

## PLANNING FOR POSSIBLE UK ENTRY INTO EMU

JOHN TOWNEND, DIRECTOR FOR EUROPE, BANK OF ENGLAND

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1 It is a great pleasure and honour to have been invited to give what is billed rather grandly as the keynote address to this ABI Seminar on the euro. I am very happy to be associated with this event, and indeed it seems to me entirely appropriate that the Seminar should be arranged by the insurance industry, since at the very heart of the motivation for making preparations here in the UK for EMU entry is to insure against the possibility of this uncertain future event.

2 Now I am the first person to recognise that preparing for possible UK entry into EMU is not at the top of your agenda at the moment. In the Bank, we have a certain reputation for market savvy, for understanding what motivates market players and how they are feeling. I think we do know how you feel, and we are quite realistic about this. We read the opinion polls, just as you do. We understand what the prevailing view in the country is at the moment about the prospects for UK entry in the foreseeable future.

3 But despite this, I want to persuade you that it is in your own interests to take preparations for possible UK entry seriously, by planning now. And, given the industry that you represent, I hope that persuading you should not be too difficult! People often say to me that they are not willing or able to justify spending large amounts of their shareholders' money on preparing for a hypothetical event. But the point about planning is that it does not involve spending large amounts of your shareholders' money. What effective planning does do is save time and money later, if the UK decides to join. Planning now is therefore a responsible approach for the management of an insurance company to take, if it is commercially aware.

4 I am conscious that a number of you are planning for possible UK entry in precisely this way already. I recognise that this must sometimes seem a lonely process. Indeed I probably know this better than anyone since part of my job in the Bank involves making plans for both the Bank of England in particular, and the City in general, to be ready. And finding interlocutors is not always easy - it must be the only job that is less popular than being England football manager! I now think I know how Moses felt but he was only in the

Wilderness for 40 days - not 40 months - and before you ask, no that is not a prediction! But the ABI has been resolute in its work on EMU preparations, and we in the Bank really appreciate the work that the Association has been doing. And in particular, I want to thank Ian Bates, Mike Bell, Enid Jones and Pat Sinclair. Like them, it is prudent for you all to plan against the risk of possible UK entry.

5 To explain why this is important and what it involves, I want first of all to talk to you about the context: the Government's policy; the timetable for a changeover; and preparatory lead-times. I would then like to explain how we in the Bank of England are approaching the task of planning for possible UK entry: both so far as our own preparations are concerned, and in co-ordinating preparations across the City. Finally, I want to consider how we can all learn from the first wave, and in particular how you can best participate in this process, in the insurance sector. This will also help to answer the following particular question: in preparing for possible UK entry, what is it exactly that is 'special' about preparations in the insurance sector?

### **The context**

6 So, first of all, the context. The important point to make about Government policy is that it has not changed. In his speech in Warsaw last month, the Prime Minister confirmed that the 'no' result in the Danish Referendum would not affect in any way the British Government's position on the euro. And the Government's position, as you will know, is to maintain the option to join a successful single currency early in the lifetime of the next Parliament, should the five economic tests announced by the Chancellor in October 1997 be met, and subject to the vote of the British people in a referendum.

7 If the UK were to join EMU, what would the timetable be? The Treasury has set out an illustrative timetable in the Government's Outline National Changeover Plans, published in March this year and February last. If the Government decided to recommend entry, there would probably be a period of four months between that Government decision and a referendum of the British people. In the event of a referendum result in favour of entry - and you might think it unlikely that our Government would put the question to the people unless it expected a positive result - there would be a further period of between 24 and 30 months before euro cash would be introduced in the UK. Within this period of 24-30 months, the actual entry point is so far left unspecified, because it will be conditional on both the practical state of readiness of the key parts of the economy, as well as on a number of policy questions.

8 Whatever the entry date, the critical point for the City is how long in advance its preparations would need to start. On the wholesale side, because the sterling financial markets would be expected to begin trading in euro immediately at entry, there would be little or no room for slippage in the preparations. Both the relevant market infrastructure as well as individual market participants' treasury operations would all need to be fully complete and ready for operation by the date of entry itself - and this applies in equal measure to banks, other financial institutions (including insurance companies) and to large corporates. We reckon that, in general, a lead-time of some 12 months would be required to implement these preparations, assuming prior planning and market consultation. So implementation would obviously need to start no later than one year before the entry date; and possibly before the referendum.

