Practical Issues Arising from the Introduction of the Euro

355 business days to go before January 1999

Issue No 5 *7 August 1997*

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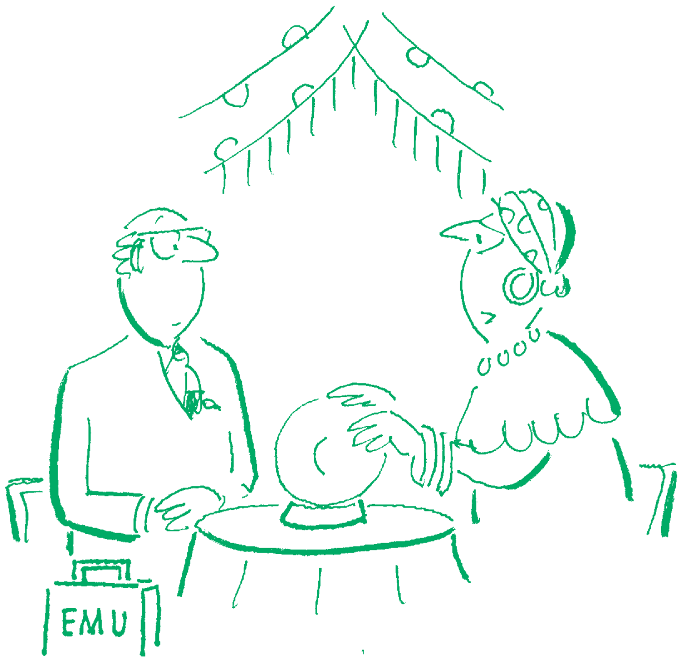


1999—ANYTHING IN PARTICULAR....?

Cartoons by Basil Hone

7 AUGUST 1997

CHAPTER 1: INTRODUCTION

1 This is the fifth in the Bank's series of broadly quarterly editions on the practical implications for the UK of the introduction of the single currency, whether or not the UK joins at the outset.

It is prudent to plan on the basis that EMU will go ahead ...

2 The Bank has consistently taken the view that, although EMU is by no means certain, it is prudent for the UK financial community to plan on the basis that EMU will go ahead on 1 January 1999. It is also clear that, if EMU goes ahead, there will be a significant impact on wholesale financial markets in London, even if the UK opts 'out'. Chart A provides a timetable of the main steps, assuming EMU goes ahead as planned.

3 Future interest rate differentials, as calculated from swap rates, between the Deutsche mark and a number of EU currencies have narrowed effectively to zero in the last two years. Others remain significantly positive, although in most cases less so by 2002 than by 1999. The prospect of participation in EMU is of course only one, though a very powerful, influence. These market data, though not conclusive, are consistent with the view that EMU is expected in markets to happen on schedule.

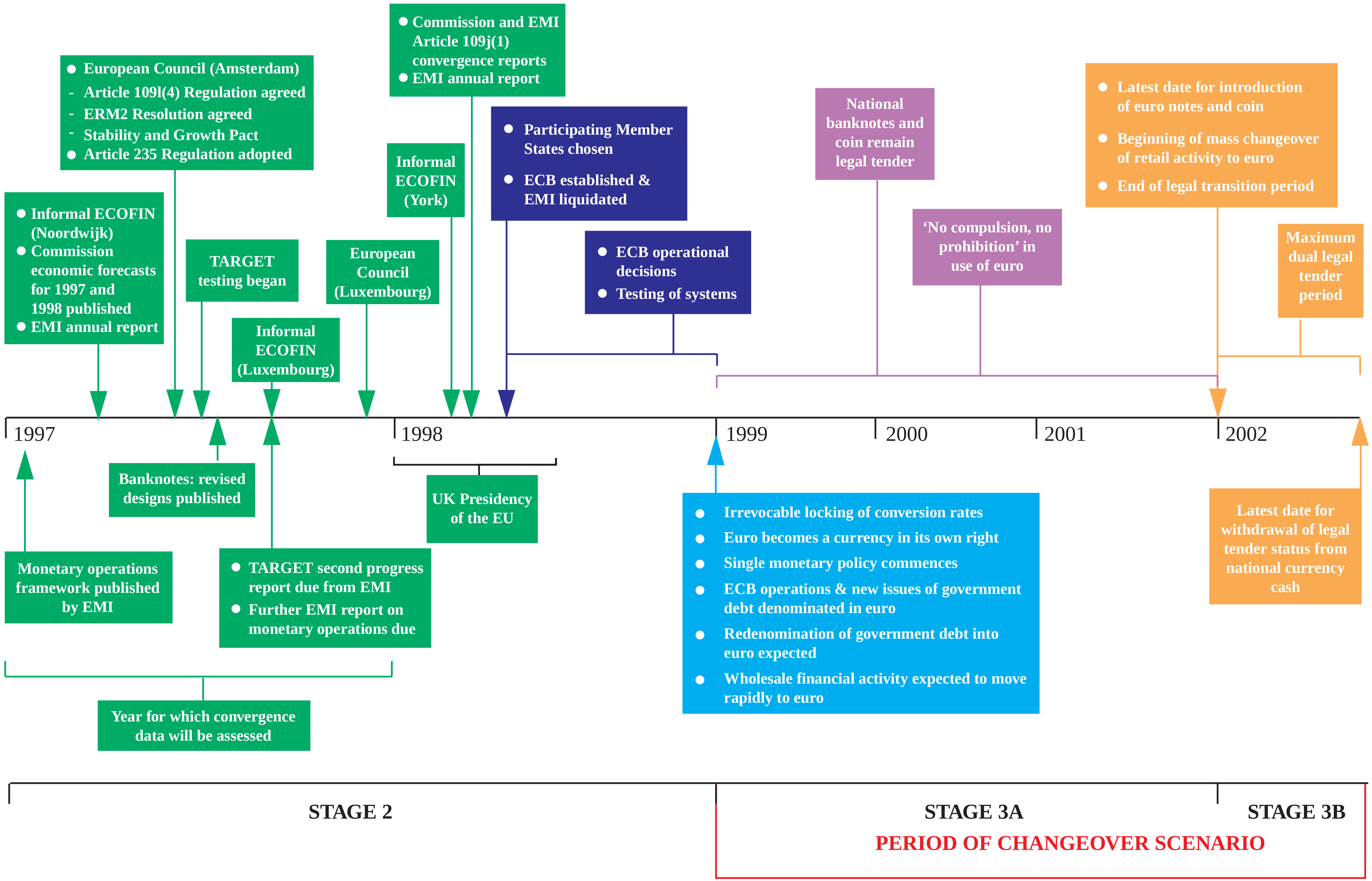
The Bank's role in the preparations continues unchanged ...

4 The Chancellor has confirmed that the Bank's role in informing and co-ordinating preparations in the financial sector for the introduction of the euro will continue unchanged. The Bank's role involves:

- ensuring that the necessary UK infrastructure is developed to allow anyone who wishes to use the euro in wholesale payments and across the financial markets to do so from the first day of EMU: this means that our attention remains focused primarily on the wholesale financial sector;
- helping the UK financial community in particular to prepare for the introduction of the euro by: explaining, as widely as possible, the relevant issues and how they are progressing; identifying areas for co-ordinated activity and cross-fertilisation; stimulating work, where necessary, within the private sector; and identifying and, where appropriate, filling gaps in the preparations;
- promoting discussion between the European Monetary Institute (EMI) and national central banks (NCBs) with market participants across Europe about practical issues on which the market is seeking a degree of consistency and co-ordination, but on which no single authority has the sole power to take decisions: the Bank has followed this approach, for example, in seeking to establish a consensus on the redenomination of securities in national denominations and on market conventions for euro-denominated securities.

PLANNED TIMETABLE FOR THE INTRODUCTION OF THE EURO

CHART A



The Chancellor has announced help for businesses to prepare ...

5 The Chancellor announced on 17 July two initiatives to help businesses to prepare for the euro. First, HM Treasury has published a guide to the practical implications of EMU for businesses, whether or not the UK joins. Second, the Chancellor is setting up an Advisory Group to bring together business representatives to discuss the practical implications of the single currency for business in order to create a two-way channel of information between the private sector and Government on this subject. In addition to these steps to help businesses, HM Treasury has published a summary by Professor David Currie of his survey of the economic arguments for and against a single currency.

The pace of financial institutions' preparations is being stepped up ...

6 There is now increasing evidence that financial institutions in the UK are taking the steps necessary to ensure that they are ready for the introduction of the euro, whether the UK joins EMU or not. In the early summer the Bank invited a sample of firms to confirm whether their preparations are on track for 1 January 1999. The response has been broadly reassuring, though some of their preparations are dependent on decisions yet to be taken (see below). The urgency of the need to prepare is now widely recognised.

7 In addition, since the previous edition of *Practical Issues*, the BBA has conducted a survey of its members, to which 143 banks contributed. 64% of respondents to the survey reported that awareness of single currency issues at a senior level within their banks in the UK was either 'very high' or 'quite high' and another 30% described awareness as 'moderate'. 62% of respondents, including all the major British banks and the great majority of larger foreign institutions in the UK, reported that they had started planning for the introduction of the euro. 14% intended to do so within the next six months, and a further 12% within the next year. The remainder included a number of smaller institutions whose activities were exclusively domestic in nature.

The Bank has taken stock of the infrastructure preparations ...

8 The Bank has taken stock of the preparation of the UK financial infrastructure to confirm that there are no major areas where work is not yet under way. Bearing in mind that only 355 business days remain before 1 January 1999, it will soon be too late for new initiatives. Wholesale market associations with whom the Bank is in contact were therefore invited in June to highlight those practical issues of most concern to them if EMU goes ahead, whether or not the UK joins, and to identify any additional steps which they consider that the authorities in the UK and in the rest of Europe should take.

9 The market associations consulted do not all take the same view, and they have different areas of interest. But there is a consensus in the market about the priorities for the period ahead, and about the areas in which preparatory work is at risk of being held up by decisions not yet taken. In some particular cases, noted below, market associations are in favour of new UK legislation, although they recognise that there is already a crowded legislative timetable in prospect.

10 The main messages drawn from these consultations with market associations and our recent contacts with financial institutions in London are summarised below.

11 *Euro markets (addressed in Chapters 2-4 of this edition).* First, market participants agree on the need to be able to trade in London in the full range of euro-denominated instruments, even if the UK opts ‘out’. Second, the development of appropriate payments mechanisms to carry out transactions in euro within the UK, and cross-border from and to the UK, is also considered important. Third, London needs to offer an efficient, secure, cost-effective and liquid market for the trading and settlement of euro-denominated securities, whatever their country of origin.

12 *Securities settlement systems (Chapter 3).* The preparation of securities settlement systems across Europe for the introduction of the euro is a complex task, not least because of the different approaches to securities settlement between different Member States and financial institutions and different approaches that may be required to meet issuers’ requirements for redenomination. The introduction of major changes to securities settlement systems, even within one market in one country, can lead to teething problems, both in the central IT infrastructure and for individual institutions as they learn how to apply the changes. Yet in relation to the euro it is envisaged that systems in many Member States will switch to the euro more or less simultaneously at the start of EMU, with considerable risk of confusion and error. An extensive programme across Europe to explain the detail of securities settlement operations is needed. This is not a problem largely, or even specifically, for the UK.

13 *Market conventions (Chapter 4).* It is widely accepted that EMU provides an opportunity to harmonise market conventions on new issues of securities in the euro money, bond and foreign exchange markets, and market associations agree on the basis on which conventions in these markets should be harmonised. But they find it difficult to see how EU-wide decisions will be taken. Harmonised practices may develop in the markets, but there is no guarantee of this. An official imprimatur on the developing consensus would be very helpful in cementing the process, and associations hope that this will be forthcoming from the EMI in the autumn. We fully support the market’s initiative, and have done everything we can to promote a consensus.

14 *Price sources (Chapter 4).* Attention is now turning to price sponsors, who need to clarify very soon how they propose to replace disappearing price sources. In the case of LIBOR, the BBA has already done so. The Bank accepts that this issue is increasingly urgent because screen providers, those promoting standard contracts and individual firms’ preparations are all dependent on price sponsors’ decisions. Screen providers are also looking for guidance on how to present information about the ‘price history’ of the euro on screens, given the absence of a real history and the need therefore to create synthetic data from the former national currencies.

15 *Redenomination of debt securities (Chapter 4).* Redenomination of debt securities is not considered necessary to be able to trade and settle them in euro from the outset of EMU. But where redenomination does take place, a limited number of standard methods of redenomination would reduce the risk of confusion in the market. This would require agreement particularly amongst sovereign issuers, who need to make decisions soon about the method of redenomination that they will adopt if they are ‘in’; but agreement may not in practice prove possible. In cases where redenomination takes place to the nearest euro cent, financial institutions need to be capable of handling decimals in nominal amounts for a transition period at least. For some institutions, this represents a substantial systems task.

16 *Redenomination of shares (Chapter 4).* Three steps are suggested to simplify the process and reduce the cost of redenominating shares for UK companies:

- the Companies Act should be amended to allow a company to redenominate its share capital by a resolution of its board of directors instead of by a resolution of shareholders at a company's general meeting. Shareholders would have the right to reverse the decision by an ordinary resolution if they objected. A similar procedure already exists to allow the dematerialisation of shares for transfer through CREST;
- the Companies Act should also be amended to change the qualifying share capital for UK registered companies from £50,000 to the equivalent of £50,000 in sterling or foreign currency; and
- legislation should be introduced to allow the issue of 'no par value' shares, which would enable companies to avoid many of the problems arising from the redenomination of par value shares. In the market's view, the next step should be for the DTI to prepare a consultative paper on the subject.

Any legislative changes are clearly matters for the Government to consider.

17 *Supervisory implications (Chapter 8).* The UK supervisory authorities should clarify whether the national currencies of participating Member States and the euro will be treated as different denominations of the same currency during the transition period, for capital adequacy and other supervisory purposes.

18 *Application of the euro Regulations in the UK (Chapter 9).* First, it is important to clarify the extent to which the euro Regulation under Article 109l(4) will apply in the UK, if the UK opts 'out', in order to provide legal certainty and to give as sound a base as possible for transactions carried out in London. Second, if some of the provisions of the Article 109l(4) Regulation would not apply to the UK if it opts 'out', an assessment needs to be made whether or not it would be in the UK's interests to replicate them through national legislation. We have not seen evidence to date that such legislation would be essential.

19 *Supplementing the euro Regulations (Chapter 9).* There may also be cases in which the market decides to supplement the euro Regulations in its own contracts. For example, ISDA has developed a continuity clause for swap contracts, consistent with the Article 235 Regulation, to provide added legal certainty. It sets out in detail several of the events associated with EMU and confirms that these events will not threaten the continuity of the relevant agreement. The clause also covers what would happen if EMU does not occur.

20 *Guidance on tax and accounting (Chapter 9).* Market associations are seeking public guidance from the Inland Revenue on a number of tax and accounting issues relating to the introduction of the euro, and there may be a need for legislation. In the market's view, the objectives should be to provide continuity and certainty of tax treatment.

21 *Systems (Chapter 9).* Preparing for the introduction of the euro and preparing for the Year 2000 are different issues for financial institutions. But the fact that the preparations for both of them are taking place at broadly the same time complicates the process. There is also concern in the market about a potential shortage of IT resources and about the state of preparedness for the introduction of the euro of some software vendors and providers of IT support.

