

A.2 Financial instruments issued before, and outstanding at, entry

(i) Nominal values

A.2.6 The nominal values of financial instruments issued before, and outstanding at, UK entry would remain denominated in sterling during the transition period after entry, unless their nominal values were redenominated from sterling to euro.

A.2.7 *Treasury bills* Treasury bills, which were dematerialised for settlement in CREST in September 2003, would be redenominated on UK entry, using the same method as for gilts.

A.2.8 *Other money market securities* with a maturity of less than one year include bank bills, some CDs, trade bills and commercial paper. After UK entry, outstanding money market securities would quickly run off and be replaced by new issues denominated in euro. The option to dematerialise these instruments was introduced in September 2003, though issuers are able to keep securities in paper form, if they prefer. For dematerialised instruments there would be three main options, if the UK joined EMU:

- they could be left to run off in sterling;
- they could be redenominated on entry; or
- those that remained outstanding on a particular date (say three months) after entry could be redenominated at that point.

The choice between these options would be for the market. The outcome might be influenced by the extent to which sterling business was replaced by euro business before entry. It is not expected that money market instruments still in bearer form would be redenominated.

A.2.9 *Other bank instruments* include the following:

- *bank deposits*, which are generally short term and not traded: it is not expected that the principal amounts outstanding on entry would be converted;
- *CDs*, which are traded and have a maturity of up to five years: CDs issued in sterling before entry would not be expected to be redenominated, where they took the form of bearer instruments; but if and when dematerialised, the same considerations would be expected to apply as for other money market securities;
- *syndicated bank loans*, which have a wide range of maturities: except where the loan documentation makes specific provision for UK entry, it is not expected that the principal amount outstanding nor the total commitment would be converted until the end of the transition period.

A.2.10 *Gilts in registered form* would be expected to be redenominated on entry. Under UK legislation, they would be expected to be redenominated by individual holding (by each stock account), and rounded to the nearest euro cent. Index-linked gilts would continue to be linked to the UK retail price index.

A.2.11 *Gilts in bearer form*, of which there are 13 issues, would be deemed to be redenominated on entry, but without requiring an actual exchange of paper instruments or physical ‘stamping over’. The UK legislation covering the redenomination of gilts might need specifically to provide for this.

A.2.12 *Minimum denominations*

- All gilts and many other sterling debt securities are transferable in minimum multiples of one penny. On redenomination, the minimum transferable multiple would be one cent.
- Requests to strip or to reconstitute gilts must be in minimum amounts of £10,000. In the event of UK entry, the euro threshold would be expected to be €10,000.
- Under the FSMA, which came into force at the end of November 2001, there is no longer any statutory minimum denomination for debt securities, except that, under the FSMA Regulated Activities Order, the proceeds of any issue of debt securities with an original maturity of less than one year with a minimum redemption value for each security of under £100,000 would count as a deposit, and the issuer could require authorisation. In the event of UK entry, a convenient round euro threshold would be needed for this amount.
- Where debt securities are managed by registrars and transferable in minimum multiples other than one penny (eg £1), registrars would need to agree with issuers new transferable multiples in euro for redenominated securities. If the euro-sterling conversion rate did not provide an exact conversion from old sterling multiples to the new euro multiples, issuers would need to instruct registrars about the rounding policy to be adopted in drawing up the register. The market might need to provide, for a limited period, a sale or repurchase facility to allow redenominated securities to be held in amounts easily divisible by the new euro multiple.

A.2.13 *ISINs* on gilts would not change on redenomination. There is a market consensus that ISINs on other sterling debt instruments should also not change, as in those first-wave countries which redenominated to the nearest euro cent: adopting the same approach for gilts and other sterling debt instruments would minimise problems for the market as a whole.

A.2.14 *Bonds by other issuers* The legislation providing for gilt redenomination on UK entry could also allow redenomination on or after entry of sterling bonds issued by other sovereign and supranational issuers and by corporate issuers under English law, using the

same method as for gilts. If corporate and other issuers wished to redenominate their sterling bonds, it is expected that they would be encouraged to do so at an interval after entry, to minimise the market's workload at entry. Issuers would need to weigh any benefits from redenomination against the costs. They would not be compelled to redenominate and, based on experience of the first wave, many issuers would not do so. It seems likely that global bearer bonds deposited with custodians would be treated in the same way as registered bonds. It is not yet clear whether special arrangements would be needed to facilitate redenomination after entry of bonds held in dematerialised form. If issuers did redenominate, the ICMSA would prefer them to do so on a coupon date.

A.2.15 Equities In the event of UK entry, and subject to any legislation, it would be up to companies whether, and if so when, to redenominate their sterling share capital into euro during the transition period (see Section B and Box 5).

A.2.16 Over-the-counter derivatives contracts outstanding in sterling at UK entry would be expected to continue in sterling rather than be converted into euro. Contracts with expiry dates after the end of the transition period would thereafter be 'read as euro' at the conversion rate. There may be market demand for an ISDA Protocol, in the event of UK entry, covering similar ground to its EMU Protocol for the first wave (eg continuity of contracts, business day conventions, price sources and payment netting).

A.2.17 Exchange-traded derivatives No decisions have yet been taken, but LIFFE expects that the conversion from sterling to euro would be handled as follows.