9 In some areas, more than twelve months would be required. That is particularly the case for the payments infrastructure, where a high volume wholesale domestic system for making euro payments would be needed if the UK were to join EMU. We are therefore very pleased that the NewCHAPS project is already under way, and planned to be completed in August next year. This project is designed to replace the current outdated technology for making sterling payments with the more modern platform used now for CHAPS euro, allowing enhanced functionality; but it will also have the incidental benefit of enabling a single high-volume euro payment system to be readily established if the UK were to join EMU. Similarly, a project is also under way to enhance delivery-versus-payment, by introducing settlement of securities in CREST against payment of central bank funds in real time in CHAPS. This project is planned to go live in November next year, and will therefore meet the ECB requirement that, by 2002, only systems of this kind will be eligible for use in extending intraday credit in TARGET, as well as for the European Central Bank's monetary operations.

10 While the remaining preparations for conversion to the euro in the wholesale markets would be likely to require about one year, it is generally accepted that preparations for the full range of retail financial services would - for many retail banks - take considerably longer. So, if preparations in the two sectors were to begin at the same time, around one year before entry, retail preparations could not be complete by the entry date. Having said this, the retail customer base of financial institutions would probably in any event want to continue to operate in sterling until close to the introduction of UK euro notes and coin, to judge by experience in the first wave. That would mean that financial institutions operating

solely in euro in the wholesale markets would need to be able to handle both euro and sterling for their retail customers. And it might also very well lead to a phased approach to the changeover, as noted in the second Outline National Changeover Plan, in which the financial markets would change to euro immediately at entry, but full provision of retail financial services in euro would be delayed for a period beyond entry.

11 Apart from the long-duration projects to upgrade CHAPS and to enhance delivery-versus-payment, there is precious little sign at the moment that the major financial institutions are beginning to implement the necessary investment to develop their own internal systems for the euro. That is not surprising; but, equally, there is no need for them to begin yet, on any reasonable estimate of the prospective date for entry, given that completion of the wholesale market preparations should be possible within one year. And the important point is that planning in the banking sector - at least amongst the major banks - to understand the detail of the changes needed if the time comes, is well advanced.

### **Planning in the Bank**

12 I can perhaps best illustrate the approach which we think you should be taking in planning for possible UK entry to EMU by explaining the approach which we ourselves are taking within the Bank of England.

13 First of all, we have looked in detail at the changes we would need to make, if the Bank were to become a full participant in the ECB framework. For the anoraks amongst you, the collective noun for the entire group of euro-area central banks is 'the Eurosystem' - I am sure you could think of a better label, but I leave that to you! Anyway if the UK were to join EMU, the Bank would become a full member of the 'Eurosystem'. There would be consequential changes to the Bank's constitutional position and hence to its Statute, changes to the foreign reserves, our finances and our balance sheet. We would need to change the way in which the Bank conducted monetary policy operations in order to comply on entry with the operational framework of the Eurosystem. For example, banks would be required to hold minimum reserves, consistent with the Eurosystem requirement; all banks would be eligible to have access to the marginal lending and deposit facilities which we would provide in common with other euro-area central banks; and to apply to be Bank counterparties to participate in the Eurosystem open market operations. This would entail significant changes to our front, middle and back offices. In addition, as I have explained, the payment infrastructure - and our own interface to it - would need to

change. Our accounting systems would need to change. Statistical requirements would change. There would be changes in our Registrar's Department. And finally, we would also, of course, have to plan for the introduction, at the appropriate time, of UK euro banknotes in place of sterling banknotes (and, yes, the question of the Queen's Head remains open).

14 Given the possible need to make all of these changes, the next step in our planning process has been to identify, and to begin elaborating, the projects (particularly the IT projects) that we would need to implement, so that the Bank could be ready by UK entry. We have divided them into four categories.

First of all, there are the projects which we need anyway, irrespective of UK entry. These include some projects with long lead-times, such as NewCHAPS and delivery-versus-payment, but we are also upgrading our entire banking systems to make them ready for the 21<sup>st</sup> century.