22 *Collateral (Chapter 10).* The market would like to see as wide a range of high quality securities as possible eligible as collateral in the European System of Central Banks' (ESCB) money market operations, and does not understand the basis for the EMI's proposal to distinguish between euro and non-euro area Member States within the EU.

23 *London as a euro centre.* London's position as a competitive financial centre for the euro depends both on the actual preparations for the euro and on perceptions that London will be an attractive financial centre in which to undertake euro business, even if the UK opts 'out'. Given the strength of the case for London, associations argue that the UK authorities should do everything possible to promote the message that London will both be ready and a highly competitive place for euro business.

24 The Bank fully endorses this message and is committed to continue pursuing it. In the period ahead, we will:

- hold another symposium later in the year, following the successful one at the Barbican in January, and would welcome views by mid-September on its format and audience;
- set out in a subsequent edition of *Practical Issues* the main messages from the symposium and any lessons to be drawn;
- continue to promote London as the international financial centre for the euro at conferences and in meetings in Europe and in other locations (such as the Far East) in the autumn; and
- review the international circulation of *Practical Issues*: of the 30,000 circulation, some 4,000 copies already go directly overseas but it may be possible to broaden the circulation even further.

Particular points to note in this edition

25 This edition of *Practical Issues* follows a similar format to previous editions. Noteworthy areas of practical work in the last three months are as follows:

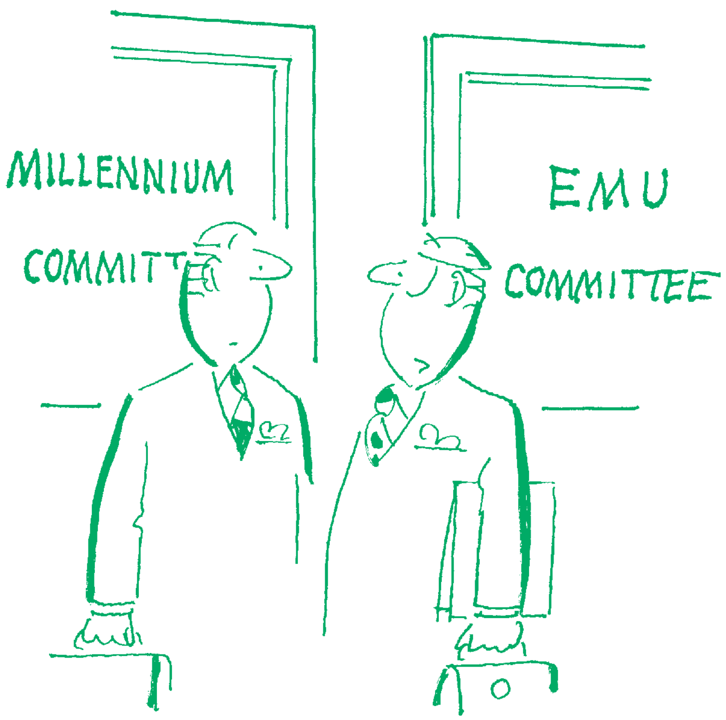
- preparations for wholesale payments in euro through a development of the UK RTGS system and through the competing alternative euro payments arrangements, including the EBA net settlement system; there has also been some progress on TARGET;
- the conclusions of a market group set up to consider technical issues on securities settlement;
- progress in agreeing on harmonised market conventions in the euro markets and standard methods of redenomination;
- 'mapping' of the preparations required to establish a euro money and foreign exchange market in London, if the UK opts 'out', together with the timing of the necessary steps;
- details of a guide published by HM Treasury about the implications of EMU for business;
- decisions about the retail payments infrastructure to be established in the UK, whether the UK is 'in' or 'out';

- adoption of the Article 235 Regulation and endorsement of the Article 109l(4) Regulation; and
- further work on the implementation of monetary policy and agreement at the Amsterdam summit in June on the Fiscal Stability and Growth Pact and ERM2.

Circulation and comments

26 We would welcome assistance in circulating our series of *Practical Issues* papers as widely as possible. Copies of this and previous editions, including in bulk, may be obtained from the Bank's Public Enquiries Group (tel no: 0171-601 4012; fax no: 0171-601 5460). They are also available on the internet (at http://www.bankofengland.co.uk). The Bank is prepared to make available to institutions copies for them to supply to their overseas offices. It reserves the right to charge for supplies in bulk.

27 We continue to welcome comments on the practical preparations for the introduction of the euro, both in relation to the work which is already under way and any potential gaps. Comments should be addressed in writing to John Townend, Deputy Director, Bank of England, Threadneedle Street, London, EC2R 8AH (fax no: 0171-601 5637). We plan to publish our sixth edition in this series during November.



"I ENVY YOU THAT EXTRA YEAR"

CHAPTER 2: WHOLESALE PAYMENTS ARRANGEMENTS

DEVELOPMENT OF CHAPS FOR EURO

1 The development of the UK wholesale payments system to accommodate the euro, as described in previous editions of *Practical Issues*, has continued on schedule. The CHAPS Clearing Company, which owns and runs the current sterling system, will provide its member banks with the facility to effect wholesale payments in euro from the beginning of 1999, and they in turn will be able to provide a full payment service in wholesale payments in euro to their customers.

2 For the situation where the UK opts 'out', a parallel CHAPS euro RTGS system - based on the S.W.I.F.T. FIN Copy service - is under construction to sit alongside the present sterling system. It is now possible that, if the UK is 'in', the new S.W.I.F.T. FIN Copy based network and the existing CHAPS sterling RTGS network will also both be used in order to accommodate a potential increase in CHAPS' membership without requiring new members to join CHAPS sterling.

3 If the UK is 'out', the resulting system will enable the processing, by a broad CHAPS membership, of euro payments - as a foreign currency - both within the UK and cross-border within the EU through its link to TARGET. And if the UK is 'in', it will allow wholesale payments immediately to switch to euro, whilst providing (by means of a field within the payment message which can hold details of the original denomination of the payment) a facility for those customers of CHAPS' member banks which wish to continue using sterling units of the euro during the transition period. The two payments systems, together with the RTGS capability at the Bank, will form one overall RTGS system processing euro and sterling.

4 CHAPS is committed to offering its members and their customers a competitive and efficient service for euro payments. The Bank fully supports this objective. CHAPS is already talking to potential applicants from a number of different countries about the possibility of membership. CHAPS is taking an increasingly high profile in explaining in some detail, to its current and potentially larger future membership, the nature of the euro facilities which it will have available from 1 January 1999.

5 Membership criteria include the need to have a settlement account at the Bank; to meet the technical and operational requirements of CHAPS; and to expect to process at least 0.5% of CHAPS overall business if and when the UK joins the single currency. Domestic and foreign-owned banks are treated equally. Remote access is possible within the technical requirements of the system but, since most major financial institutions are already represented in London, it is not clear why it should be needed.

6 Membership of the CHAPS Clearing Company will be made available to banks wishing to operate only in CHAPS euro. A bank joining CHAPS on this basis would become a full member of the CHAPS Clearing Company, with a share in the ownership of CHAPS and a say in how CHAPS is run and developed. Access is available to CHAPS sterling as well if required. The membership fee is determined at the time of entry and is based on cost recovery for the entry

TECHNICAL SPECIFICATION OF CHAPS EURO

The CHAPS euro technical specification gives details of:

- the major components of the system and the way they are interconnected
- payment processing, including:
  - the types of payment supported by the system
  - the processing carried out by both sender and receiver
  - how members are informed about non-CHAPS euro transfers
  - an overview of the queuing arrangements
  - facilities for cancelling unsettled payments
  - ways in which settlement can be suspended
  - the settlement periods for payments of differing types
  - contingency measures for use when the Bank may be unable to receive or process CHAPS settlement requests
  - how the various parties in a CHAPS euro payment are identified
- business control (ie the facilities which are provided to allow members, the Bank of England and the CHAPS inspectorate to control the business aspects of the CHAPS euro payment system), including:
  - the mechanism by which a member obtains liquidity to operate his euro settlement account at the Bank of England
  - the daily business processing cycle of the CHAPS euro system
  - the facilities available to members for the business level control of their payment systems
  - the facilities available to the Bank of England for the business level control of the RTGS processor
  - the role of the CHAPS inspectorate in the CHAPS euro system
  - the various clocks used within the CHAPS euro system and how they are synchronised
- recovery, contingency, resilience, and availability: the facilities within each of the CHAPS euro system components for providing a reliable system
- the performance and capacity characteristics of the system
- member system flexibility: areas of future change that CHAPS euro members need to take into account in designing or modifying their payments systems
- the security features built into the system
- the test and training facilities to be used during the development, testing and implementation of the system and for any future changes
- the audit and archiving facilities within the system
- message formats: the detailed format of all payments messages supported by the system, both domestic and cross-border, and the format of the non-payments message that has been specifically developed for CHAPS euro.

process and a share of the unamortised assets of the system; the membership fee for access to CHAPS euro alone will be significantly lower than that for CHAPS sterling. Work is now proceeding on the governance issues arising from these decisions, and issues relating to the possible migration to a new future technical platform.

7 The technical specification of the new CHAPS euro system, based on S.W.I.F.T.'s FIN Copy service, has now been fully articulated by CHAPS (see box on previous page). Its development is now under way and testing will start this autumn. As a broad guide, banks which are ready to join the testing programme in spring 1998 should be able to join CHAPS by 1 January 1999. Once the system is live, a shorter entry process is likely.

8 None of the decisions on TARGET which remain to be taken at European level has a major bearing on the system's specification or development.

TARGET

9 There has been some progress on both policy and technical fronts.

Pricing policy

10 On pricing policy, we have already reported the EMI Council's decision that there would be a common end-to-end price within TARGET for cross-border transactions, unless the EU competition authorities raised objections. The EMI has now had a preliminary response from the Commission and can go ahead.

11 The Commission fully supports the principle of full cost recovery in determing pricing in TARGET, in order to avoid unfair competition between TARGET and other payment arrangements. It proposes to review this issue some two-three years after the TARGET system has been put into operation, when sufficient data could be available to assess whether this principle is being respected.

12 The EMI Council has already agreed that, in addition to full cost recovery, there should be no cost pooling: it remains unclear how these two principles can be made consistent with a common end-to-end cross-border price. Work has, however, been proceeding to try to establish a common price methodology, taking account of development and running costs for the Interlinking, as well as the average cost of processing a domestic RTGS payment and a forecast of the expected volume of cross-border payments.

13 Based on the above considerations, the EMI's *Second Progress Report on TARGET* in September is likely to set out a range within which the ECB Governing Council is expected next year to fix a uniform price for cross-border TARGET payments. The market currently believes that the price will be in the range of 1.5-3.0 euro. Further work is under way on whether TARGET participants should be offered a fee package according to how much they use the system. By comparison, the ECU Banking Association (EBA) is currently proposing to charge within a range of 0.5-0.8 euro for payments settling within its net end-of-day euro system.

Intraday liquidity

14 On the only other substantive outstanding policy issue, of the terms of access to intraday liquidity for central banks both within and connected to TARGET, the basic position remains the same as reported in previous editions of *Practical Issues*. But there is some progress to report on one of the options being considered to prevent intraday credit provided outside the euro area being extended into overnight credit.

15 Where it had previously been proposed that an earlier closing time might be applied to 'out' NCBs' links to TARGET than for 'in' NCBs, it has now been agreed (subject to ultimate decisions by the ECB Governing Council) that it would remain possible for 'in' and 'out' NCBs to operate on the basis of the same operating hours each day. But beyond a defined point towards the very end of the business day, each 'out' NCB would need to maintain a credit position with the euro area as a whole to make further payments. This would enable both 'in' and 'out' NCBs to continue to operate throughout the day until TARGET closed; and, by leading 'out' NCBs to repay fully any intraday liquidity outstanding at this liquidity deadline (in order to be permitted to continue using the system), it would equally mean that spillover would not occur outside the euro area.

16 The ECB Governing Council would decide when the liquidity deadline should be, although there is an understanding that it would not be earlier than the cut-off point for customer transactions, which would be common to both 'in' and 'out' Member States. This would allow banks in 'out' as well as 'in' Member States to have a period to square their positions without being affected by further customer flows. Beyond the liquidity deadline, an 'out' NCB would not be able to make further outgoing payments if there was a negative balance on its collective position vis-à-vis 'in' NCBs. An 'out' NCB would therefore have to ensure, if necessary through borrowing on its own account, that there was a positive balance on its settlement banks' collective euro accounts.

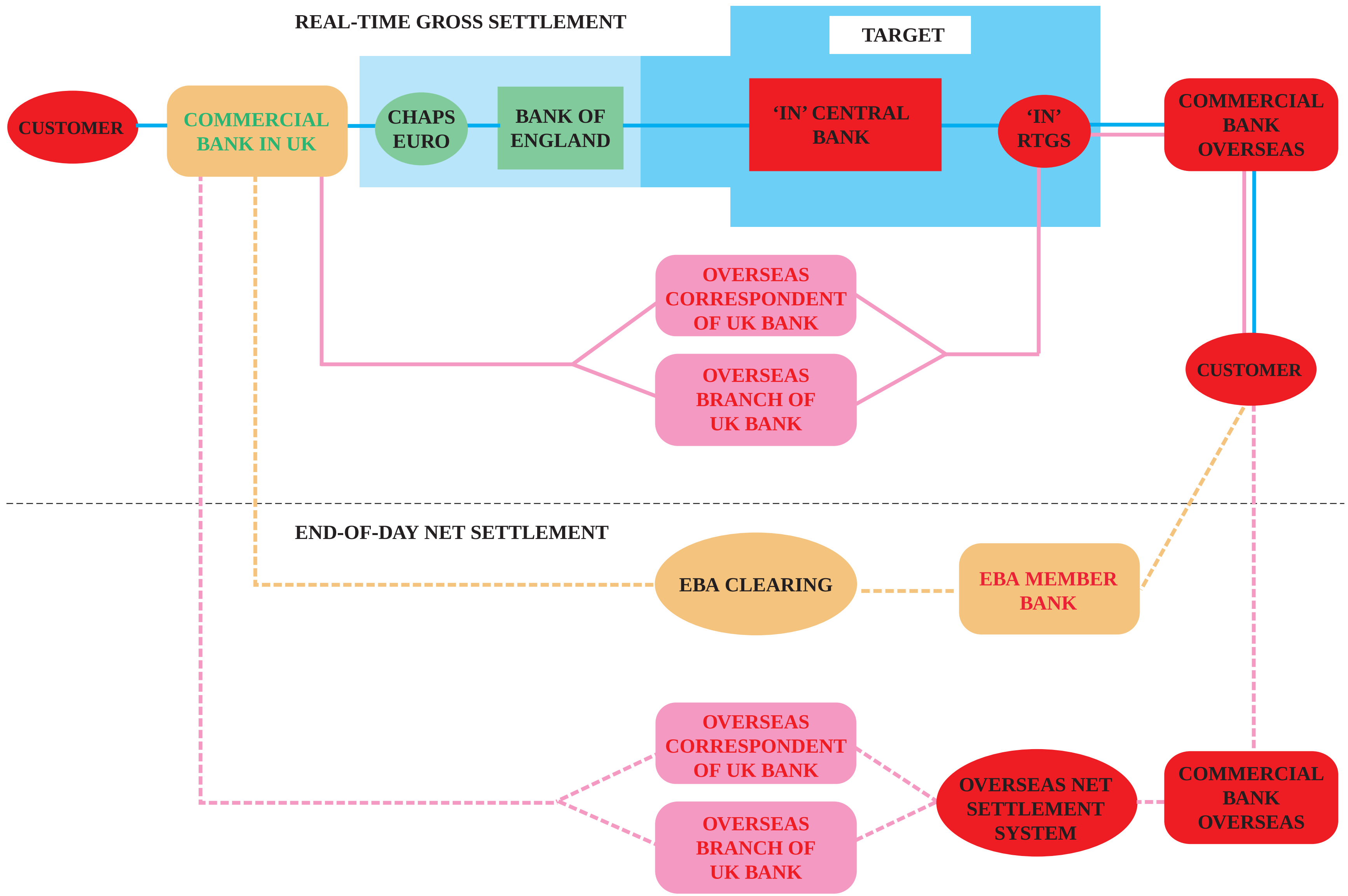
17 For 'in' NCBs, this proposal would directly address the spillover issue. To the extent that it did so, and that a level-playing field was established in other respects, this could allow equal access to intraday liquidity by 'in' and 'out' NCBs for virtually the entire banking day.

