

EXPLANATORY NOTES ON DEEDS RELATING TO ELIGIBLE DEBT SECURITIES

1. Introduction

1.1 These explanatory notes relate to two *pro forma* deeds pursuant to which uncertificated units of CREST eligible debt securities (**EDS**) are constituted, the terms of which broadly speaking correspond to certain material money market instruments (one deed covers the equivalent of commercial paper and certificates of deposit and the other deed covers the equivalent of bankers' acceptances). Unless otherwise stated, the following notes apply to both *pro forma* deeds.

1.2 The deeds refer to units of an eligible debt security (a unit being the smallest transferable amount of the security, for instance 1p, as determined in accordance with its terms of issue) and that terminology is adopted in these notes. The term eligible debt security has the meaning given in the amended Uncertificated Securities Regulations 2001 (**USRs**). This is as follows:

““eligible debt security” means a security that satisfies the following conditions-

- (i) the security is constituted by an order, promise, engagement or acknowledgement to pay on demand, or at a determinable future time, a sum in money to, or to the order of, the holder of one or more units of the security; and
- (ii) the current terms of issue of the security provide that its units may only be held in uncertificated form and title to them may only be transferred by means of a relevant system;”

The phrase “determinable future time” must itself be interpreted in accordance with regulation 3(6) of the USRs which provides that a sum of money “is to be regarded as payable at a determinable future time if it is payable-

- “(i) at a future time fixed by or in accordance with the current terms of issue of the security; or
- (ii) at the expiry of a fixed period after the occurrence of a specified event which is certain to happen, though the time of happening may be uncertain”

but “is not to be regarded as payable at a determinable future time if it is payable on a contingency”.

1.3 The deeds are intended to be used in respect of the issue of units of a single eligible debt security or a programme of such securities which may include eligible debt securities corresponding to different types of money market instruments, for example, commercial paper or certificates of deposit under one of the *pro forma* deeds (although the second *pro forma* deed is intended only to cover securities corresponding to bankers’ acceptances). Where the deed is used for the issue of units under a programme of eligible debt securities, the issuer will not need to enter into a separate deed for each issue but simply complete a Notice of Issue on each occasion that it proposes to constitute EDSs under the programme. As explained below, the deed together with a Notice of Issue, are the instruments which constitute the units of the eligible debt security. It is intended that the deed be issued in conjunction with such other documents as may be customary for a particular type of money market instrument, for example an information memorandum for commercial paper. It is anticipated that existing standard programme documentation could be used, albeit with certain consequential amendments to reflect the issue of EDSs.

1.4 The *pro forma* deeds are intended in principle only to include those terms which are required in order for uncertificated units to be constituted and issued. The terms will therefore need to be adapted to include any required commercial terms. In some cases the document contemplates that a particular term will need to be inserted (e.g. to deal with any withholding tax on a payment by the issuer), but in other cases the issuer may need to add provisions to accommodate terms specific to a particular issue or programme (e.g. a guarantee provision).

1.5 Non-material (uncertificated) units will have different legal characteristics from their paper equivalents. A number of general observations can be made about EDSs and the *pro forma* terms:

- there is no general provision for a paper interface although, in accordance with the CREST Rules, there are provisions to address the situation where a holder ceases to be a CREST member or where the securities cease to be capable of being held in CREST. In either case, compulsory cancellation/transfer provisions apply (see comment on clause 7 below);
- material MMIs are negotiable (negotiability confers property rights on holders which are superior to those conferred only by contract, in particular the right to take possession free of any preceding equities). However, this concept is not relevant for uncertificated units recorded in CREST in respect of which legal title is provided to the holder by the entry of his name on the relevant CREST records (i.e. the relevant “Operator register of eligible debt securities”). A change in the register represents a change in legal title (i.e. there is electronic transfer of title for uncertificated units);
- uncertificated units of an eligible debt security are capable of being fungible with other uncertificated units of the same eligible debt security but not with their material equivalent;
- uncertificated units of an eligible debt security are similar to uncertificated units of other debt securities issued into CREST except that there is no provision for the possibility of their being held in certificated form outside CREST (an eligible debt security being a “wholly dematerialised security”) and the issuer has no statutory obligation to maintain a related “record of securities”.

2. Legal structure and regulatory matters

2.1 Each of the *pro forma* documents is structured as a deed to ensure that holders of securities issued under it acquire directly enforceable rights against the issuer.