Second, there are projects which are specific to EMU but which are not resource-intensive. They include some of the legal and financial work necessary in planning for EMU. We reckon that we can undertake these projects over time without diverting resources unduly from other tasks.

Third, there are EMU projects which would be resource-intensive but which could, with prior planning, be implemented between a Government decision to recommend entry and the actual entry date. Work in implementing much of the monetary policy operational framework of the Eurosystem falls into this category.

And then finally, there are EMU-specific projects which would be resource-intensive and which could probably not be completed by entry, unless implementation were to begin before a Government decision.

15 Our approach has been to go ahead with projects that are needed anyway, whether we join or not. They mean that the Bank will be in a much better position than to prepare specifically for the euro, should the need arise. We also intend to go ahead with projects which are not resource-intensive, because they do not divert resources from our other more immediate responsibilities. In the case of projects which are resource-intensive, we are also confident that, by planning them in advance, we can implement them between a Government decision and entry. Once we have planned all these projects, that leaves very few, if any, projects in the final category, which are EMU-specific and where actual

implementation would need to begin before a Government decision.

16 So, under the approach that we are taking, we are continuing with our planning work, and we are also proceeding to implement those IT projects that we need to implement anyway, irrespective of whether the UK joins EMU, but in a 'euro-friendly' way. On this basis, we are confident that we too could be ready for entry within a period of 12 months, come the day. By planning in this way, we keep open the option of being ready to join EMU, if and when the decision is taken, without spending money before we need to do so; and without at this stage diverting resources from our other more immediate responsibilities and tasks.

17 I hope you will agree this is a rather prudent and sensible approach for a major institution like the Bank of England to take; but I hope you will also consider after today whether there are any lessons here for your own firms.

### **Planning in the City**

18 We are taking a similar approach to planning more generally in the City. Clearly, preparing for the euro is not an unfamiliar task in the City. We were all involved in the preparations for the launch of the euro at the beginning of last year. And from a technical point of view, these preparations were an unqualified success. The task of converting the sterling markets to euro would require as intensive and extensive preparations as those in the run-up to the euro's launch. On that occasion, meticulous planning paid off, and we would expect the City to follow a similar approach if the UK were to join, though the constituency of City institutions primarily affected would be different. In the run-up to the launch of the euro, the main market firms affected in the City were the international investment banks. If the UK were to join, the main City firms affected would be the clearing banks and building societies, and of course the insurance companies which you represent here today.

19 Planning in the City for possible UK entry is co-ordinated through the City Euro Group, which the Bank established and which I chair. The City Euro Group fits into the overall project management structure overseen by the Treasury at official level, under the Chancellor's Standing Committee, on which the Governor represents the Bank.

20 We have tried to make the City Euro Group a truly representative pan-City body by including representatives of

all the main financial associations, some 70 people in all; and we are very pleased that the ABI is represented by John Hale. We meet three times a year at present. The two main purposes of the Group are to identify the key issues and to ensure that they are pursued; and to communicate the state of the developing planning and preparations as widely as possible, so that City firms are fully informed about the context within which they need to prepare.

21 Because the City Euro Group is a large representative body, we have been using smaller informal sub-groups to do the detailed planning work. I will give you two examples. One is that, in our latest *Practical Issues* published two weeks ago (and I assuming that you are all aware, and avid readers, of this publication but if any of you are not this is available either directly from the Bank or through your Association), we have set out a preliminary but detailed technical guide to how the sterling financial markets might change over to the euro, if the UK were to join. We have drawn this up in collaboration with market experts on the City Euro Group. It is intended for use by market practitioners in their preparations for possible UK entry. And we propose to update it, as more information becomes available.

22 Another example is our sub-group looking in detail at the relationship between the preparations in wholesale markets and retail financial services. Through this group, we hope to obtain a better understanding of the practicability of the kind of phased approach to the changeover in the UK to which I have already referred.