18 The Bank, for its part, continues to believe that different terms of access to intraday liquidity for 'out' NCBs would not be warranted by any monetary policy argument, provided that there are adequate arrangements to prevent spillover.

19 We described in the last edition the regime already in place in the UK RTGS system to minimise the risk of spillover, with demonstrable success, and that similar arrangements could apply equally effectively in TARGET. They would allow intraday liquidity to circulate freely. By contrast, any restrictions on access to intraday credit, wherever they are applied, would simply have the effect of making the whole system less efficient, slowing payments throughout the system, and making it less attractive for banks to use everywhere. This would be regrettable and counter-productive. It would make it more likely that banks would use other competing cross-border payments systems, which are in any event likely to be cheaper, for those payments other than the limited number of transactions which are time-critical. Chart B illustrates the alternative routes for making cross-border payments.

ALTERNATIVE CROSS-BORDER PAYMENT ARRANGEMENTS

CHART B



20 The Bank's objective remains that TARGET becomes established as a high-volume, low-cost, system of choice for wholesale cross-border euro transfers throughout the EU. This will depend, as we noted in the last edition, on its low cost and efficiency on the one hand, and appropriate terms of access to intraday liquidity on the other. In the event that ultimately the ECB Governing Council decides to provide inadequate access to intraday liquidity to 'out' central banks, a wide range of alternative sources of liquidity will be available.

21 Given that material aspects remain the subject of negotiation, it may not be appropriate fully to elaborate the mechanics of liquidity provision in the UK euro RTGS system until discussions at the EMI and ECB are concluded. However this does not affect in any major way the technical specification or development of CHAPS euro, which can therefore proceed as planned and remains on schedule.

22 Banks operating in the UK will be provided with a secure and efficient euro RTGS payment facility for both domestic and cross-border transactions, and will be able to make payments in euro as cost effectively as they can today in sterling. In addition the full range of competing alternatives to effect cross-border payments in euro, including correspondent banking, use of overseas branches, and the EBA net settlement system, will be available from the UK. Given these options, the Bank does not believe that the questions about access to intraday liquidity within TARGET are material to the development of activity in euro in London.

Technical aspects

Timetable and a critical path

23 Meanwhile in all EU Member States the technical development of TARGET has continued: new RTGS systems have become operational in several countries, but the original deadline - that all EU Member States should have an RTGS system operational by July 1997 - has not been met; and it is clear that not all Member States will have the infrastructure in place to enable them to participate in the TARGET project's final and critical simulation phase by July 1998. The EMI has postponed this ultimate deadline until the start of September 1998. There is clearly no room for any further slippage in the timetable.

24 CHAPS is significantly the largest existing RTGS system in Europe, with daily flows averaging nearly 70,000 payments and daily turnover averaging £150 bn. The UK's experience in successfully building a reliable, high volume, RTGS system has proved invaluable in our assistance at the EMI in the development of TARGET. We are now actively helping the EMI develop a critical path analysis for the project, in order to identify the significance of any delay in one part of the project for the remainder (see Chart C).

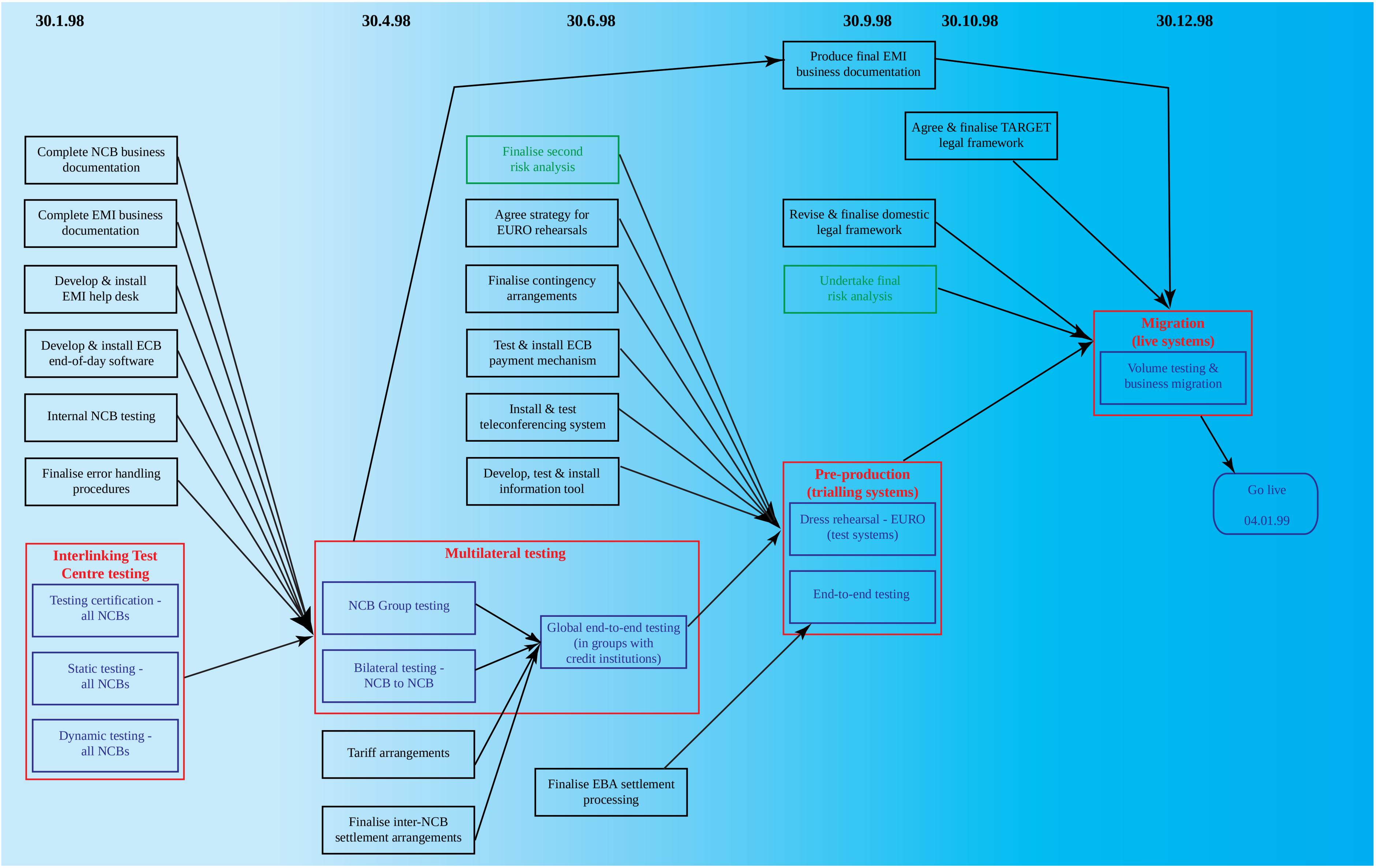
Interlinking testing has begun

25 Following the completion of negotiations and the formal signing of an agreement between the EMI and S.W.I.F.T., as initial network provider of the Interlinking, testing of NCB links within the TARGET system using the EMI's test centre began on schedule on 1 July. Indeed, whilst acting as a pilot tester during June, the Bank of England was the first NCB to send a message successfully to, and receive an acknowledgment from, the EMI.

AN INDICATIVE CRITICAL PATH FOR TARGET

CHART C

Tasks to be completed by date shown (dates are indicative and have not been finalised with the EMI and other NCBs)



TARGET closing days

26 Progress has been made elsewhere in EMI discussions on a number of outstanding technical issues, notably on TARGET closing days. In response to market demand, the EMI Council has decided that the TARGET system should be closed completely only on Christmas Day and New Year's Day (the only two days which are current public holidays in all 15 EU Member States): but national RTGS systems may, if they wish, also close on any other days, such as national or regional holidays. Where there is more than one national RTGS system open, it has been agreed that the Interlinking component will also open. Similarly when Christmas and New Year fall at weekends, it is likely that it will be left to national RTGS systems to decide whether to close on another day instead, given that not all EU Member States follow the UK's practice of having a public holiday in lieu the following Monday.

End-of-day TARGET procedures

27 Agreement has been reached on end-of-day procedures in the TARGET system to ensure that the TARGET business day is completed in an orderly, timely and irrevocable manner. These cover the normal operating day, where there will be a cut-off for the processing of customer payments at 17.00 (based on the clock where the ECB is established, known as ECB time) and for interbank payments at 18.00 to coincide with the close of the TARGET day. The latest that any interbank payment input into the system by 18.00 should reach the beneficiary is 18.30 (it should normally be just a few minutes after 18.00), so at that time all NCBs will initiate their end-of-day control procedures.

28 Arrangements have also been agreed for 'abnormal' situations, for example where problems develop with the ECB's own end-of-day control procedures, payments are received through the Interlinking after the end-of-day control processes have been initiated, or problems arise which necessitate a delayed closing time to TARGET.

29 In an extreme situation where the system of an NCB or the ECB may have become inoperable, it has been agreed that TARGET should remain open no later than 20.00. After that time any further payments received through the Interlinking may be rejected by the receiving NCB. If by 20.00 the problem has not been resolved, an enforced closing procedure would be initiated manually. Our concern in establishing these procedures has been to ensure that a balance is struck between the need to process customer payments on the day in question and to avoid the system closing so late as to put in question the punctual start of the following day's business. We believe that an appropriate balance has been struck.

Documentation

30 We hope that full details of these procedures will be published as an annex to the EMI's *Second Progress Report on TARGET*. A number of technical documents for the TARGET system - the Interlinking Specification, Minimum Common Performance Features of RTGS systems and a Data Dictionary (which originally appeared as an annex to the *First Progress Report on TARGET* in August 1996) - have been updated and will be released at the same time.

Questions outstanding

31 A substantial amount of work remains. Discussions continue on start-of-day procedures, where NCBs have yet to agree whether there should be a common opening time, at 07.00 ECB time, or whether as we believe NCBs should be given flexibility to open their national systems earlier to meet local market demand. We do not believe there are any monetary policy implications in this question, and that it can safely be treated in accordance with the subsidiarity principle.

32 Work is also under way on drafting the legal documentation for TARGET, with an aim to complete this task by November. There will be an ECB guideline to cover the main Interlinking rules (operation of inter-NCB accounts, payment processing including obligations and liabilities of sending/receiving NCBs, security provisions, pricing, audit, emergencies, dispute resolution etc) with a separate contract to extend the provisions of the guideline to ‘out’ NCBs.

33 At the same time, the particular TARGET service level which NCBs will offer to their RTGS members is also being actively considered. The TARGET service level agreement will be derived from, and need to be consistent with, the TARGET legal framework.

EBA CLEARING

34 There has been further discussion at the EMI about end-of-day settlement arrangements within the ESCB for the EBA’s same-day euro payments system. Two basic options are being considered. In the first, centralised, arrangement the EBA would have a single settlement account at the ECB or at one NCB, into which EBA clearing members with end-of-day ‘short’ positions would pay the required funds and from which the EBA would pay those clearing members with end-of-day ‘long’ positions. The payments would be handled via TARGET. In the second, decentralised, option the EBA would have settlement accounts at every NCB for which there are clearing members. Settlement of clearing members’ short and long positions would be handled at a national level via the relevant ‘local’ EBA settlement account, with a mechanism to even out imbalances between those accounts.

35 Discussions at the EMI have yet to be concluded. A single settlement account arrangement would arguably be more straightforward, and therefore quicker and easier to operate, but neutrality of location has assumed a particular importance in the discussions. The EBA have made clear that a decision by September at the latest is required to enable them to start the necessary technical work.

36 The EBA has prepared a legal arrangement for its clearing system which is at present under scrutiny at the EMI and a number of NCBs.

CHAPTER 3: SECURITIES SETTLEMENT SYSTEMS

1 The providers of both UK national and international securities settlement systems have continued the development work necessary for the clearing and settlement of euro-denominated securities. The first part of this chapter describes the latest developments. In the second part, a number of technical issues on securities settlement which have been raised by market practitioners are addressed, with the help of the Bank's Securities Settlement Group which it established in the spring.

Securities settlement systems in the UK

UK 'out'

2 If the UK is 'out', UK-based issuers of foreign currency paper may issue euro-denominated securities, giving rise to market demand for euro settlement facilities in London. London's approach has always been to provide market services on demand, and settlement facilities will therefore be provided to meet market demand for settlement in euro.

3 CGO will have multi-currency functionality once it has been upgraded. As a result it will be capable of settling gilts, other sterling debt securities and debt securities denominated in euro; the consideration for any of these securities may be expressed in either sterling or euro.

4 CMO, however, does not have multi-currency functionality. Further, unlike CGO which settles only fungible instruments, CMO can settle only individual (non-fungible) instruments[1]. In the short-term, the existing CMO would continue to operate in sterling, and would be cloned to meet demand for settlement of any non-fungible euro instruments in the UK 'out' scenario. Demand for settlement of fungible euro money market instruments could be satisfied by other settlement systems, including CGO and CREST.

5 The Bank intends to continue consulting the market to gauge the scale of potential demand to settle in London fungible and non-fungible euro-denominated securities. The options need to be assessed in the context of a possible merger in the medium-term between systems which currently handle different types of security (CGO/CMO/CREST). Such a merger would have strategic attractions but would not be possible before 1 January 1999.

6 CREST is already a multi-currency system, settling transactions in either Irish pounds or sterling (and US dollars from the autumn), and will settle euro securities, whether or not the UK and/or Ireland are 'in' from 1 January 1999. If either country is 'out', some issuers may nevertheless choose to redenominate their equity, though redenomination of equities does not directly affect trading and settlement. CREST will offer euro as an additional settlement currency. CREST's plans were explained in the April edition of *Practical Issues*.

1 Eligible and ineligible bank bills, Treasury bills, local authority bills, trade bills, physical and dematerialised bank and building society CDs and commercial paper.

UK 'in'

7 If the UK is 'in', CMO will switch from 1 January 1999 to a euro-based system (for non-fungible money market instruments). It is not yet clear for example how quickly the bill market would switch to euro, but it has been decided that the system records of any remaining sterling instruments will from then on be expressed in euro. For fungible money market instruments, the options are the same as for the UK 'out' scenario - issuance into another system taking account of a possible merger between systems in the medium term.