2.2 Each deed contemplates that units are constituted by the completion of a Notice of Issue which forms a schedule to the deed. Accordingly, no units of a particular eligible debt security are actually constituted by the deed itself until a relevant Notice of Issue is completed.

2.3 The issue of EDS is likely to be made pursuant to the terms of an issuing and paying agency agreement (*IPA agreement*) between the issuer and its IPA. However, since it is likely that the IPA agreement would contain commercial terms which are not relevant to holders and which issuers/IPAs would not wish to be disclosed to holders, the *pro forma* terms do not refer to the IPA agreement. However, issuers should note that if it is intended that holders be bound by or otherwise be on notice of any provision of the IPA agreement, then some mechanism will be required to achieve this (e.g. the holder could be given separate notice of the relevant terms in the deed or in a schedule to the deed).

2.4 As with material MMIs, issuers of EDS will have to consider their regulatory position and if seeking to rely on the deposit-taking exemption in article 9(2) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, they will have to ensure that the relevant conditions are met.

3. Commentary on the main provisions of the *pro forma* deeds

Parties to deed for acceptances

3.1 The parties to the acceptance deed are the acceptor equivalent (the Primary Issuer) and one or more drawer equivalents (each a Secondary Issuer). The deed relating to the issue of EDS equivalent to acceptances contemplates that more than one drawer equivalent (i.e. Secondary Issuer) may be an initial party to the deed and those

parties are listed in Schedule 1 to the deed. However, the acceptor could execute the deed at a time when there are no drawers (so that all drawers would accede to the deed by means of a deed of adherence mechanism – on this see the consideration of clause 4 below) and in this case no Secondary Issuer details would be entered into Schedule 1 initially.

Clause 2 (Payment obligation of the Issuer)

Deed for CD/CP

3.2 Clause 2.1 of the CD/CP deed contains:

- (a) in respect of units corresponding to CDs, the acknowledgement by the issuer that a sum has been deposited with it on terms that the principal amount is payable at maturity and any interest on the units is payable at the rate and at the times (if any) specified in the terms; and
- (b) in respect of other units, the promise of the issuer to pay the principal amount of the units on the relevant maturity date together with any interest at the rate and at the times (if any) specified in the terms.

Deed for acceptances

3.3 Clause 2.1 of the acceptances deed contains the promise of the primary issuer (equivalent to the acceptor of the bill) to pay the principal amount of the units on the relevant maturity date.

3.4 Clause 2.2 makes provision for a secondary issuer (equivalent to the drawer of a bill) to make these payments if the primary issuer fails to do so. The liability of the secondary issuer in respect of the debt obligation constituted by the deed is expressed to be that of a “principal debtor” (as against each holder).

Clause 3 (Payments)

3.5 Clause 3 of the CD/CP deed provides for the mechanics of payments of principal and interest. All payments are required to be CREST payments. Clause 3.4 provides for the maturity date and interest payment date to be adjusted if it would otherwise not fall on a business day (generally to the next business day but it may be adjusted to the preceding business day where the next business day would fall in the next calendar month).

3.6 Clause 3 of the acceptances deed makes similar provision except that interest is not contemplated in the context of acceptances.

3.7 Any required tax provisions (e.g. gross-up) will need to be inserted in to the relevant deed.

Clause 4

Deed for CD/CP

3.8 Clause 4 of the CD/CP deed contemplates that the issuer will insert the method of calculating interest in the case of interest bearing units (whether fixed or floating rate).

Deed for acceptances

3.9 Clause 4 of the deed for acceptances contains an accession mechanism under which drawer equivalents can become a party to the deed merely by counter-signing a short deed of adherence (set out in Schedule 2 to the *pro forma* deed). The deed provides that the acceptor equivalent (the Primary Issuer) will sign the deed of adherence on its own behalf and on behalf of the other drawers. As noted above, the acceptor could sign the main deed at a time when there are no drawers party to it (so that all drawers would accede to the deed by means of the deed of adherence which

might be executed on their behalf by the acceptor pursuant to powers of attorney granted by the drawers).

Clause 5 (Status)

3.10 Each deed provides that the payment obligations of the issuer (or each issuer in the case of acceptances) are unsecured obligations of the issuer ranking *pari passu* without any preference with all present and future unsecured and unsubordinated indebtedness of the issuer.

Clause 6 (Constitution, issue and transfer of units)

3.11 Under this clause, when the issuer (or issuers in the case of acceptances) proposes to constitute and issue uncertificated units of an eligible debt security it:

- (a) constitutes the units by completing a Notice of Issue (containing the required information but in a form selected by the issuer – which could include an IPA Issuance Message) which then becomes a schedule to the deed; and
- (b) effects the issue of such units by entering or procuring the entry in the relevant Operator register of securities of the required particulars.

