

Box 6 UK EURO CHANGEOVER: SUMMARY

This box summarises the main technical assumptions about a changeover in sterling financial markets, and identifies in each case (in italics) those who would be responsible for taking decisions.

Financial instruments issued before, and outstanding at, entry

(i) Nominal values

- *Treasury bills* Treasury bills, which were dematerialised for settlement in CREST in September 2003, would be redenominated on entry, using the same method as for gilts. *For decision by HMT/DMO.*
- *Other money market securities (including CDs)* If dematerialised, there would be three main options: run-off in sterling; redenomination on entry; or redenomination at a later date. The choice would be for the market. Any remaining bearer instruments would not be redenominated. *For decision by individual market firms.*
- *Wholesale bank deposits* The principal amounts outstanding at UK entry would be expected to run off in sterling rather than be converted to euro. *For decision by individual market firms, with BBA guidance.*
- *Syndicated bank loans* Except where the loan documentation makes specific provision for UK entry, the principal amounts outstanding and the total commitment would not be converted until the end of the transition period. *For decision by individual market firms.*
- *Gilts in registered form* would, under UK legislation, be redenominated on entry by individual holding (by cash stock account), and rounded to the nearest euro cent. Index-linked gilts would continue to be linked to the UK retail price index. *For decision by HMT/DMO.*
- *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 gilt redenomination might need specifically to provide for this. *For decision by HMT/DMO.*
- *Gilt strips* In the event of UK entry, the euro threshold would be expected to be €10,000. *For decision by HMT/DMO.*
- *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 re-denominated to the nearest euro cent: adopting the same approach for sterling debt instruments would minimise problems for the market as a whole. *It would be for market firms to confirm this approach.*
- *Bonds by other issuers (sovereigns, supranationals and corporates)* Under UK legislation, sterling bonds by other issuers under English law could be redenominated, using the same method as for gilts; if corporate issuers wished to redenominate their sterling bonds, they would be encouraged to do so at an interval after entry, to minimise

the market's workload at entry. If issuers did redenominate, the ICMSA would prefer them to do so on a coupon date. Bearer bonds (eg sterling Eurobonds) would not be redenominated. *For decision by issuers.*

- *Share capital* Subject to any UK legislation, it would be up to companies whether, and if so when after entry, to redenominate their sterling share capital into euro, preferably using a method which left unchanged the number of shares held by each shareholder, in order to avoid corporate actions. *For decision by issuing companies, subject to market guidance (in Section B.3, and Box 5).*
- *Over-the-counter derivatives* contracts outstanding in sterling at UK entry would be expected to run off in sterling rather than be converted into euro. *For decision by individual market firms, with guidance from ISDA.*
- *Exchange-traded derivatives* Open positions on Short Sterling contracts expiring after entry would be converted on a mandatory basis using a ratio set by the LIFFE Board. In the case of *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. In the case of *equity index* contracts, individual equity options would reflect the denomination in which the underlying share was quoted. On indices, a standard euro-denominated multiplier would be used for all newly introduced contract months. *For decision by LIFFE.*

(ii) Cash-flow payments

- After UK entry, HM Treasury's designated Registrar, currently Computershare, would make cash-flow payments (ie interest and repayment of principal) on *gilts* in euro. *For decision by HMT/DMO.* Issuers of *other sterling* debt would make cash-flow payments in euro, whether or not the financial instruments concerned had been redenominated, with banks converting euro payments into sterling for their personal and small business customers. The only exceptions would be cash-flow payments on non-gilt securities managed by 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. *For decision by individual issuers.*
- *Euro/sterling swaps* would give rise to cash flows in both directions during the transition period. 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. *For decision by individual market firms, with guidance from ISDA.*
- In the case of *equities*, from UK entry, institutional investors would generally want payment in euro, but small investors in sterling. Company registrars would continue paying dividends in sterling, subject to the guidelines drawn up by banks, registrars and representatives of issuing companies. Banks would convert sterling payments into euro for institutional investors. *For decision by companies, subject to market guidance (in Section B.2).*

(iii) Market conventions

- Short-term sterling-denominated *money market* instruments and interbank deposits would 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. *For decision by individual market firms, with guidance from LIFFE, where relevant.*
- Gilts already use the same market day-count conventions as the euro area (ie actual/actual). It is expected that gilts would continue to be issued with semi-annual rather than annual coupons. *For decision by HMT/DMO.*
- *Other issues of sterling bonds* currently use a day count of actual/365 in the case of domestic issues, and 30/360 in the case of international issues. If redenominated, market participants would prefer market conventions (ie the interest day count and payment dates) on these bonds not to change. *For decision by individual market firms, with guidance from IPMA and ISMA.*