8 In relation to CGO, although no formal decisions have been taken about how and when gilts would be redenominated if the UK were to join, it is assumed that the UK would follow decisions taken in a number of EU Member States to redenominate on or shortly after that date. The Registrar and CGO would therefore expect to convert the outstanding stock of gilts to euro, close to the beginning of the transition period. Conversion of gilts would be expected to take the form of simple redenomination[2], thus avoiding the necessity to change ISINs (see below). As part of the way redenomination is effected, the CGO settlement banks have also indicated that they would prefer a 'big bang' conversion of forward-dated sterling deliveries, rather than allowing sterling settlement instructions input before 1 January 1999, with intended settlement dates of up to a year ahead, to remain denominated in sterling.

9 While CGO has to deal with only a small number of issuers, principally HM Government, CREST must deal with many; and, if the UK is 'in', it is the issuer who will decide whether and when to redenominate. Any redenomination of corporate bonds and equities is likely to be spread over time. CREST will be able to accommodate any of the redenomination mechanisms currently being discussed in the market place, including redenomination with the same or a new ISIN, and redenomination to the nearest euro cent or euro.

10 At present there are two principal methods of making gilt dividend and redemption payments to CGO members, via BACS or via paper warrants. If these arrangements are still in place in 1999, BACS will be able to handle euro transactions, and paper warrants might be issued only in euro. But it is likely that, by then, dividend and redemption payments will be distributed to CGO members directly through the CGO system, by crediting their (euro) cash memorandum accounts.

11 Dividend and coupon payments in euro could be paid through the CREST payments mechanism if registrars so chose. All registration details (dividend mandates etc) should remain unchanged by the process of redenomination.

The ICSDs

12 The ICSDs (Euroclear and Cedel) will both be able to settle, as of 1 January 1999, the domestic securities of all Member States in the euro area (and other European countries) as well as Eurobonds[3], whether denominated in euro or not, and whether redenominated or not. Both the euro and the various national denominations of the euro will continue to be available as settlement currencies after 1 January 1999, but within certain constraints (see below). Their

2 Methods of redenomination were described in the Report of the Group of market practitioners published in the April edition of *Practical Issues*. Terms used here follow the conventions of that Report.

3 ie traditional international bonds.

systems will be capable of applying any of the redenomination mechanisms currently being considered. Discussions are continuing between Euroclear and Cedel to ensure that the bridge between them is not disrupted by the changeover.

13   Morgan Guaranty, as operator of the Euroclear System, recommends that the system should be used as follows from 1 January 1999:

- the euro denomination should be used exclusively as settlement currency[4] for both internal Euroclear settlement and settlement between Euroclear participants and counterparties in national markets;
- the two counterparties to a trade should continue to agree on the denomination of the transaction (since settlement currency is a matching field);
- income and redemption proceeds should be paid in euro instead of the national denominations for non-redenominated securities;
- money transfer and cash management should be performed in euro only; and
- changes to reporting should be limited to the minimum required (eg tax reporting as required by national authorities).

14   These recommendations would minimise the disruption for users of the system in terms of settlement, cash and credit management, and report layouts. However, as the system has multi-currency functionality, the option of settlement in national denominations will be provided, within certain constraints:

- the two counterparties will again have to agree on the settlement currency if internal Euroclear settlement in national denomination is desired (this is a matching field);
- settlement between a Euroclear participant and a counterparty in a national market may only be in a national denomination if this option is available in that market;
- credit and cash management facilities for national denominations will have to be managed as if they are separate currencies but a specific instruction will allow conversion of national denominations into the euro on a same-day basis;
- income and redemption proceeds will still be credited in euro instead of national denominations for non-redenominated securities; and
- in order to limit adaptation costs as much as possible and to avoid system changes only relevant to the transition period, comprehensive dual-currency reporting will not be offered.

15   Cedel Bank will similarly provide its customers with the choice of a single euro account or separate national denomination accounts (with the possibility to convert between denominations same-day), following broadly the same outline as explained above. However, coupon, dividend and redemption proceeds will be credited in the denomination in which the issuer has made the payment through its paying agents, unless the customer has opted for a euro account only, in which case the proceeds will be converted where necessary.

4   The currency of the nominal amount of the securities will depend upon whether or not the issuers have decided to redenominate.

16 Because Euroclear and Cedel Bank intend to accommodate different redenomination methods, system changes will be made to allow euro nominal amounts to be expressed to two decimal places. On redenomination date, the systems will convert the nominal amounts of participants' pending transactions. The denomination of the cash leg as specified by the participants will be left unchanged, except for transactions with a counterparty in a Member State where the wholesale financial system is moving exclusively to use the euro from 1 January 1999.

Cross-border use of collateral

17 Preparatory work at the EMI and NCBs for the implementation of the Correspondent Central Banking Model (CCBM) (described in the April edition of *Practical Issues*) is on schedule. The CCBM enables counterparties of 'in' NCBs to borrow from their NCB using collateral located in another Member State. The NCB in the other Member State acts as the custodian (correspondent) of the lending central bank. The CCBM will be the main model for the cross-border use of collateral for both tier 1 and marketable tier 2 eligible assets provided by all NCBs from the start of Stage 3. The Guarantee Model (also described in the April edition) will not now be implemented, although there are likely to be specific arrangements similar in effect to enable cross-border use of the non-marketable assets that France (and possibly other Member States) will have on its tier 2 collateral list.

18 In addition to the CCBM, other means of taking collateral cross-border are under consideration, provided they meet the necessary minimum standards (see below).

Future cross-border settlement links

19 The EMI is discussing with Euroclear and Cedel and with the European national CSDs whether it will be possible to make use of existing and planned links between the CSDs to settle central bank operations in Stage 3. Such links make it possible to settle a wide range of ESCB collateral assets (and potentially all such assets) in a single CSD. The ICSDs already have in place links to all the EU national CSDs, either via direct membership or through intermediaries. The national CSDs are working on the creation of a network of bilateral links. (This work is being undertaken by the new European Central Securities Depositories Associations (ECSDA), a grouping of private sector national systems; but ECSDA will be involving the NCBs that run systems and the ICSDs in the work on linkages.) ECSDA propose to have in place a network of free-of-payment links by the start of Stage 3.

Minimum standards

20 The EMI and NCBs have been considering what minimum common standards should apply to securities settlement systems where they are used for the provision by counterparties of collateral against central bank credit from the start of Stage 3. The detail of these standards is being refined in consultation with the operators of the securities settlement systems. It will be important to ensure that the standards are objective and can be achieved by both national CSDs and the ICSDs by the start of Stage 3.

21 In setting minimum standards, NCBs' immediate interest is the safe and efficient implementation of monetary policy and payments system operations; they will also have regard for the security and efficiency of settlement systems generally, given the potential for them to

cause systemic risk. The standards will address, *inter alia*: legal, custody and settlement risks; the transparency of the risks and obligations borne by participants; access and exit criteria; and the operational reliability of systems. They will also address intraday finality and harmonisation of operating hours and opening days, and may address transactions in securities originally issued in one CSD that are settled in another to which it is linked.

Legal issues

22 Potential conflicts between national insolvency laws in the EU and the rules of payment and securities settlement systems, which could affect the legal certainty of settlement (domestic as well as cross-border), will be addressed by an EU Directive (the Directive on the limitation of systemic risk in payment and securities settlement systems, formerly known as the Settlement Finality Directive) which is currently under negotiation and likely to be adopted early next year. *Inter alia*, the Directive will eliminate 'zero hour' insolvency rules for payment and settlement systems, where they still exist, and should help to clarify the position concerning collateral, including interests in securities held via book-entry systems. The Directive will therefore provide a useful underpinning to cross-border payment and settlement arrangements in Stage 3. However, the national implementing legislation will not have to be in place until well after 1 January 1999.

S.W.I.F.T. message standards

23 S.W.I.F.T. set up a Working Group earlier this year to look at its message standards in relation to EMU. The Working Group aimed to make minimal changes to the message standards, and to ensure that any special facilities required for the transition period could subsequently be removed. In June the S.W.I.F.T. Board accepted the following recommendations from the Working Group:

- publication of a S.W.I.F.T. Euro Guide to provide S.W.I.F.T. users with guidelines, recommendations and scenarios for the most efficient use of S.W.I.F.T. messages at the outset of EMU and during the transition period. Publication of the guide is scheduled before year-end;
- implementation of the EUR currency code for the euro (see Chapter 9) on the S.W.I.F.T. network for test and training purposes from 9 September 1997, and for live usage from May 1998. This will allow input of forward-dated trades once the participating Member States are known. Certain S.W.I.F.T. messages are to be validated to ensure that, if the settlement amount is denominated in EUR, the value date is on or after 1 January 1999. A list of the messages and fields to be validated will be included in S.W.I.F.T.'s Euro Guide, and in the S.W.I.F.T Standards Release Guide also due to be published before year-end; and
- implementation in the September 1998 Standards Release of a structured facility for 'Euro Related Information' (ERI) to be used in the 'free' text fields of existing messages. The information in the ERI, which will be optional for users, will for example contain the original currency and amount. Other codes will be added, including to indicate the redenomination of securities.

SECURITIES SETTLEMENT: TECHNICAL ISSUES ARISING FROM THE INTRODUCTION OF THE EURO

24 The purpose of this section is to consider a number of technical issues of concern to providers and users of the securities settlement systems which serve London's international financial markets and to raise market awareness of possible ways to tackle them. The technical issues have been discussed by a Securities Settlement Group established in the spring and chaired by the Bank: the Group comprises market practitioners and settlement experts, together with the operators of the various settlement systems - the Bank (in respect of CGO and CMO), CREST, Euroclear and Cedel Bank - and others with related interests, such as LCH. The conclusions set out here are broadly endorsed by the Group, and there has also been consultation among the membership of the market associations represented, including the CGO User Liaison Group and the CMO Consultative Group.

'Intelligent matching'

25 In the ICSDs and CREST (and in due course the upgraded CGO), each party to a trade must input an electronic instruction for matching, one matching field of which is currency of settlement. It had been suggested by some market participants that, for the transition period, settlement systems should offer 'intelligent matching', where an instruction due to settle in euro would be matched against an equivalent instruction due to settle in the national denomination of a participating Member State. However, the main arguments against intelligent matching are as follows:

- since the two counterparties to a transaction must agree the currency of settlement at the point of trading, it should be possible for both counterparties to input that currency in the relevant matching field of the settlement instruction. So it is unclear why a central intelligent matching facility would in practice be required; and
- the ICSDs, CREST and CGO have all indicated that the systems work required to provide intelligent matching would be expensive. If the market moved quickly to adopt euro settlement only, wherever possible, any demand that did exist for intelligent matching might well be short-lived. Hence the systems work would not be justified on grounds of cost.

26 Intelligent matching will therefore not be a facility offered by CGO, CMO or CREST in the UK, or by the ICSDs. Both the Kassenverein in Germany and Sicovam in France are believed to be taking the same approach.

Changing ISINs for redenominated securities?

27 The International Securities Identification Number (ISIN) is an ISO international standard. The Association of National Numbering Agencies (ANNA) acts as the ISO Registration Authority for the standard, and the National Numbering Agencies (the London Stock Exchange (LSE) in the UK) follow ANNA's interpretation of the ISO allocation rules. The current rules should not require a change in ISIN on whole issues of redenominated securities, except in the case of conversion offers.

28 Whilst the current ISO rules do not specifically cater for the introduction of a new currency, there is a rule for 'issues with different denominations'. For shares the rule is that, if different categories of shares are issued, then each share category should receive its own ISIN, but if certificates consist of multiples of the same category of share, only one ISIN should be assigned. For bonds the rule is that there should be only one ISIN for different denominations, if they are fungible. The test is therefore largely one of fungibility. In other words, where the holder is indifferent as to which of two financial instruments are held because they are interchangeable, the same ISIN applies.

29 If bonds are redenominated in the context of the introduction of the euro by *simple redenomination*[5] they are essentially unchanged, having merely been expressed in a replacement currency. Their terms and conditions remain the same and their value is unaltered. If the whole issue is redenominated, the relationship between the securities concerned is unaltered. Although there will be physical certificates whose face value is still expressed in the national denomination, these certificates will be interchangeable with certificates denominated in euro. The holder should be indifferent as to which he holds. To allocate a different ISIN to such securities could therefore cause confusion as to the underlying nature of the securities and the effect of redenomination.

30 If simple redenomination of a whole issue is followed by *renominalisation* of the whole issue, fungibility is similarly maintained. In the process a small part of the issue may have been cashed out, but that does not alter the interchangeability between 'old' and 'new'. Applying the current rules would therefore result in the ISIN remaining unchanged.

31 However, redenomination via a *conversion offer* could result in the issue becoming split, with part of it redenominated and part of it remaining in the national denomination. In this case it is likely that the rump stock in the national denomination would be less liquid than the redenominated stock. Investors would no longer be indifferent between the two parts of the split issue. The rump stock in this example would not be fungible with the redenominated stock. The redenominated portion should therefore have a new ISIN, while the rump retains the 'old' ISIN.

32 Similarly, if market conventions do not change on fully redenominated securities, there should be no need for a change in ISIN. However, if *reconventioning* takes place within the terms of a conversion offer, there should be a new ISIN for the redenominated portion according to the approach advocated above.

33 Under the current rules, therefore, the same ISIN should be kept for both simple redenomination and renominalisation of whole issues. New ISINs would only be needed for *conversion offers*.

34 However, the question is whether the practical consequences of this approach are such that there is a strong argument for applying *different* rules. To assess whether there is a strong case for this, the following issues have been considered by the Group:

- *Physical certificates:* If new ISINs were allocated, certificates in existence on which the ISIN was printed would have the 'wrong' ISIN codes on them. If they were not to

5 Methods of redenomination were described in the Report of the Group of market practitioners published in the April edition of *Practical Issues*. Terms used here follow the conventions of that Report.

be physically exchanged for new certificates (which would be an unnecessary administrative burden), the old certificates would need to be valid against the new ISIN.

- *Changing static data*[6]: One argument put forward in favour of changing ISINs is that this would allow static data recorded in a firm's database to be changed over a period of time rather than overnight. Some market participants also take the view that changing the denomination of a security in a firm's database would be complex *without* creating a new ISIN. However, other market participants do not believe the database changes would be more complex: if ISINs did not change, that would not necessarily require an 'overnight' changeover of static data. In the upgraded CGO, for instance, any necessary changes in security details could be input several days in advance to take effect at the appointed time.
- *History of transactions:* Transaction histories would not necessarily be fragmented by a new ISIN, provided that firms linked the existing ISIN to the new one in their back-office systems, or linked their internal codes, if used. This is an issue which the equity market manages effectively now (eg for consolidations and share splits). But if the ISIN did not change, transaction histories could obviously be maintained without such linkages.
- *Open forward-dated trades:* If ISINs were to change, a method for ensuring the completion of forward-dated trades would be required, but it would be readily available.
- *Systems:* Institutions may use ISIN numbers for cross-border transactions, but another set of numbers (eg SEDOL codes) for domestic transactions. Many also maintain their own codes with links to the ISIN codes. Changing the ISIN codes would mean having to change all the links with internal codes. There would be less work for registrars if ISINs were kept unchanged.
- *Code conversion tables:* New ISIN codes would mean that the ANNA would have to issue code conversion tables to ensure the correct codes were used.

35 The Group recognises that the arguments for and against amending the rules applying to ISINs are finely balanced. For some, the wholesale creation of new ISINs for redenominated securities would be a convenient and highly visible trigger for the automation of change. For others, the change is unnecessary, and potentially disruptive. All the central settlement systems will be able to handle redenomination irrespective of whether the ISIN is retained or changed.

