury, it seems only right and proper that a protective guide for this market is needed in order to ~~fit~~ ^{keep} ~~it~~ ^{KEEP} its uses more in line with European expansion. And secondly, that United States companies should not rock the boat by swamping the market with large borrowings.

* I.T has been announced in the last 24 hours that the guidelines are to be further extended.

Firstly by curtailing the investments of United States companies in Canada and secondly by taking certain countries off the exempted list ^{for nationals} for investment in United States securities without the withholding tax of 15%.

Size of Market

* These measures are to be applied

1967	334	Mill	Other countries	211	U.S. DOMESTIC
21972	227		341		4,720
	<u>561</u>		<u>552</u>	TOTAL	4,980
				1113	

All this business must once again underline the flexibility of a London Merchant Bank. All the work that has been done in the last few years on the capital raising operation, although on a competitive basis, has been ultimately to the benefit of the consumer. The scouring of Europe for good investors has revealed fresh sources of dollar capital to supplement the growing use of the Deutsche Mark and the gradual liberalisation of the sterling market. The marketing experience of London has given bankers a field in which to experiment with such ideas as joint Deutsche Mark/Sterling loans; investors have been given a wider range of securities and some of them have been introduced to convertible bonds for the first time. Borrowers have benefitted from all these developments as also from ^{REDUCED}~~production~~ costs in the finer pricing of issues.

It must not be forgotten that the education and understanding of ^{NOT the U.K.} both the equity and bond market on the Continent of Europe is still far behind that of North America, and it will require a considerable period of stability and well managed financial acumen to increase the interest in these securities. At the same time, the systems of each country in Europe is different : taxation, accountancy, legalities, all require a further and better understanding. Therefore, the merchant banker has - as much through his correspondence with friends on the Continent of Europe - to understand the procedure; also, he hopes that in some measure he can play a part in influencing them on the

lines of the City of London, which, with the help of the capital markets of New York, should be the basis of the future.

This leads me to two other significant points. First, in our dealings abroad we naturally come into contact with all types of exchange rates and differential currencies. This requires a considerable amount of professional skill: but this does lead me to another point. Our Foreign Exchange department is also our Bullion department, by which I mean that every morning at 10.30 there is a gathering of the Bullion Market - of which there are five members (and we are the Chairman) to fix the world price of gold. This is a very important function as not only is it working for the stability of the dollar, but also the stability of the pound. Very recently, during the period of the sterling crisis, this function played an even more important part as it was partly through this media that the Bank of England was able to maintain and sustain the sterling currency. And I think you would all admit, that however much confidence was shaken ~~and however much the promises of~~
~~which attempted measure, to do down the sterling area by running~~
~~we~~, we in London, with the help of our friends in other parts of the world were able to bring the sterling back on to a stable plain. And let us hope that with the new measure in force, and a sustained activity, and increase of productivity in the United Kingdom, the sterling currency will remain stable for some time to come.

I think it is important to touch on the aspects of exports. Through the medium of export guarantees and the skill of the merchant bank, exports to various parts of the world are financed. We attempt to interest people in all parts of the world in the need for British exports, but more important still is the need to be competitive, not only in the cost of production and delivery dates, but also in interest rates ^{of} ~~on~~ the export. The Government have helped by reducing interest rates for exports and by allowing concessions to export producers. ~~exporting to Africa, South America and Asia~~

There may be many cases in which one is building a composite plant with more than one national, in which case package deals may have to be arranged on an export basis. Sometimes we have, say, in putting up a refinery in Brazil, to utilize German, Italian, French, as well as English, financing operations, because the parts may come from all these countries; therefore, the organisations equivalent to export credit guarantee in these countries ~~have also to understand the position.~~ HASTO BE UTILIZED

Finally, I would just like to say a few words about our own bank. My family have been associated with Merchant Banking - as you know - for many years. To-day, I think we are in the forefront of this field and I believe this is mainly due to being able to offer opportunities to non-members of the family. In so doing, we may cover many ranges of work, for example, we have a Merchant Bank in Salisbury, Rhodesia, which has been established

for nearly ten years - and it is much worry to us at the present time owing to the difficulties there, but one of my Partners is in constant contact and frequently visits the area. It is not possible at this moment to foretell what will happen, but one thing is certain, and that is that the merchant bank, which also has a Branch in Lusaka, Zambia, is serving a very useful purpose in re-organising and helping to stimulate capital investment in this important area of Africa. *MANCHESTER BRANCH - FRENCH - CONTINENTAL*
300 STAFF 150 WOMEN - ADMINISTRATION - EXPERTISE.

So under our roof altogether we carry out many functions and I think that nowhere in the world - if I might say this - other than the Merchant Banks in London, can so much take place ~~under one roof~~. ~~And~~ you in Toronto are lucky to be able to participate freely in buying and selling of shares without the burden of capital gain. At the same time you cannot - I do not think - participate so freely as we can in the merchant bank, in commercial banking, investment banking, trust banking, long-term finance, medium-term finance and export credits.

Well, Gentlemen, I hope I have covered as much as I can within the time allowed, and I hope this has been of some interest to you. I would like - in my final remarks - to say that the stimulating atmosphere of the Canadian scene is one which may, or may not, be worthy of a merchant bank. It may also be of interest that at the present time the dependence on Canadian

initiative to help in financing the under-developed and developing countries through the medium of these long-term loans, is something of which ~~we~~ I hope you all here will be very cognisant.

In this field you all can play a part.

Thankyou.