New financial instruments issued after entry

- *New financial instruments* issued after UK entry would be denominated in euro rather than sterling, as would the associated cash-flow payments. There are some possible exceptions (see Section A.3). *For decision by individual market firms.*
- *Market conventions* New financial instruments issued in euro after UK entry would use the then prevailing euro market conventions, which differ from the currently used sterling market conventions in a number of ways (see Section A.3). *For decision by individual market firms.*
- *Day-count conventions* From UK entry, interest rates would be quoted with actual/365 for products that were not explicitly market-linked and actual/360 for market-linked rates, with appropriate annotation where the presumption did not apply. In the event of UK entry, all financial institutions would have to consider the day-count basis to be used for products and services for their personal and small business customers and the implications for their treasury management of any differences with the wholesale markets (see Section A.3 and Box 4). *For decision by individual market firms, with guidance from the BBA.*
- *Settlement periods* If normal settlement periods in the sterling money market were to conform to those in the euro market, this would mean from settlement on the same day to settlement two business days later. *For decision by individual market firms, with guidance from the BBA.*
- *Business days* CHAPS and CREST, which would settle only in euro from UK entry, would have to be open on all TARGET business days. BACS and the Cheque and Credit Clearing could settle only on days on which CHAPS was open, and would remain closed on UK Bank Holidays, in accordance with existing practice. Exchanges, like the London Stock Exchange, might continue to be closed on UK Bank Holidays, even when these were TARGET business days, as is currently the case with many exchanges in the

euro area. *For decision by individual market firms, with guidance from APACS, CREST, the London Stock Exchange and LIFFE.*

Financial transactions undertaken before entry but settled afterwards

- *Over-the-counter transactions* It is not yet clear whether market practitioners would prefer OTC transactions to run off or be converted, except for OTC derivatives, which would be allowed to expire, though a limited number of market practitioners might agree to convert them on a bilateral basis. *For decision by individual market firms, with guidance from ISDA in the case of OTC derivatives.*
- *Money market and foreign exchange transactions* entered into in sterling prior to UK entry but settled afterwards would be expected to be settled in euro in accordance with the counterparty's existing standard settlement instructions (SSIs) for euro payments. Market participants should review their settlement arrangements in good time before entry, and any necessary SSI changes should be provided to counterparties at least six weeks before entry to allow time for processing. Sterling SSIs should not be used for market transactions after UK entry, but settlement of transactions with customers and non-market participants would be able to continue in sterling after entry until the end of the transition period. *For decision by individual market firms, with guidance from BBA/APACS.*
- Transactions involving sterling *price sources* would be replaced with euro price sources. The WMBA has already decided that SONIA would be replaced by EURONIA (as opposed to EONIA). The BBA has not yet decided how it would replace sterling LIBOR and would consult the market before doing so. If sterling LIBOR (which is fixed on a t+0 basis) were replaced by euro LIBOR or EURIBOR (which are fixed on a t+2 basis), there would be a mismatch between the value date and the corresponding period starting date. For sterling syndicated loans, the treatment of fixings would depend on the provisions in the loan documentation (see Section A.4). *For decision by market firms, with guidance from the BBA, where relevant.*
- In the case of *gilts and any other debt instruments redenominated on entry*, financial transactions undertaken in sterling before entry but settled afterwards would, subject to market consultation, be settled in euro. Market firms would not reconfirm trades following redenomination, unless bilaterally agreed otherwise. *For decision by individual market firms.*
- In the case of *repo* transactions, market participants would be encouraged to change over to euro in a particular way (see Section A.4). *For decision by individual market firms.*
- In the case of *debt instruments* not redenominated on entry and equities, CREST proposes that transactions outstanding at entry should settle in sterling for a period of 25 business days after entry, when it would either convert to euro or request market firms to delete and reinput in euro. *For decision by CREST.*

Financial transactions undertaken after entry

- *Cash and derivatives* transactions undertaken after entry would be settled in euro, unless bilaterally agreed to settle in sterling. *For decision by individual market firms.*
- In the case of *debt* instruments, the considerations (including accrued interest) would be calculated in euro and settled in euro after entry. *For decision by individual market firms.*
- In the case of *equities*, the London Stock Exchange has proposed that all shares not already priced in euro (rather than sterling) before entry would be priced in euro from entry, and all equity transactions after entry should be priced and settled in euro (rather than sterling). *For decision by the London Stock Exchange.*