36 Of those consulted, those with a dealing background appear on balance to have a preference for changing ISINs, whereas those with a settlement background appear on balance to have a preference for retaining the existing ISIN. Much appears to depend on the precise way individual institutions have set up their own internal systems, notably whether they use the ISIN code itself or an internal code to capture securities details. However, it appears that those preferring to change ISINs could cope nevertheless if they were not, whereas a marginally greater number preferring not to change feel they would have a significant systems problem if ISINs did change. There is a consensus that certainty is of greater importance and that a decision, one way or the other, should be taken as soon as possible.

6 ie data which do not usually change, or change only infrequently, such as securities' descriptions, counterparty bank account numbers and payment routings.

37 The majority of the Group takes the view that the current ISIN rules should apply without amendment so that, except in the case of conversion offers, redenomination should *not* lead to a change in ISINs. The LSE, as the NNA for the UK, agrees with this conclusion.

Internal accounting for forward-dated transactions, including repos

38 When securities are redenominated from national denominations to euro, there will be a number of pending transactions which have been traded but have not yet reached value date. For such securities, assuming a normal settlement cycle, the practical effects arising from redenomination will be short-lived. However, long-dated repo transactions may have maturity dates several months into the future and such trades present particular difficulties for market participants' back office accounting procedures. Since repo transactions are often repeatedly rolled over, changing the maturity details to reflect redenomination could involve retrospectively unwinding the book entries of a series of complex transactions spanning several months.

39 The Group recommends that market participants work with industry user groups to obtain agreement on internal accounting methods for complex transactions such as repos. The Bank will report on progress in more detail in the next edition of *Practical Issues*.

Capacity of systems to handle decimal nominal amounts

40 If the UK is 'in', it is assumed that outstanding gilts will be redenominated, and that the minimum amount will be one euro cent. Under Article 8(4) of the 109l(4) Regulation, other issuers of sterling debt securities could then follow suit (see Chapter 9). Although outstanding sterling money market instruments may not in practice be redenominated but left to run off, CMO will need to be able to display the euro equivalent of sterling nominal values and these will generally be to two decimal places. Irrespective of whether the UK is 'in' or 'out', the need to handle nominal amounts expressed to two places of decimals will arise when trading securities denominated in the currencies of other participating Member States, if they are redenominated to two decimal places.

41 The Group has therefore considered whether securities settlement systems and market participants would in practice be able to handle decimals in nominal amounts. CGO, CMO and CREST are able to do so, and their members should similarly therefore be able to cope. Euroclear and Cedel Bank cannot currently handle decimals, but they have both now decided to undertake the necessary development work to enable their systems to cope with nominal amounts expressed to two places of decimals. The Group has concluded that market participants will need to ensure that their systems can handle nominal amounts expressed to two places of decimals.

Currency of coupon, dividend and redemption payments

42 After 1 January 1999, if the UK is 'in', coupon, dividend and redemption payments for both euro and sterling-denominated securities may be in euro only. In both cases, if an investor (eg a retail investor) wishes to receive payments in the national denomination during the transition period, there will be an obligation on the investor's bank to make the conversion on the investor's behalf. Euroclear will credit income and redemption payments to participants' accounts in euro only, including for non-redenominated securities. Cedel will credit accounts in the denomination paid by the issuer through its paying agent, unless the participant only holds a

euro account. The retail investor should be prepared to accept this procedure so long as there are no additional charges for conversion into the national denomination.

Input and settlement of national denomination instruments after end of transition period

43   Instruments in national denominations will not need physically to be redenominated after the end of the transition period because the Regulation on the euro under Article 109l(4) stipulates that from this point on references to national denominations will be read as references to the euro denomination at the respective conversion rates.

Settlement on public holidays

44   Securities settlement systems are likely to be influenced by the decision that the TARGET Interlinking is to be open on all weekdays when more than one national RTGS system is open: that is, all weekdays except Christmas Day and New Year's Day. The ICSDs are currently open on all weekdays except Christmas Day and New Year's Day, but other systems are at present closed on other days as well. Securities settlement systems hold assets which may be used as collateral to obtain liquidity in RTGS systems, and it is therefore likely that they will need to be open when TARGET is open, to facilitate the movement of collateral. Further, settlement systems may open on days granted in lieu of public holidays to mirror Euroclear and Cedel Bank. If the direct members of CHAPS and CHAPS euro decide to remain open whenever the TARGET Interlinking is open, the CGO and CMO may also need to be open. CREST will similarly adjust its opening days in the light of its customers' wishes and decisions made by other systems. If the direct members of the payment and settlement systems agree that the systems should be open, the Group considers that it is for individual institutions to determine on commercial grounds whether they also wish to be open.

CHAPTER 4: FINANCIAL MARKETS AND EXCHANGES

1 In our April edition, we published the Report of market practitioners in London's international financial markets on *Redenomination and Market Conventions*. We comment here on follow-up to the Report and related developments in two main sections: the money and bond (and associated derivative) markets; and the equity (and associated derivative) markets.

MONEY AND BOND MARKETS

Harmonised market conventions

2 Following a meeting with the EMI on 9 July, all the relevant market associations[1] issued a joint statement on harmonised market conventions for the euro. The market associations believe that harmonised conventions will promote liquidity and transparency in the new euro markets, and will prevent confusion and disputes between market participants. They also believe that early decisions on harmonised market conventions will allow the financial markets to make the necessary systems changes to prepare for Stage 3.

3 The market associations recommend that the conventions they propose (see box below) should be adopted as standard market practice for financial instruments issued after Stage 3 begins, and for financial instruments issued beforehand which are designed to redenominate into euro. But they recommend that existing conventions should be retained for existing instruments, because of the legal obstacles involved in revising existing conventions and the dangers of hedging mismatches if underlying and derivative instruments do not all switch to the new conventions.

RECOMMENDED MARKET CONVENTIONS FOR THE EURO

Euro money markets

- Day count basis: actual/360
- Settlement basis: spot (two day) standard
- Fixing period for derivatives contracts: two day rate fixing convention
- Business days: TARGET operating days should form the basis for euro business days

Euro bond markets

- Day count basis: actual/actual
- Quotation basis: decimals rather than fractions
- Business days: TARGET operating days should form the basis for euro business days
- Coupon frequency: no standardised practice is recommended
- Settlement dates: the standard for internationally traded cross-border transactions for the euro should remain on a T+3 business day cycle

Euro foreign exchange markets

- Settlement timing: spot convention, with interest accrual beginning on the second day after the deal has been struck
- Quotation: 'certain for uncertain' (ie 1 euro = x foreign currency units)
- Reference rate: the ECB (or NCBs) should be responsible for the publication of daily closing reference rates

1 ACI, Cedel Bank, EMF, IPMA, ISDA, EBF, EFFAS, IPAA, ISMA and Euroclear.

4 These recommendations are consistent with those of the Market Conventions Group published in the April edition of *Practical Issues*. They have also been endorsed by the Giovannini Group of market practitioners, whose Report was published by the European Commission on 2 July. The Bank fully supports these market initiatives and the developing market consensus. It is hoped that the EMI will also offer its endorsement in the autumn, which would be very helpful in encouraging the adoption ultimately of harmonised conventions.

Price sources

5 The introduction of the euro raises the question whether existing price sources for national currency money markets (such as DM LIBOR and French franc PIBOR) will cease to exist and be replaced by euro rates, if the currencies concerned participate in the euro area. There is also a possibility that some national price source panels will cease to exist and be replaced by a single euro pricing panel for the euro area as a whole ('EURIBOR'). It is for price sponsors themselves to determine whether national currency rates continue to be quoted or whether euro rates are adopted, and if so who should quote them. But the question remains whether, in the case of existing contracts, national currency rates quoted by a national pricing panel could be succeeded by a euro rate quoted by a different panel.

6 ISDA published a consultative paper on 11 June calling on price sponsors to announce their plans for the transition to the euro, so that the markets can start to examine the business, systems and legal implications of the changeover. In particular, ISDA recommended that:

- price source sponsors should have announced by 31 July 1997 whether they intend to continue providing national currency quotations; whether they intend to offer replacement euro quotes or instead cease to exist; and what the technical parameters for euro quotes will be, if these are provided;
- the EMI should monitor progress on the replacement of disappearing price sources, particularly in the case of national central bank price sponsors;
- EURIBOR sponsors should have announced by 31 July 1997 the technical parameters for euro quotation;
- screen service providers should by 1 September 1997 publish for consultation their plans for successor price sources, including details of screen layouts for old and new pages; and ensure that plans for successor pages take into account the need to accommodate market conventions for old national currency rates; and
- the ISDA documentation task force should by 1 November 1997 prepare revised definitions which reflect the changes announced by price sponsors and screen providers.

7 LIBOR is the standard measure used for the cost of funds in the London market and is used globally. BBA LIBOR is defined as the offered interest rate quoted by major banks in London for placing deposits with other banks at 11.00 London time. Sixteen banks selected by the BBA are surveyed on the basis of market activity and perceived market reputation, and the results are published on-screen. The highest four and lowest four quotes are disregarded and the remainder are averaged. (In some currencies, only eight banks are surveyed and the highest two and lowest two disregarded, with the rest averaged.) All the reference bank quotes are published on-screen to ensure transparency.

8 On 4 June, the BBA issued a consultative paper on *The Introduction of a BBA Euro LIBOR*. The main points in the BBA's proposals have been confirmed as a result of consultation with the market. They are:

- in the event that the euro is introduced in place of the ECU, the BBA will cease to fix LIBOR for the ECU and replace it immediately with a LIBOR fixing for the euro;
- euro LIBOR will be fixed as a 'spot' currency ie on the basis of two days value (T+2). Unlike sterling transactions, where banks process transactions for same day settlement (T+0), most non-sterling transactions in London markets are settled on a spot basis to allow time for trades to be confirmed by each counterparty and matched, and for any errors to be corrected. In due course, the normal settlement timetable may be reduced. A cash fixing will also be provided if there is sufficient market demand, as there may be, given the scope for same day settlement of euro transactions that TARGET will provide;
- the interest day count convention for calculating interest accrual for euro LIBOR will be the actual number of days elapsed divided by 360. This is the day count convention for euro money market transactions recommended by the EMI. If the UK was to join EMU, fixings would therefore be based on a 360 day year, as opposed to the 365 day year on which sterling fixings are based at present, and will continue to be based if the UK stays 'out'. Interest rates for sterling based contracts outstanding if and when the UK goes 'in' will also continue to be shown on a 365 day basis;
- euro LIBOR will be fixed on the basis of quotes from the London offices of major banks active in the euro market at 11.00 London time on London business days. If London banks stay open on all the days on which the TARGET Interlinking is open, then the BBA will consider publishing a euro LIBOR fixing on those days, even if they are UK public holidays;
- the 16 euro LIBOR reference banks are likely to be chosen by the BBA in the second half of 1998. The banks selected will be the major providers of liquidity in the London market, have a good reputation among their peer group and be representative of the London market as a whole. There will be no discrimination on the basis of country of headquarters; and
- settlement rates for existing currencies participating in the euro, with the exception of the ECU, should continue to be fixed after 1 January 1999 and until value for 31 December 2001. The BBA expects that the interest rates posted for national currency LIBORs should be the same as the interest rate posted for euro LIBOR.

9 The EBF is expected to announce its plans for EURIBOR shortly. Following the meeting between the EMI and market associations on 9 July, the EMI has asked NCBs to collect information about price sponsors' future plans for their reference rates, so that the EMI can collate it and make it available to the market associations concerned.

10 Several market associations have also recently suggested to the EMI that the ESCB should sponsor euro overnight rates, on the grounds that overnight rates are effective rates used in actual transactions rather than indicative reference rates, and consequently will be too complex for the market itself to collect and calculate. The Bank believes it would be right for the ESCB to

respond to this market need but with each contributing NCB doing so in a way which reflects its own national circumstances.

Business days for the euro

11 Public holidays will vary by country in the EMU area. There are around 50 days on which there is a public holiday in at least one EU Member State. But the market needs a harmonised definition of the possible value dates for euro transactions because of the need for certainty about the basis on which market prices are quoted. Without a common definition, counterparties would always have to specify the value date for which they are dealing. This would only be possible at a cost for automated foreign exchange matching systems which associate a currency with a single set of holidays. It would also split market liquidity and risk confusion.

12 The EMI has recommended that the TARGET Interlinking should be open on all weekdays when more than one national RTGS system is open. This means that the TARGET Interlinking will be closed only on Christmas Day and New Year's Day, when they fall on a weekday, though NCBs may close their national RTGS systems on other national holidays if they choose. The consensus in the London market is that possible value dates for euro transactions should be defined by convention as those when the TARGET Interlinking is open. Counterparties would, of course, remain free to agree different value dates for particular transactions. Unless otherwise agreed, however, all days defined by the ESCB to be days when the TARGET Interlinking is open would be value dates. If a payment fell on a day when the RTGS were closed in the centre where the counterparty maintained its normal euro settlement account, the parties would have to arrange for the payment to be made through settlement accounts in another European centre where an RTGS linked to TARGET was open. This would require counterparties to pre-fund nostro accounts in other centres. But the cost could be minimised if one or more centres were open on all days when another centre was closed.

13 The value dates for transactions will depend on the settlement convention. Where the convention is spot (T+2), the consensus in the London market is that counterparties should settle spot unless the day two days after the trade date is not a day when the TARGET Interlinking is open, in which case counterparties should settle on the next day when the TARGET Interlinking is open. If the local RTGS is closed two days after the trade date, the recipient should make arrangements to receive the funds through a settlement account in a European centre with an RTGS linked to TARGET that is open on that day.

14 For practical reasons, CHAPS euro may be open on every day that the TARGET Interlinking is open so that euro transactions can always settle in London. This would mean that CHAPS euro and the market would remain open on some current UK public holidays. The legal implications of such a decision remain to be fully investigated. However, even if the UK market were to be closed on UK public holidays, UK banks could still arrange to settle euro transactions in another European centre that is open.

Standard methods of redenomination

15 The Market Conventions Group concluded that there were more disadvantages than advantages in the redenomination of private sector issues of debt securities. This judgement has not changed as a result of the finalisation of the wording of Article 8(4) of the 109l(4) Regulation (see Chapter 9). But sovereign issuers in participating Member States are expected to redenominate into euro units some or all of their outstanding securities in national currency units soon after EMU begins. In cases in which redenomination does take place, the decision about the method of redenomination is for the issuer concerned under national law. There is not yet a consensus among sovereign issuers about a single method of redenomination. The French Government has recently announced that it will redenominate to the nearest euro, and 'cash out' the residual euro cents. Some other governments are expected to redenominate to the nearest euro cent.

16 Although a *single* method of redenomination is therefore unlikely to be agreed, the Group recommended that a very limited number of *standard* methods of redenomination should be used to avoid confusion in the market. In deciding between different methods of redenomination, the main questions to be resolved appear to be the following.

