

Money Market Instruments in CREST

Guidance for issuers

Dematerialisation of UK Money Market Instruments (MMIs) is due to take effect in Autumn 2003. CRESTCo, the Bank of England and HM Treasury have been working with market participants to integrate the settlement of MMIs with the gilt/equities settlement arrangements in the CREST system. This integration will be achieved by allowing the creation of a new form of UK security – the 'eligible debt security' (EDS). EDSs will be identical in economic terms to the existing forms of MMIs as a means of raising short-term finance by issuers, but will be held and transferred in dematerialised, registered form in CREST.

Such significant changes require amendments to legislation, as well as technical changes to CREST. This process is underway and issuance in CREST is scheduled to begin from mid-September 2003, with the Central Moneymarkets Office (CMO) scheduled to close in October 2003. The transition from the issue and settlement of MMIs as physical instruments to the issue and settlement of MMIs as EDSs will also inevitably require firms active in the UK money market to make some changes to their current practices and procedures.

Key features

- An EDS will share all of the economic characteristics of the equivalent MMI, and will have the same UK tax and accounting treatment as the equivalent MMI;
- an EDS may only be held and transferred in dematerialised form through CREST. It will not be possible to issue a certificated EDS, however, the option of issuing physical MMIs outside the new regime will continue;
- an EDS will be constituted and issued by issuers as a registered security. The register will be the electronic records within CREST;
- the role of the current CMO lodging agent will be replaced by a CREST Issuing and Paying Agent (IPA);
- transfer of legal title to units of an EDS will be effected by means of book-entry in the CREST records between the stock accounts of the CREST members concerned. CRESTCo and the Bank of England have taken legal advice from leading counsel that the quality of title given to securities transferred through CREST is as good as the title given on delivery of a negotiable instrument;
- an EDS can be issued on terms which correspond to physical Certificates of Deposit (CDs), Commercial Paper (CP) or bankers' acceptances. An EDS which is equivalent to a banker's acceptance will be constituted as a single debt obligation in respect of which both the 'primary issuer' and the 'secondary issuer' are liable, as against the holder, as principal debtors. The 'primary issuer' of such an EDS will be equivalent to the acceptor of a physical acceptance and the 'secondary issuer' will be equivalent to the drawer; and
- EDSs will be issued as fungible uncertificated units where they are part of the same issue and will be divisible into minimum denominations determined by the issuer (potentially in units of one penny). However, an EDS will not be fungible with physical MMIs sharing the same economic features.

Benefits

Dematerialisation of MMIs in the form of EDSs will generate many benefits for issuers and investors:

- fast same-day issuance – for next day (or potentially even same day) maturity, on a straight-through processing basis;
- reduction in the costs of issuance (in particular the cost associated with immobilisation of the instruments in a depository);
- delivery versus payment at the highest achievable standards for issuers and investors. For sterling and euro EDSs, certainty of payment in central bank funds with simultaneous delivery of the securities, for issuers and transferors (through their settlement banks);
- acceptance of EDSs with a maturity of greater than one year and support for both fixed and floating rate coupons (where relevant). CREST will also automate the process of the payment of interim coupons and redemption proceeds from the IPA to investors;
- integration of settlement into members' and IPAs' back office systems through modern interface standards and increasing efficiency through straight-through processing; and
- a wider range of functionality than CMO, e.g. a broad range of term and overnight repo functions to enhance the liquidity in EDSs; central valuation of EDSs as collateral; a wider range of settlement currencies; and enhanced asset reconciliation.

Legal requirements

Dematerialisation will require changes to the current contractual arrangements underpinning issuance. The contractual arrangements for EDSs will need to cover:

- the issuer's contract with CRESTCo;
- legal opinions (if applicable);
- the constitution and issue of EDSs; and
- the issuer's contract with its IPA.

For an EDS corresponding to an acceptance, amendment may be required to the current contractual arrangements between the drawer ('secondary issuer') and its accepting bank ('primary issuer').

The issuer's contract with CRESTCo

An issuer who wishes to issue an EDS into CREST will need to become a participating issuer in CREST by completing the Issuer Application Form (IAF). Issuers will therefore become subject to the CREST Rules in the same way that they are subject to the CMO mandatory terms and conditions.

The IAF will cover all EDSs to be issued into CREST by that issuer through a specified IPA.

The issuer is required to warrant that an EDS issued into CREST complies with the statutory requirements and those of CRESTCo. These warranties offer investors reassurance that units of an EDS which they hold in CREST are properly constituted and issued through CREST, and will protect the integrity of the CREST system.