23 This sub-group is considering questions, such as: how would gilt-edged payments be handled, in the period after entry but before retail preparations were complete? Could registrars pay dividends to shareholders in sterling, while receiving banks made the necessary conversion to euro for institutional investors? And how would market participants handle the funding mismatch between their wholesale book in euro, which would operate on the day-count convention in the euro money market of actual/360, whilst retail bank deposits in sterling might continue to be calculated on the basis of actual/365? We have again published in our new *Practical Issues* a consultation document prepared by this sub-group; members of the City Euro Group have all had the opportunity to comment; and we hope to make available the results of this consultation in due course.

### **Learning from the first wave**

24 A common theme of our planning work both in the Bank and in the City Euro Group is learning from the first wave of

countries which have already joined EMU. We found that it was very useful to collaborate with the first wave in the changeover to wholesale markets during the conversion weekend at the beginning of last year. And now that preparations are being made for the completion of the changeover in the first wave at the end of next year - including the change in banks' and insurance companies' entire retail operations - followed by the introduction of euro banknotes and coin and withdrawal of old national banknotes and coin in the early months of 2002, we need to learn what we can from the first wave about this retail changeover, too. Learning about the retail changeover in the first wave is important because financial institutions in the UK will be directly and indirectly affected now at the margin, through their links with the euro area. But it is also important because it may ultimately be relevant to a UK changeover, though clearly we would also need to take account of possible differences with the first wave, if we were a later entrant. And, of course, the time to learn lessons is now, before memories fade.

25 For our part, in planning for possible UK entry and as part of the Government's 'prepare and decide' policy, we are keen to learn as much as we can from the changeover in the first wave. In the Bank, we are in regular contact with our counterparts in the European Central Bank, and the national central banks within the euro area, to see what lessons we can learn from their experiences, albeit that our own circumstances might ultimately be different. As a result, we have been able to publish in the new *Practical Issues* a detailed analysis of the different approaches which euro-area countries, and particularly their financial sectors, are taking towards completing the changeover to the euro.

26 But beyond this, we are also concerned that City institutions themselves learn from the first wave as much as they can. That is why, at the latest City Euro Group meeting in September, I asked members to consider three main questions. Is enough being done to learn the lessons for individual institutions or sectors? Is there a process for sharing more general lessons? And is there scope for greater co-ordination of the lessons learned than is currently in place? We will be considering these questions in more detail with the City Euro Group at our next meeting, in January.

27 I have also specifically encouraged the ABI to do what it can to learn from the first wave in the insurance sector. And I very much hope that individual insurance companies will themselves learn what they can from their counterparts and links to the euro area, because this will help to cut lead-times, and minimise costs, if the UK joins. And as I say, the time to do this is now, before memories fade.

28 I hope that, through the ABI, you will feed in to us anything which you do learn through engaging in this way. We are keen to understand in detail how the changeover in the insurance sector would work. And in particular, we need to know whether there is anything 'special' about preparations in the insurance sector that makes you different from other sectors. In this respect, the experience of the first wave may provide some guidance. For example, how are your counterparts in the first wave proposing to treat historic information after the end of the transition period? How are they proposing to deal with the rounding of recurring monthly payments? And are they proposing during the transition period simply to notify policy holders if and when they propose to convert, unless policy holders object, or are they proposing specifically to seek policy holders' consent?

29 I should, of course, add that there is a competitive angle on all this. You cannot afford to take the risk of being caught out by not being ready in time. The market as a whole will be ready, and there will be no excuses for individual firms if they are not. Market forces apply. So be prepared is not just the appropriate motto for Boy Scouts - it applies to you!

### **Conclusion**

30 I have talked about planning for possible UK entry into EMU. In doing so, I have talked about the overall context in which planning is taking place; our own approach to planning in the Bank; and the approach we are taking to co-ordinating the planning process in the City. And I have talked about how we might best go about learning lessons from the changeover in the first wave.

31 There are three main messages that I want to leave with you.

- First, it is prudent to take preparing for possible UK entry seriously, a message which - as I have said - I hope will be readily understood in the insurance sector.
- Second, at this stage, taking the preparations seriously means planning, not spending significant amounts of your shareholders' money.
- And third, take the opportunity to learn as many lessons as you can from your counterparts in, and links with, the first wave. And I hope you will share these lessons with us, so that they can be absorbed into the City-wide and national plans as necessary.

I wish you the very best of luck!