- If redenomination takes place, should it take the form of simple redenomination to the nearest euro cent, or renominalisation to the nearest euro accompanied by 'cashing out' the residual euro cents? (The ICSDs have decided that they will undertake the necessary IT expenditure to enable their systems to cope with decimals in nominal amounts: see Chapter 3).
- Should redenomination be calculated 'bottom up', and if so by rounding investor holdings or minimum nominal amounts? A third option is a combination: for example, rounding investor holdings where these are known (eg in the case of registered securities which take the form of book entries at a CSD), and rounding the minimum nominal amounts represented by individual bonds where investor holdings are not known centrally (eg in the case of bearer securities which take the form of physical certificates for individual bonds).
- Should profits and losses on redenomination arising from rounding lie where they fall, and how should they be accounted for?
- In cases in which individual bonds are traded in round minimum nominal amounts (eg DM1,000), should they be redenominated into odd minimum nominal amounts in the euro equivalent, or should special provision be made to enable them to be traded in any amount of euro and cents, or alternatively should they continue to be traded in round amounts of euro, but with 'odd lots'?
- Should new issues trade in any amount of euro and cents, in which case the need to be able to handle odd amounts is a permanent problem, or should new issues trade in round amounts, in which case the need to be able to handle odd amounts is a transitional problem only?

17 Finally, it is worth noting that there have been further issues of 'euro style' bonds, along the lines described in the April edition of *Practical Issues*. But there is no consensus yet in the market about the use of standard language in the prospectuses of these 'euro style' issues.

Issuing procedures

18 The Giovannini Group argues in its Report that some informal co-ordination of government debt issuance in the euro market could enhance liquidity, transparency and predictability in the markets. The Giovannini Group concludes that the pre-announcement of issuing calendars would be welcomed by the market, though opportunistic issuing should not be precluded. It also concludes that the harmonisation of syndication and tender procedures is not required. These conclusions are consistent with those reached in London by the Market Conventions Group.

Benchmarks

19 The market will decide which issues it wants to treat as benchmarks in the euro bond market. The Giovannini Group concludes that potential benchmark issuers will need to present new issue calendars with regular issues, scheduled well in advance, to obtain the market's support. It also notes that some supranational issuers with sufficient issuing volume, such as the EIB, could compete with sovereign issuers for benchmark status. It foresees as one possibility that different issuers will fulfil the benchmark role for particular sectors of the yield curve.

Ratings

20 The debate about the impact of participation in Stage 3 on sovereign credit ratings continues. One view is that participation in EMU could result in a downward adjustment in sovereign credit ratings, on the basis that euro-denominated debt should be treated as foreign currency debt, given the transfer of monetary sovereignty to the ECB. Another view is that participation in EMU will strengthen the sustainability of fiscal policy through the Stability and Growth Pact (see Chapter 10), and through prevention of the monetary financing of debt, thereby providing support for sovereign credit ratings.

21 The Giovannini Group considers that the EU will probably be rated AAA and that corporates will no longer be capped by the credit rating of the Member State in which they are located. All the same, it considers that corporate ratings are in general unlikely to change significantly as a direct result of EMU. The Group also notes that, as the EMI is proposing to include non-sovereign debt in the pool of eligible assets for open market operations of the ECB, the question will arise how to ensure that ratings are consistent across the euro area.

LIFFE AND LCH

During the first half of 1997, LIFFE traded more than 100 million contracts for the first time. Short-term interest rate ('STIR') contracts had a dominant competitive position, with open interest at the end of June 1997 showing a 90% market share.

Volatility in cross currency interest rate spreads has declined as a result of increasing convergence in short-term continental European interest rates. In response, on 14 July LIFFE and LCH introduced margin offsets for cross-currency spread positions in LIFFE's STIR contracts. This will result in lower costs for users. Initial margin savings are expected to be around 15%. Cross-currency positions will attract margin reductions of 50%, 30% or 20%, and contract combinations in the highest offset band will be considered first.

LIFFE will launch futures and options on the five-year German Government bond (‘Bobl’) on 18 September. The market-making scheme for Bobl is designed to guarantee liquidity and market depth from the launch, and the floor’s expertise in options and spread trading should create a favourable environment for the contract to develop. Together with the Euromark and Bund contracts, the additional coverage provided by Bobl will enable users to have access to all the main areas of the Deutsche mark yield curve. The launch of Bobl is a key element in LIFFE’s strategy to be the main euro derivatives exchange after EMU.

LIFFE has conducted wide-ranging discussions with market participants on how best to consolidate its STIR contracts and ensure continuity in its bond contracts. It is in the process of establishing a ‘contract design working party’ of market participants which will assess the implications of EMU for LIFFE’s contracts. It is also consulting users and index providers on the possibility of introducing a pan-European equity index.

Finally, LIFFE and LCH are running a joint programme of single currency consultations to discuss issues relating to payments and settlements. A joint consultation paper on the options for LCH’s systems to handle euro payments will be issued shortly. LCH aims to have enhanced systems ready for testing by mid-1998.

EQUITY MARKETS

London Stock Exchange

22 Since our last edition, the London Stock Exchange (LSE) has published a Report on the impact of EMU on the equity markets, *Economic and Monetary Union: the Equity Markets*. Copies are available from the London Stock Exchange’s Public Information Unit on 0171-797 1372. The Report considers the implications of EMU for various equity market participants, and summarises the LSE’s own preparatory work. In addition to identifying specific changes which the LSE has in hand to be ready for EMU, the Report also identifies individual issues which can best be resolved in co-ordination with appropriate market participants. It is therefore actively discussing arrangements with market participants, the Government, and other external organisations. The LSE will be ready for the introduction of the euro, whether or not the UK joins in the first wave of membership.

23 Unusually among European exchanges, the LSE already operates a multi-currency trading platform offering trading in 36 currencies. It therefore has the ability to offer listing and trading in more than one currency. As a result, whether or not the UK joins EMU initially, the LSE could support trading in both sterling and the euro for individual securities, should the market so desire. It is working to identify the regulatory implications of this option and continues to co-operate with CREST to ensure that the entire ‘trading through to settlement’ process will be able to handle the euro, as and when the market desires. Furthermore, if the UK does join EMU, the flexibility of the LSE’s systems gives UK companies, investors and member firms the option of following the Continental model of a ‘big bang’ (see below), or taking a more flexible approach to listing and trading equities. Whatever choice is made, currency conversions will continue to be carried out by member firms’ in-house systems as at present.

24 The LSE has considered the denomination of a company’s capital base for the listing and trading of securities. The choice of currency for trading and reporting does not depend on the currency in which the security is denominated; for example, securities which remain denominated in sterling could nevertheless be traded in euro. The LSE recognises, however, that companies may wish to redenominate their securities, and is concerned that this process should be as simple and cost effective as possible for issuers. If the UK is ‘in’, the LSE expects the redenomination of share capital to be facilitated by enabling EMU-related legislation. Even if the UK does not join EMU, the LSE would support enabling legislation to facilitate redenomination, and would favour a move to allow no par value shares.

FTSE International

25 Decisions need to be taken about the implications of the introduction of the euro for equity indices. It could affect derivatives contracts and fund management benchmarks. One major index supplier based in London, FTSE International, has said that it recognises the importance of continuity in the composition of indices, even if the currency in which shares are traded changes. FTSE International is developing a new series of ‘Eurotop indices’ to meet the demand for pan-European indices, if EMU goes ahead.

Continental stock exchanges

26 Both the Giovannini Report and the Report by the Federation of European Stock Exchanges (FESE) on *The transition to the euro* (published in May) indicate broad agreement, as a matter of general policy, that Continental stock exchanges in participating Member States will quote and trade only in euro from the beginning of Stage 3, and that the trading of derivative products related to equities listed on stock exchanges will switch to euro at the same time. Whilst these Reports are not binding, such a policy aims to be consistent with other organised markets and to help planning, and it also recognises the constraint that many European exchanges are not currently capable of handling multi-currency trading. As noted above, the LSE’s systems are already multi-currency and it therefore has the opportunity to take a more flexible approach.

27 The implication is that quotations displayed on the screens of trading systems in participating Member States would be in euro. Transactions would be executed, recorded, matched, confirmed and transmitted to settlement in euro, and the inter-market settlement process would be in euro. That would leave financial intermediaries to make the conversions needed to account to their clients in national denominations, where clients require this. Transactions undertaken in national currency on or before 31 December 1998 would be settled on the due date in 1999 in euro. Unexecuted orders remaining in a central order execution system over the transition weekend (31 December 1998 to 4 January 1999) would be cancelled, with the effect that financial intermediaries would have to convert these orders and reintroduce them, unless they had agreed on an automatic conversion procedure with their clients.

28 FESE argues that redenomination of a company’s share capital would be a natural consequence of a change in the company’s accounting unit. It therefore regards redenomination as a decision whose timing is a matter for each company rather than a direct consequence of a stock exchange’s decision to trade in euro. To keep costs to the minimum, the decision to redenominate could be taken at an annual general meeting. There are four main options for redenomination: leaving shares indefinitely with a par value of unrounded euro; rounding the

share par value to the nearest euro cent; renominalising the par value to a round number of euro; and moving to no par value shares (as is common in the US, Belgium and Luxembourg). Where companies opt for a change in the nominal value, FESE considers that the change should be made by means of a capital increase or reduction. But it recommends no par value shares so as to avoid the need for physical exchange of share certificates and capital adjustment. No par value shares are allowed by the Community's Second Company Law Directive, though they would require national legislation in most Member States, including the UK.

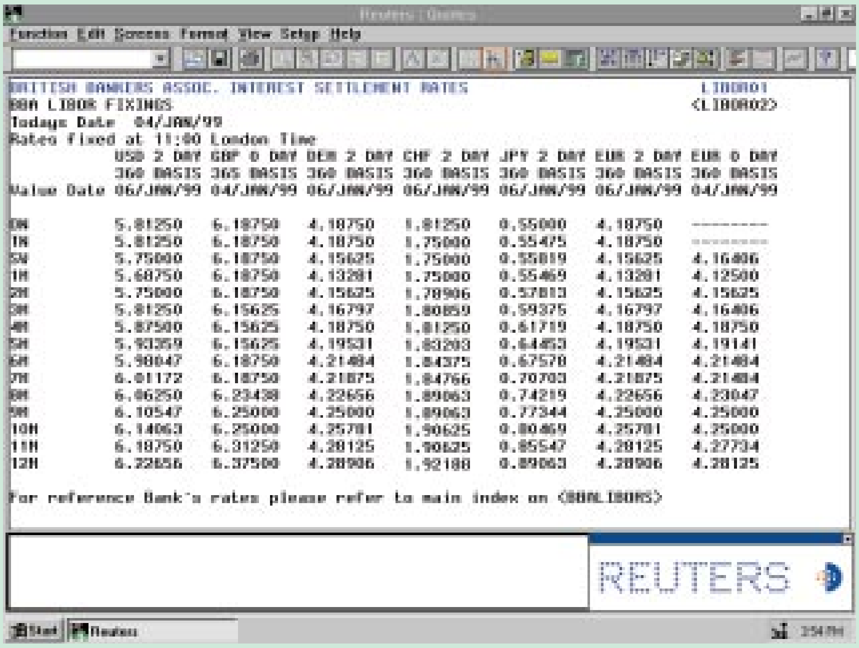
29 The approach taken by FESE is to avoid any change in market conventions which is not strictly necessary for the changeover. However, one potential exception relates to a standard scale of tick sizes, which it proposes should be studied. It also considers that a standard settlement period would be desirable, though not realistic in the near future, as the capability of different exchanges varies greatly. Finally, it emphasises continuity in two specific areas. First, it considers that historical series of stock exchange prices can be restated in euro using the conversion rates, though it recognises that this may be difficult when several participating currencies are affected. Similarly, figures in prospectuses showing revenues, profits and asset values in historical series for comparative purposes should be converted at the conversion rates. Second, it considers that there is no need for existing stock exchange indices to be affected by changes in the denomination of shares. On the contrary, continuity is important, given the large volume of index-linked derivatives.

SCREEN PAGES

The Bank has held a preliminary meeting with screen providers and market practitioners to consider the implications of the introduction of the euro for screens. There are a number of issues that screen providers need to settle in good time before 1 January 1999, including whether they should replace information in national currency units with information in euro units on the same screen page; whether they can obtain instructions from price sponsors in time; and on what basis they should present 'price histories' for the euro covering the period leading up to 1 January 1999, given that the euro is only due to come into existence on that date. These are all matters for the market. But as a way of encouraging a consensus in the market, the Bank will be holding a further meeting on price histories for the euro in the early autumn. The Bank has also agreed to raise with the supervisory authorities the implications for 'value at risk' models. In order to promote market awareness and debate, the Bank is publishing in this edition of *Practical Issues* two further 'straw man' screens from Reuters, and stands ready to provide similar facilities in future editions for other screen providers.

Illustrative screen 1: BBA LIBOR fixings

This screen follows the BBA's paper *The Introduction of a BBA Euro LIBOR*. It has been assumed that in addition to spot (T+2) fixings, the BBA will create cash (T+0) fixings for the euro. It has also been assumed that the BBA will continue to supply LIBOR fixings for national currencies post EMU: these fixings are envisaged as the same as the fixing for euro LIBOR.



BRITISH BANKERS ASSOC. INTEREST SETTLEMENT RATES LIBOR01
BBA LIBOR FIXINGS <LIBOR02>
Todays Date 04/JAN/99
Rates fixed at 11:00 London Time

	USD 2 DAY 360 BASIS	GBP 0 DAY 365 BASIS	DEM 2 DAY 360 BASIS	CHF 2 DAY 360 BASIS	JPY 2 DAY 360 BASIS	EUR 2 DAY 360 BASIS	EUR 0 DAY 360 BASIS
Value Date	06/JAN/99	04/JAN/99	06/JAN/99	06/JAN/99	06/JAN/99	06/JAN/99	04/JAN/99
ON	5.81250	6.18750	4.18750	1.81250	0.55000	4.18750	--------
1W	5.81250	6.18750	4.18750	1.75000	0.55475	4.18750	--------
2W	5.75000	6.18750	4.15625	1.75000	0.55819	4.15625	4.16406
1M	5.68750	6.18750	4.13281	1.75000	0.55469	4.13281	4.12500
2M	5.75000	6.18750	4.15625	1.78906	0.57813	4.15625	4.15625
3M	5.81250	6.15625	4.16797	1.80859	0.59375	4.16797	4.16406
4M	5.87500	6.15625	4.18750	1.81250	0.61719	4.18750	4.18750
5M	5.93359	6.15625	4.19531	1.83203	0.64453	4.19531	4.19141
6M	5.98047	6.18750	4.21484	1.84375	0.67578	4.21484	4.21484
7M	6.01172	6.18750	4.21875	1.84766	0.70703	4.21875	4.21484
8M	6.06250	6.23438	4.22656	1.89063	0.74219	4.22656	4.23047
9M	6.10547	6.25000	4.25000	1.89063	0.77344	4.25000	4.25000
10M	6.14063	6.25000	4.25781	1.90625	0.80469	4.25781	4.25000
11M	6.18750	6.31250	4.28125	1.90625	0.85547	4.28125	4.27734
12M	6.22656	6.37500	4.28906	1.92188	0.89063	4.28906	4.28125

For reference Bank's rates please refer to main index on <BBALIBORS>

Illustrative screen 2: synthetic history of a one-year euro interest rate

The following screen highlights the difficulties of measuring volatility in a one-year euro interest rate prior to EMU. One method to create a synthetic history would be to use ECU history prior to EMU, but there are others.

'MAPPING' OF THE LONDON MONEY AND FOREIGN EXCHANGE MARKETS IF THE UK IS 'OUT'

This box consists of an edited version of the BBA's 'map' of the UK money and foreign exchange markets, if the UK is 'out'. The map consists of a preliminary description of money and foreign exchange market transactions before EMU (using the Deutsche mark as an example) and after EMU (in euro), a table of the steps required between now and 1 January 1999, and Chart D showing the time relationships between each of the steps. Comments on the map are welcome, and should be sent to the BBA. In the period ahead, the Bank will be discussing with the BBA and others a possible extension of the 'mapping' exercise to other wholesale financial markets in London, whether the UK is 'in' or 'out'.