Clause 6.2 permits an issuer to amend a notice from time to time (e.g. to correct errors) and, in the case of units corresponding to CD/CP, to issue notices relating to tap issues.

3.12 The information required in the Notice of Issue is set out in a schedule to the deed, and is structured in such a way so as to allow issuers to customise the terms of issue relating to units as required. For instance, to reflect the terms usually associated with a CD, as well as any other relevant boxes, the maturity date would be inserted in the “Interest Payment Date” field.

3.13 Clause 6.4(b) provides that units shall be in issue only when the relevant particulars are entered on the CREST register – this is the point at which the stock is credited to the account of the relevant holder and not when it is created in the account of the IPA.

3.14 Clause 6 also provides that units may only be held in uncertificated form and are transferable only in CREST and that they are transferable free from encumbrances.

3.15 Any transfer must be in amounts which are an integral number of units. An individual “unit” is the smallest possible unit which, in accordance with the terms of issue, may be transferred by one holder to another. Issuers must specify a unit value and may also choose in addition to specify a different minimum transfer amount, consistent in either case with applicable market conventions and regulatory considerations (if any).

Clause 7 (Compulsory cancellation or transfer)

3.16 As noted above, in accordance with the CREST Rules this clause addresses the situation where a holder ceases to be a CREST member or where uncertificated units of the security cease to be capable of being held in CREST. Although the CREST Rules require appropriate provision to be made in these circumstances to protect the rights and interest of holders (and give cancellation or transfer as possible provisions), the Rules are not prescriptive as to the actual steps to be taken and clause 7 could therefore be amended provided that appropriate provision is made, consistent with the USRs and the applicable CREST requirements.

3.17 As drafted, clause 7 provides that the issuer can elect either:

- (a) to cancel uncertificated units and issue a physical instrument on substantially the same terms and which confer on the holder(s) materially the same rights against the issuer immediately after the cancellation as were conferred by the units immediately before the cancellation; or

- (b) to arrange for the transfer of the units to another CREST member as nominee for the relevant holder (provided that uncertificated units of the security remains capable of being held in CREST).

3.18 Any required provision for the allocation of the costs of cancellation or transfer will need to be inserted.

Clause 10 (Benefit of deed)

3.19 Clause 10.1 provides that the deed is for the benefit of the holders of uncertificated units from time to time and their successors in title.

3.20 Clause 10.3 contemplates that issuers may wish to include:

- (a) a provision for making a copy of the deed available to holders; and
- (b) in relation to EDS corresponding to acceptances, a provision restricting the disclosure of the identity of a secondary issuer (“A” say) to any other secondary issuer or to any holder other than a holder of units for which A is the secondary issuer.

Clause 11 (Evidence of entries on CREST registers)

3.21 Regulation 24 of the USRs provides (insofar as it is relevant to eligible debt securities) that an Operator register of eligible debt securities is prima facie evidence of the matters directed or authorised by the Regulations to be inserted in it (save where any such matters relate to the registration of transfers which were not carried out in accordance with the Regulations).

3.22 Clause 11.1 provides that a certificate from CRESTCo as to the matters which are or were at any one time recorded on such a register (e.g. the details of a holder and of the number of units held in his name) is conclusive evidence that such matters are or were at that time so recorded save in the case of manifest error. The purpose of this

provision is to enable a holder to enforce his rights in reliance on a certificate from CRESTCo without the need to produce the register itself in evidence but it does not affect the statutory provision that the register itself is prima facie evidence of the matters recorded in it.

Clause 12 (Boilerplate)

3.23 Any required boilerplate provisions (e.g. notices) will need to be inserted.

Clause 13 (Law and jurisdiction)

3.24 Any required jurisdiction provisions will need to be inserted.

Execution and storage of deed and notices of issue

3.25 It is advisable that the deed (and in the context of acceptances, any deed of adherence) be executed in hard copy form. However, notices of issue may if required be created and stored in electronic form only (although it may be appropriate in those circumstances for the notices to be authenticated by some form of electronic signature).

3.26 It will be important for issuers (or in practice their IPAs) as an evidential matter to store notices of issue in such a way that it is possible to identify the deed under which each notice was issued. This is particularly important where the notice takes the form of an IPA Issuance Message since the issuance message does not include a “deed” field permitting the identification of the relevant deed.