For an EDS corresponding to a banker's acceptance, the primary and secondary issuers will need to execute the IAF jointly. An issuer using several accepting banks to raise finance through acceptances or, alternatively, several IPAs for the issue of EDSs will need to execute an IAF for each combination of relationships. However, this will only need to be performed once and will cover all prospective future issues of EDSs by that issuer with that accepting bank and/or through that IPA.

Legal opinions

Where an issuer is incorporated outside the United Kingdom, CRESTCo will require a legal opinion on:

- that issuer's authority and capacity to execute the IAF and related agreements; and
- the legality and enforceability of the IAF and related agreements as a matter of the laws of the issuer's home jurisdiction. Where issuers are incorporated in multi-jurisdictional/federal states (e.g. the USA), the opinion will be required at the level of both state and federal law.

The legal opinions will cover all EDSs to be issued into CREST by that issuer.

Similar legal opinions are already required from overseas incorporated issuers of contractually dematerialised CDs in CMO. However, CRESTCo has significantly simplified the process:

- the opinion on authority and capacity can be prepared by the issuer's in-house counsel; and
- issuers incorporated in the same jurisdiction may jointly instruct an external counsel for provision of the legal

opinion on legality and enforceability on a generic, jurisdiction-specific basis.

Constitution and issue

Issuers will have to constitute and issue EDSs on terms that are consistent with the relevant legislation (the Uncertificated Securities Regulations 2001 as amended for EDSs) and the CREST Rules. In consultation with members of the Sterling Money Markets Liaison Group, the Bank of England has prepared two sets of pro forma standard terms of issue for EDSs (one for EDSs corresponding to CDs and CP and one for EDSs corresponding to bankers' acceptances). It is expected that these will become the common standard for most issuance of MMIs as EDSs.

The pro forma terms include the general terms and conditions governing the constitution and issue, by way of deed, of a single EDS or a programme of such securities which may include EDSs corresponding to different types of material MMIs. These terms will have to be adapted to include certain commercial terms as required (e.g. a guarantee provision).

The execution of the deed is expected to be a one-off action on the part of an issuer as part of the transition process. Once the deed has been executed, the issuer (or its IPA under a power of attorney) will:

- constitute an EDS by completing a Notice of Issue under the deed containing the required economic terms for that EDS (e.g. nominal value, maturity date and coupon). The Notice can be issued in any form selected by the issuer, but generally this will be done electronically with the Notice forming part of the IPA Issuance Message; and
- effect the issue of the EDS by procuring the entry of each holder's details in the CREST register (i.e. by means of an electronic issuer-instruction sent by the IPA to CREST as 'CREST sponsor' for the issuer).

The issuer's contract with its IPA

Issuers will need to amend their current IPA agreements (or enter into new agreements) to reflect the new arrangements and this is a matter which issuers should raise with their IPAs at an early stage.

Further information

Copies of the relevant CREST documents including the draft IAF and the pro forma legal opinions can be found at <http://www.crestco.co.uk/home.html#news/cmo-migration>. Copies of the draft pro forma standard terms of issue can be found at <http://www.bankofengland.co.uk>.

The table below summarises which documentation issuers are required to complete by 1 August 2003 before EDS issuance can commence within CREST. Issuers should liaise with their IPAs to ensure that these documents are completed in good time.

Document	Required for/by	Signed by	Held by	Remarks
CREST Issuer Application Form (IAF)	All issuers (one IAF per IPA used by the issuer)	Issuer	CREST	May be signed by 'accepting bank' on behalf of the secondary issuer ('drawer'), subject to satisfactory evidence of authority
Legal opinion – authority and capacity	Non-UK issuers only	External counsel or issuer's in-house counsel	CREST	
Legal opinion – jurisdiction	Non-UK issuers only	External counsel	CREST	Only one opinion from each jurisdiction needed
EDS deed	All issuers	Issuer	IPA	For an EDS corresponding to a banker's acceptance, 'drawers' may sign up using one page accession deed
Notice of issue	To constitute each issue of EDSs under the EDS deed	Written signature not required if issuing by means of an authenticated CREST instruction	IPA	Can be issued in electronic form
IPA agreement	All issuers (unless issuer also acts as IPA)	Issuer/IPA	Issuer/ IPA	May be signed by 'accepting bank' on behalf of the secondary issuer ('drawer')

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Note:

This fact sheet is not intended to be, and should not be relied upon as, a substitute for legal, tax or accounting advice. Any person proposing to issue or hold title to units of an EDS should seek separate advice. Whilst care has been taken in the preparation of this fact sheet, CRESTCo accepts no responsibility or liability for any loss which may arise in connection with its use by any person.

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