Money market transactions

At present, Deutsche mark interbank deposit rates are quoted for, say, one month Deutsche marks, on information feeds and automated broking screens, by brokers and directly by banks. Unless stated otherwise, these quotations are for value (ie the Deutsche marks are to be delivered by the depositor) on the second Frankfurt business day after dealing (the spot day). The maturity date is the same day of the following month, unless this is not a business day in Frankfurt. In that case it is the next business day following, except if this is in the next calendar month, when the previous business day is used.

When a deal has been struck, the receiving bank advises the paying bank of the bank account in Frankfurt to which the funds are to be paid. The paying bank instructs its correspondent in Frankfurt via S.W.I.F.T. to make the payment via the German payments system. Prior to maturity, the depositing (ie original paying) bank advises its counterparty about the bank in Frankfurt to which the deposit is to be repaid, with interest for the month calculated on the basis of the actual number of days from the spot date to the maturity date (counting only one of the two end-days) and divided by 360. The deposit-taking bank instructs its correspondent in Frankfurt via S.W.I.F.T. to make the payment via the German payments system. In practice, many banks agree standard settlement instructions (SSIs) for all Deutsche mark payments so that all details are known as soon as the deal is struck.

By contrast, interbank sterling one month quotations in London are for value that day. The paying bank usually sends the payment directly to the receiving bank's account via CHAPS. The interest calculation uses a divisor of 365.

After EMU, euro deposits will be available for same day value as well as for value on the second London business day after dealing (the spot day). This will require clarity in the terms being quoted and attention to the value date when transactions are concluded, recorded and confirmed. The basis of interest calculation will be the actual number of days from value to maturity divided by 360.

The receiving bank will be able to request payment of euro to its account in London or Frankfurt (or another centre). The paying bank will then have a choice of payment methods. For an account in London, it can initiate payment directly via CHAPS euro. For an account in Frankfurt, it can instruct its correspondent in Frankfurt via S.W.I.F.T. to make the payment via the German RTGS or net settlement systems. Alternatively it can initiate the payment directly via the link from CHAPS euro to TARGET, or it can make the payment via the EBA's system. The same choices of account location and payment method are available at maturity. The choice of payment location will affect the management of nostro and clearing balances and liquidity management in the various RTGS systems. A choice will have to be made between separate funding of nostro accounts in different euro centres and concentrating the balances wherever possible on a single account.

Foreign exchange market transactions

At present, spot foreign exchange quotations are made for value on the second London business day after the trade, if this is a business day in the centre of both currencies involved in the transaction. If not, the value date is the next day which is a business day in both centres, even if not in London. Settlement is made in each currency in the same way as for deposits.

After EMU, it will be possible to settle euro via CHAPS. So the spot date calculation will not depend on other centres being open. For transactions between sterling and euro, value will be for the second London business day after trade, even if (say) Frankfurt and Paris are closed, because delivery will be available for both sides of the transaction in London. Provided that the relevant centre's settlement system is operational, it will also be possible to deliver euro in Frankfurt or Paris. Where both parties specify London payment, same day settlement of transactions between euro and sterling will be an alternative. Transactions between euro and dollars will be for spot value, taking into account business days in New York.

Outstanding transactions

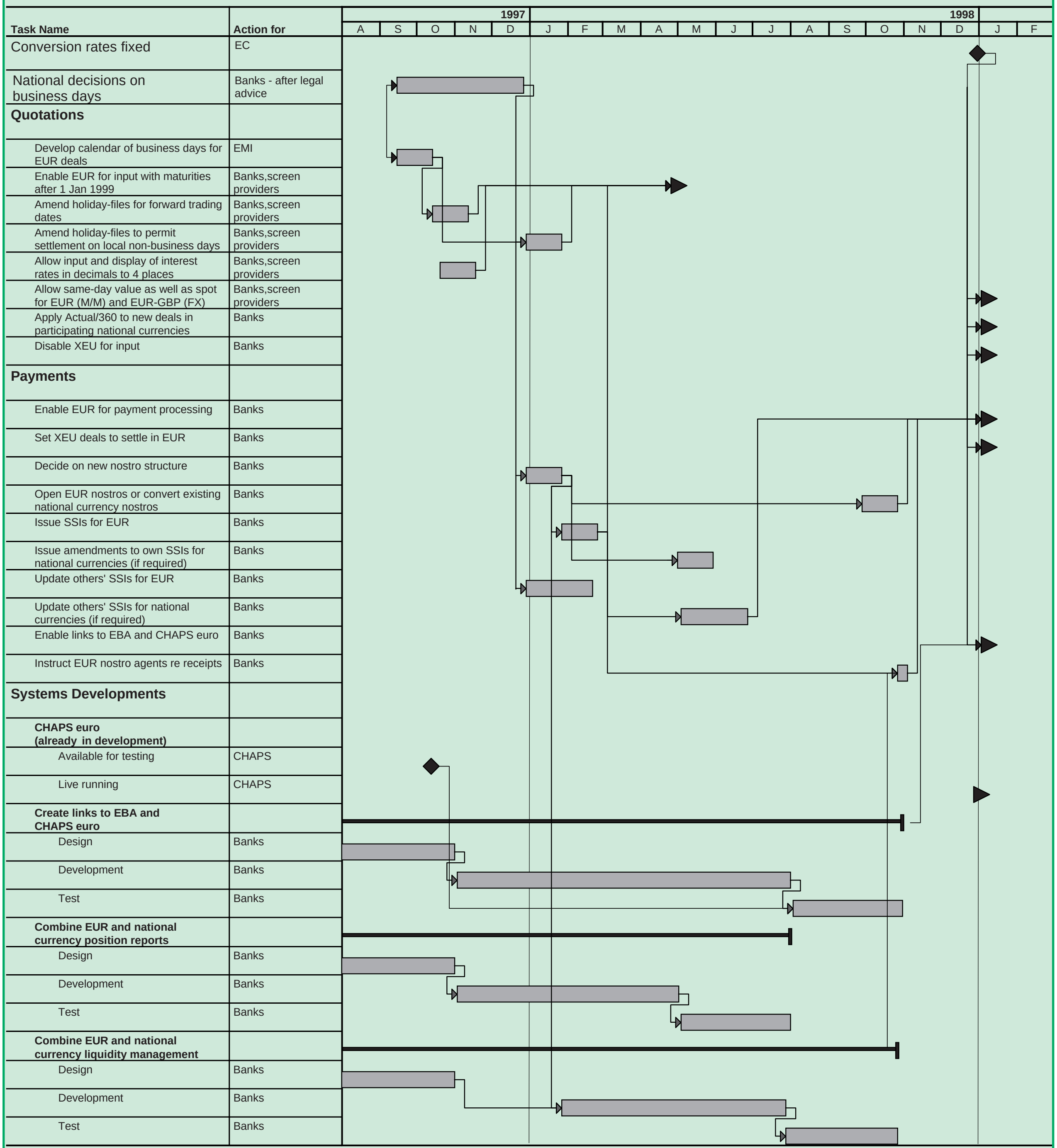
Deutsche mark transactions contracted before the end of 1998 and maturing in 1999 or later will be booked for settlement and remain payable in Deutsche marks to the depositing bank's nostro account in Frankfurt. They will be subject to the 'no compulsion, no prohibition' rule in the Article 109l(4) Regulation. Under this rule, the counterparty will be able to repay euro instead of Deutsche mark because the bank maintaining the nostro account will undertake the necessary conversion. The depositing bank will also be able to change the denomination of the nostro account to euro and receive Deutsche mark payments on it. If this can be done without a change of account number, no change in settlement instructions will be required.

In the foreign exchange and derivatives markets, it will be possible to book forward contracts involving euro before 1999. A grey euro deposit market may also emerge during 1998. But it will not be possible to make euro payments before 1999. Any settlement before 1999 will have to be in an existing currency. Counterparties entering euro deals before 1999 should be clear how settlement is to occur in the event that, for whatever reason, EMU does not go ahead on 1 January 1999 as planned.

EURO MONEY AND FOREIGN EXCHANGE TRANSACTIONS: SUMMARY OF STEPS AND ACTION REQUIRED

Process	Current situation	After 1 January 1999	Action required
Quotation 1 Value date deposits	Spot value according to national business days	Spot value according to TARGET business days; same-day value also possible	Amend system holiday-files for forward trading dates; distinguish same-day from spot value quotations
2 Maturity date	Same day in following month, adjusted for national non-business days	Same day in following month adjusted for TARGET non-business days	Amend system holiday-files to permit settlement on local non-business days
3 Interest basis	Actual days from value to maturity / 360 for DM	Actual days from value to maturity / 360	Amend all participating currencies to Actual/360 day count; note that this applies only to new deals - existing deals continue on previous day count basis
4 Interest rates	Fractions	Decimals (accurate to an agreed number of places)	Amend input and display fields to handle decimals (accurate to an agreed number of places)
5 Value date (foreign exchange)	Second London business day if also a business day for each currency involved (otherwise next business day for both currencies, even if a holiday in London)	Second London business day for EUR-GBP; same-day value also possible; no change for deals involving non-euro currencies	Amend system holiday-files for forward trading dates; distinguish same-day from spot value quotations for EUR-GBP
Payment 6 Currency	Settled in national currencies at local offices and ECU via EBA clearing	EUR deals settled in EUR (or national currency at payer’s option); ECU normally to settle in EUR; national currency deals settled in national currency (or EUR at payer’s option); receiving banks will provide conversion facilities	Enable EUR code to allow matching and payment instructions to be processed in euro; note that conversion of existing deals is optional; disable XEU code; check ECU contracts
7 Location	Appropriate national financial centre	London or any participating financial centre for EUR; as before for non-euro currencies	Instruct counterparties and/or amend Standard Settlement Instructions if necessary
8 System	Nostro accounts at correspondents	CHAPS euro and TARGET; EBA; or nostro accounts at correspondents	Paying away: enable EUR payments to be made via EBA or CHAPS euro; update payment instructions to take account of changes Receiving: inform counterparties of any changes to account details or changes to correspondents
9 Cover (ensuring sufficient funds are on nostro accounts to cover payments being made)	Nostro management within each Member State	Directed to appropriate account location or single nostro account	Agree receipt instructions with correspondents

EMU MAPPING: EURO MONEY AND FX MARKETS - UK 'OUT' CHART D



Source: BBA

CHAPTER 5: BUSINESS PREPARATIONS

1 This Chapter describes the Chancellor's initiatives to help UK businesses prepare for the euro; recent work by the CBI and British Chambers of Commerce; and finally mentions briefly some other business preparations under way.

THE CHANCELLOR'S BUSINESS INITIATIVES

2 The Chancellor announced on 17 July two initiatives to help businesses to prepare for the euro:

- first, HM Treasury has published a guide to the practical implications of EMU, which looks at the practical and strategic effects on business, whether or not the UK decides to join (see box below); and
- second, the Chancellor is establishing an Advisory Group of representatives from a wide range of business and trade associations and other interested bodies to discuss practical aspects of EMU.

In addition, in order to help launch a more constructive and informed debate on the single currency, HM Treasury has published Professor David Currie's summary of his survey of the economic arguments for and against a single currency. It is available from the Public Enquiries Unit of HM Treasury on 0171-270 4860, and it can be read at http://www.hm-treasury.gov.uk , on the internet.

HM TREASURY'S BOOKLET: *EMU - Practical Information for Business*

The Treasury booklet says that the competitive environment for businesses will change in the euro area as a result of cheaper transaction costs, the removal of uncertainty about exchange rates, and the quotation of prices in the same currency, which will make price differences more obvious. The importance of these factors for individual UK firms will clearly depend on whether the UK joins EMU, but there will still be effects for firms engaged in cross-border trade and investment in the euro area, even if the UK stays 'out'. The Treasury recommends that businesses should review their strategy, taking these factors into account.

The Treasury booklet also draws together the main practical implications of EMU, recognising that these will vary from firm to firm, and that they depend on whether the UK joins:

- *Financial systems and accounts*. If the UK stays 'out', firms which currently keep accounts of dealings in other major European currencies will need to handle the euro. But other businesses' accounts will not be affected. If the UK joins, firms can continue to compile their accounts in sterling at least until the end of the transition period. Alternatively, if they wish, they can change all their systems to account in euro earlier or change different systems at different times.

- *Cash handling*. Retailers handling large volumes of euro notes and coin need to consider how to receive cash and give change, account for cash transactions, make their operations transparent to the customer, and guard against fraud and theft.
- *Business finance*. The financial services provided to companies by banks and the relative attraction for companies of borrowing through banks, or by issuing bonds and equity, may change as a result of EMU, and companies should consider the implications for their financing.
- *Pricing policy and price displays*. Since prices quoted in national currency are unlikely to convert into 'attractive' or 'round' numbers in euro, companies operating in the euro area need to decide whether to set new pricing points, and if so when, or whether to consider new pricing and packaging strategies. They also need to consider the implications of the euro for price marking and display.
- *Taxation*. The tax authorities in the UK already accept payments (although not declarations) for some purposes in a number of currencies. It is likely that they would accept some payments in euro, especially for corporate taxes, during the transition period. They are looking at options available for declaring and paying taxes in euro, especially if the UK were to join.
- *Training and personnel*. In all businesses affected by the introduction of the euro, staff need to understand changes affecting the business resulting from EMU, and be able to explain the implications to customers. If the UK were to join, businesses, trades unions and employees would need to consider the effects on paying salaries and on pensions.
- *Other issues*. Other issues which firms need to consider in good time include the legal and systems implications of the euro.

The Treasury booklet will be supplemented by factsheets, particularly on detailed practical preparations. Copies of the booklet are available by writing to EMU initiative, PO Box 506, London SE99 7UY, stating how many are required. The booklet contains an order form for additional copies and to receive updated information. This information is also available on the internet at http://www.hm-treasury.gov.uk, and the booklet will be made available over the summer through libraries, Government offices and trade associations.

CBI AND BRITISH CHAMBERS OF COMMERCE

3 As noted in previous editions of *Practical Issues*, the CBI and British Chambers of Commerce (BCC), with the support of the Bank, have been staging a series of seminars around the UK since late last year to explain the background to EMU, the timetable for the transition and the practical and strategic implications for business. Eleven seminars took place in all, attracting an average audience of around seventy. The seminars have succeeded in raising awareness of EMU and the range of issues that UK companies need to address. A detailed checklist setting out the conclusions is being drawn up by the CBI and BCC, with the aim of publication in the autumn.

4 At a policy level, the CBI issued a statement on 22 July expressing support for UK membership of EMU under the right conditions, but advising against joining on 1 January 1999 if EMU goes ahead then. The BCC is also consulting its membership about their views on the desirability of EMU, the optimal entry-date and possible membership of ERM2.