- *Short Sterling contracts* Open positions in Short Sterling contracts expiring after the date of UK entry would be converted on a mandatory basis using a ratio set by the Board of LIFFE. The ratio would be based on the conversion rate. The timing of the conversion, and the reference rate against which settlement would be made, would be notified, following market consultations, after a Government decision to recommend entry.
- *Gilt contracts* All delivery months listed after a decision on UK entry would have a notional value denominated in euro. The contract size would be determined after market consultation. Appropriate functionality would be made available to facilitate the rolling of positions from sterling to euro-denominated contracts.
- *Equity index contracts*
 - (i) The denomination of individual equity options would reflect the denomination in which the underlying share was quoted. If the trading of any shares changed from sterling to euro before UK entry, the option exercise prices and premiums would be converted into euro at the forward euro/sterling exchange rate for the appropriate expiry date. If conversion occurred on UK entry, the conversion rate would be used. Following conversion, the option premium would be quoted in cents per share.

- (ii) Assuming that the FTSE 100 and FTSE 250 indices continued to be calculated in sterling until UK entry, futures and options on these indices would retain their sterling multiplier until then. Following UK entry, a standard euro-denominated multiplier would be used for all newly introduced contract months.
- *Commodity contracts* The value of open positions in soft commodity contracts (ie cocoa and wheat) expiring after UK entry would be converted on a mandatory basis using a ratio set by the Board of LIFFE, determined by the conversion rate.

A.2.18 *End of the transition period* In the case of any sterling financial instruments not redenominated by the end of the transition period, the sterling nominal values would be 'read as euro' at the conversion rate.

(ii) Cash-flow payments

A.2.19 During the transition period after UK entry, cash-flow payments (ie interest payments and repayments of principal) on *debt* instruments *redenominated* from sterling to euro would thereafter be expected to be made in euro. (Retail investors would rely on their banks to convert the payments and credit their accounts in sterling.) In the case of cash-flow payments on *debt* instruments which were *not* redenominated, the market's preference would be for issuers to make all cash-flow payments in euro. The only exceptions would be cash-flow payments on non-gilt securities managed by the HM Treasury's designated Registrar, currently Computershare Investor Services plc (Computershare), and unquoted loan stocks, which would continue to be made in sterling until the end of the transition period, unless the issuer chose to redenominate earlier.

A.2.20 *Euro/sterling swaps* A special situation would arise in the case of cash-flow payments on euro/sterling swaps. During the transition period after UK entry, these swaps would be in different denominations of the same currency. However, they would still give rise to cash flows in both directions. If there were market demand for a multilateral protocol along the lines of ISDA's 1998 EMU Protocol, parties could determine whether payments between them should be made gross or net by adhering to the Protocol. Market participants that did not do so would be expected to be able to cope with netting payments on the basis of bilateral agreements.

A.2.21 In the case of *equities*, it is assumed that, from UK entry, institutional investors would generally want payment from company registrars in euro, but retail investors would want payment in sterling. Any dividends paid through CREST would only be settled in euro after entry (this would mean that the receiving banks would have to convert into sterling any such payments for clients with sterling accounts). For all dividends paid via BACS or by cheque, guidance is given in Section B.

A.2.22 *End of the transition period* In the case of any sterling financial instruments still outstanding at the end of the transition period, all cash-flow payments thereafter would be made in euro at the conversion rate.

(iii) Market conventions

A.2.23 Market conventions on sterling financial instruments issued before and outstanding at entry would in general remain unchanged, whether they were redenominated or not, unless there were contractual provisions to change conventions.

- Short-term sterling-denominated *money market* instruments and interbank deposits would be expected to keep existing conventions, except in the case of LIFFE's Short Sterling contract, which already allows for the possible adoption of euro market conventions, in the event of UK entry. Keeping existing conventions would mean, for example, that interest on bank deposits outstanding in sterling on entry would continue to be calculated until maturity on an actual/365 basis, rather than actual/360. In the case of syndicated bank loans, contracts written before entry in sterling on the basis of an actual/365 day count would not change until maturity, even though they would be likely to be funded from entry in euro on the basis of actual/360. Interest rates could be recalculated from one basis to the other, if required. Keeping existing conventions would also mean that payments of interest and repayments of principal for short-term money market instruments and interbank deposits would continue to be made on London business days only. Although it would be open to the market to decide that the TARGET holiday on 1 May should not be treated as a London business day for market transactions like short-term money market instruments and interbank deposits, such a decision would not necessarily affect other contracts, such as syndicated bank loans, where the specific terms of the contract would continue to apply.
- *Gilts*, which would be redenominated on entry, already use the same market day-count conventions as the euro area (ie actual/actual). It is expected that gilts would continue for the foreseeable future to be issued with semi-annual rather than annual coupons.
- *Other issuers of sterling bonds* currently use a day count of actual/365 in the case of domestic issues, and actual/actual in the case of international issues. If any of these issuers chose to redenominate their bonds, market participants would prefer market conventions (ie the interest day count and payment dates) on these bonds not to change.

A.2.24 Before UK entry, the Government could choose to make separate issues of gilts denominated in sterling and euro with identical coupons and other characteristics, with the intention that these separate issues would be fungible in euro after entry.