OTHER BUSINESS PREPARATIONS

5 Preparations for the introduction of the euro are continuing, particularly among UK companies involved in cross-border trade and investment. A number of major UK financial institutions have produced guides for their customers, and made presentations to them around the country. Some of the more striking messages can be summarised as follows:

- EMU is a key challenge for a company's board of directors. They must ensure that they fully understand the implications of EMU, and take ultimate responsibility for the company's response. Shareholders will expect to know how the business is preparing for EMU, whether or not the UK joins;
- the establishment of the euro area is likely to act as a spur to mergers and acquisitions activity, as the elimination of exchange rate risk encourages companies to expand across borders;
- information systems are the key to the EMU changeover process. But the changeover to the euro cannot be reduced to mere information systems problems, as it will involve major strategic and organisational issues;
- a number of large companies across Continental Europe have already decided to work in euro from the outset of EMU. They may try to encourage their suppliers to follow suit;
- multinational companies with operations inside the euro area may consider using the euro as their reporting currency, even if they are predominantly UK-based; and
- it may be appropriate for a company to consolidate its bank accounts in different participating Member States into one euro account.

6 In order to help businesses to understand and respond to the IT implications of EMU, the British Computer Society (BCS) is about to publish a booklet, which may be obtained from the address shown on page 75; and there is also a forthcoming publication from BASDA and CSSA.

CHAPTER 6: RETAIL PREPARATIONS

1 Two conferences were held in May on preparations for the euro at the retail level. One was a 'Round Table' organised by the European Commission in Brussels, and the other was a 'retail workshop' organised jointly by APACS, the BBA and the British Retail Consortium (BRC). This Chapter begins with an update on preparations for retail payments in the UK, and includes a summary of the outcome of the retail workshop. Later sections cover broader elements of the retail changeover, including the conclusions of the Commission's Round Table.

RETAIL PAYMENTS

2 The basic plan for retail payments in the UK remains as outlined in previous editions and is summarised in the box below. The approach has been to reach industry agreement on how the central infrastructure necessary to accommodate the single currency should be developed. Having agreed the nature of the necessary infrastructure and the timescale for its introduction, individual banks are free to choose when to adapt their own specific systems and to launch euro-denominated products and services. This will vary according to their individual strategies and their customers' needs.

RETAIL PAYMENTS SYSTEM DEVELOPMENT

Will systems be available on 1 January 1999?

SYSTEM	'OUT'	'IN'
BACS	YES Capability to 'switch on' parallel euro batch processing in response to demand	YES Parallel sterling and euro batch processing from 1 January 1999
PAPER CREDITS	YES Capability to handle the expected low volumes of euro cheques	YES Manual or automated facility to handle the potentially high volume of euro cheques
ATMs	NOT NECESSARY	NO ATMs to be converted over a short period leading up to E-day so most can dispense euro notes from then
CARDS	NOT NECESSARY Customers may choose to be billed in euro if issuer allows	NO POS terminals will convert over a period of time leading up to E-day. Customers may choose to be billed in euro earlier if issuer allows

3 The underlying philosophy is that it remains prudent to plan on the basis that EMU will go ahead on 1 January 1999, and that the infrastructure for retail payments should be ready, whether the UK is 'in' or 'out'. In practice not all retail payments media may be required from the outset,

even if the UK is ‘in’. If the UK is ‘out’, planning is complicated by uncertainty over the probable scale of demand for euro retail payments. The rest of this section describes planning for the ‘in’ and ‘out’ scenarios for each of the clearings separately.

Cheque and credit

4 The Board of the Cheque and Credit Clearing Company met on 2 July and agreed that work should proceed on both the functional specification for processing cheques in the UK 'in' scenario and the new cheque standard. Both banks and retailers would strongly prefer individuals’ use of cheque transactions to change over to euro from the date of issue of euro cash (E-day). A significant volume of cheques is drawn for trade payments, and it is from this source that early demand is anticipated.

5 It has been decided that a fully-automated system for processing separate euro-denominated cheques, with the currency indicated by the euro symbol and a two-digit transaction code in the MICR codeline, will be available early in the transition period, but not from 1 January 1999. Such a system could be introduced, if demand warranted, by mid-2000 at the latest. The need for a contingency capability is recognised and the feasibility of using the extended currency clearings to handle euro-denominated paper payments in a UK ‘out’ scenario has been assessed. The conclusion is that this solution is only appropriate for low volumes. Therefore, further work on evaluating manual or semi-automated systems for processing high volumes of euro-denominated cheques is under way.

6 Work to develop a new euro credit system has begun. This will only be needed in the ‘in’ scenario. However it has been estimated that substantial demand is unlikely until well into the transition period.

BACS and automated payments

7 In June the BACS Board approved plans, which were foreshadowed in the last edition of *Practical Issues*, to develop the BACS infrastructure to allow it to handle euro transactions from 1 January 1999. The date on which this service will be ‘switched on’ will depend on the demand for euro transactions in either UK ‘in’ or UK ‘out’ scenarios.

8 Originators will input separate batches of euro and sterling items; the currency indicator will be held in the batch header rather than at transaction level. Items will remain in their original currency as they pass through the infrastructure. If the receiving account is held in a different currency, the receiving bank will make the necessary conversion.

Notes and coin

9 The process of introducing a new set of notes and coin whilst withdrawing the old will present a considerable logistical challenge. This will require additional storage, transportation and security arrangements and the most careful and timely planning. NCBs of all participating Member States are expected to provide a full complement of notes during the latter part of 2001 in time for E-day, the day when they will begin to be introduced into circulation (as explained below).

10 In the UK these issues primarily affect the commercial banks, which play a central role in the cash processing and distribution cycle, acting as the link between the Bank of England and the Royal Mint and between businesses and individuals. In other EU Member States, the NCB usually carries out these tasks.

11 APACS Cash Services Group has set up a cash euro project team to develop a blueprint for the withdrawal of sterling and the introduction of euro cash. The target completion date is end-1997. Initial workshops held by the project team have concentrated on the operational issues expected to arise from the introduction of the euro. A major data gathering exercise is, however, needed to ascertain the likely stock of notes and coin required and where these will be stored prior to E-day. The project team has held early discussions with other sectors affected, including the retail and vending industries. Meanwhile, Cash Services Group members are involved in detailed data input to the project team.

Cards

12 The APACS Card Payments Single Currency Working Group has produced a paper setting out a number of planning assumptions as the basis for future work and discussion with other interested parties. Development of the UK card payment systems for euro transactions will involve a number of institutions: not only issuers and acquirers, but the card schemes and third party providers. The Card Payments Group will steer and co-ordinate this programme of inter-related subjects. This will ensure that a co-ordinated approach is taken by the entire card industry. As with cheques, the preferred scenario will, under the ‘in’ scenario, be for the bulk of cards to change over from E-day; but it is recognised that in both ‘in’ and ‘out’ scenarios there will be a need to cater for some use of euro-denominated card transactions from 1 January 1999. The originating transaction currency will be determined by agreement between the merchant and the acquirer. The choice of denomination for billing the card holder is a separate matter. The international card schemes, VISA, Mastercard and Europay have confirmed their ability to cater for the euro as a billing and settlement currency from 1 January 1999. SWITCH, the UK domestic debit card scheme, is also working to this target date although, as noted above, significant demand may well emerge only later in the transition.

13 The ATM industry, through the APACS ATM Group, is developing an operational plan to clarify how the changeover will be managed at ATM level. The final plan will be available by the end of this year. Discussions can then be held with third parties, eg card schemes and manufacturers, to ensure that the requirements of the plan can be met.

14 In summary, retail payments in euro by cheque, automated credit or credit card will be facilitated during the transition period, but substantial volumes are unlikely to arise in the early stages of the transition. Substantial demand for retail payment facilities in euro if the UK is ‘out’ is also generally considered unlikely.

OTHER RETAIL PREPARATIONS

Working Groups on practical implementation issues

15 APACS and the BBA have jointly convened two separate Working Groups to examine the practical issues arising from, first, the application of the conversion and rounding rules and,

second, the rules relating to the principle of 'no compulsion, no prohibition', as established by the Article 235 and Article 109l(4) Regulations, respectively. The Working Groups' recommendations are being published as discussion documents. The aim is to disseminate these widely and agree a cross-industry approach. Copies of the draft Reports mentioned below are available from APACS.

16 The draft Report of the Conversion and Rounding Working Group was issued in July. It considers the detailed problems which can arise as a result of converting payment amounts from sterling to euro and vice-versa. These conversion issues include, *inter alia*, how entries should be shown on customers' statements, how rounded bank charges should be reflected, and how to adjust batch and individual items where frequent rounding differences between the two figures occur.

17 The 'no compulsion, no prohibition' Working Group has examined the various scenarios under which obligations may be imposed by the legal framework and the implications for payments systems (see also Chapter 9 below).

Retail workshop

18 In May, a cross-industry workshop was organised by APACS, the BBA and the BRC to look at issues arising from the transition to the single currency in retail markets. Attendees were drawn from across the retailing, utilities, business and financial services sectors. The workshop's aim was to help ensure that retail issues arising from the transition to the single currency are addressed in a proper and timely fashion, through sharing information between sectors and co-ordinating planning activity.

19 A high degree of consensus emerged, with agreement on the following principles:

- a Government-led national co-ordination board is required, at least from the moment of UK commitment to participate and preferably sooner;
- the preferred date for E-day is mid-February 2002;
- the end of the transition period should coincide with the introduction of notes and coin;
- the length of the note exchange period should be as short as possible and in any case no longer than three months;
- non-cash payments at point-of-sale, whilst a competitive issue, will not as a general rule be widely promoted before E-day;
- national co-ordination of trialling euro payments at the point-of-sale is required before E-day;
- there is a need to involve consumer representatives, Government departments and the Post Office from now on;
- utilities wish to move to billing in euro in a co-ordinated fashion, close to E-day;
- there is a need for co-operation and a common language, when developing customer communications; and

- a minimum of three years is required to prepare the retail markets following any decision to enter the single currency.

20 APACS, the BBA and the BRC have subsequently sent a joint letter to the EMI, the European Commission and HM Government on the preferred date for the introduction of euro notes and coin, its coincidence with the end of the transition period, and the length of the changeover period.

21 The workshop represents the beginning of a cross-industry co-operative approach to planning for the introduction of the euro at retail level. In future, it is hoped to include representatives from consumer groups and Government departments. Copies of the proceedings are available from APACS.

Commission Round Table

22 The Commission Round Table on 15 May in Brussels was attended by around 250 people, mainly drawn from associations representing consumers, retail and other businesses and financial institutions. Some of the topics covered are listed below; a summary of the proceedings has been published by the Commission.

23 *Issue date for euro notes and coins*. There was little support for 1 January 2002 because of its proximity to Christmas. Early 2001 is not practicable, and so the actual choice is effectively reduced to autumn 2001 or February 2002. Most private sector representatives preferred the later date, but the Commission maintained its preference for the earlier date, as the later one would involve a change in the Madrid transition scenario, and give the impression of delay.

24 *Length of dual circulation period*. The predominant view was that the period should be considerably shorter than the six months provided for in the Madrid transition scenario, and that an autumn launch would need to be coupled with a short period of dual circulation so as not to coincide with Christmas. The Commission favoured a dual circulation period of ‘a few weeks’.

25 *Dual price displays*. Consumer organisations argued that dual displays should be mandatory for six months before E-day and continue for a period afterwards; but retail associations were opposed to legislation, arguing that competition was the best way to protect consumers against price increases.

26 *Conversion charges*. Consumer organisations argued that consumers should not be charged where conversion was obligatory (eg in the case of the conversion of national into euro notes and coin). Banking associations argued that they should be permitted to charge where banks were providing ‘genuine’ services. There was agreement that any charges should be transparent.

27 *Other topics*. These included discussions on becoming accustomed to a new scale of prices and values; training; and the role of the public authorities.

28 In terms of next steps, the Commission proposes to announce any decisions within its competence in this area in April/May 1998 at the same time as the participating Member States are chosen. There is expected to be a meeting in late September on the date for E-day, after which the EMI will take its decision; a conference organised by the Luxembourg Presidency in

November on consumer issues; and another Round Table a couple of months in advance of the announcement to discuss the Commission's draft proposals. In order to inform its proposals, the Commission intends to convene expert consultative groups on: banking and conversion charges; dual displays; helping consumers to adjust to prices in euro; small and medium-sized enterprises; and the role of education and training.

Legal implications of alternative dates for the introduction of euro notes and coin

29 In accordance with the Madrid transition scenario, the Article 109l(4) Regulation on the introduction of the euro (see Chapter 9) currently envisages that euro notes and coin will be issued no later than end-2001. If a date in autumn 2001 were chosen, the question would arise whether the Regulation should be changed to move forward the legal end-date to the transition, which is currently set at precisely end-2001. There are practical arguments in both directions. If the legal transition were to continue to end-2001 and E-day were to be brought forward, it might be necessary to adjust those final provisions of the Regulation relating to the remaining legal tender status and withdrawal of national notes and coin, so that they came into force on E-day rather than, as currently drafted, at the end of the legal transition period. If it were decided to delay the introduction of euro notes and coin to February 2002, this would probably also require amendment to the Regulation at least to adjust the legal end of the transition period. Although that would be inconsistent with the Madrid transition scenario in respect of the date for the introduction of euro notes and coin, the other relevant element in that scenario - namely, that the period of dual legal tender circulation of national and euro notes and coin should end no later than mid-2002 - could still be respected.

Other UK preparations

30 The Consumers' Association (CA) has issued a position paper entitled *European Monetary Union: Practical Implications and Implementation Issues for Consumers*, and is now finalising a document explaining the macro-economic arguments for and against EMU to the general public. In the former paper, the CA argues in favour of a European Directive on dual pricing, which would set broad compulsory principles to be implemented at national level in accordance with Member States' individual retailing laws.

CHAPTER 7: CASE STUDIES ON PLANNING FOR THE INTRODUCTION OF THE EURO

1 Against the background of infrastructure preparations to allow use of the euro in the UK from 1 January 1999, whether 'in' or 'out', individual financial institutions and businesses are making their own practical preparations. This Chapter explains how four particular institutions, including the Bank of England, are preparing. We are grateful to Barclays Bank, HSBC and Marks & Spencer for the other contributions. They set out their own views and not necessarily those of the Bank. Further examples will be provided in future editions, including Lloyds TSB, National Westminster Bank and a number of other UK and foreign institutions.

A: BANK OF ENGLAND

2 The Bank itself is preparing for EMU, on the basis of a 1 January 1999 start date, for both UK 'in' and 'out' scenarios. The preparations are on schedule so far.

The project comprises 90 tasks

3 The Bank has identified 90 *technical* EMU tasks which need to be completed, all but 12 of them by 1 January 1999: these are separate from all of the single currency *policy* work in which the Bank is engaged. Some of the tasks involve substantial preparations whilst others are more straightforward. Many involve IT development. The technical tasks can be divided into three broad groups: about one-third are required *whether or not* the UK is an initial member of EMU (such as TARGET); a small number (fewer than 10) are required *only* if the UK is not a member of EMU on 1 January 1999; and the rest, over half, are needed *only* if the UK is a member of EMU, either on 1 January 1999 or a later date if the UK joins subsequently.

4 The Bank regards it as prudent to continue with all these preparations at the present time. One advantage is that this will allow the Bank to benefit from the communal trialling of some systems jointly with the EMI and other NCBs.

5 For many tasks the Bank is developing flexible solutions able to cover the range of possible outcomes and including tasks where the EMI is keeping options open for ultimate ECB decision. Some systems development will also need to accommodate both preparations for EMU and the consequences flowing from the Chancellor's recent proposals on the operational independence of the Bank.

MAIN BANK EMU PREPARATORY TASKS AND THEIR INTERCONNECTIONS

CHART E

Some are relevant only to UK ‘in’ or UK ‘out’

What is the Bank doing?

6 The Bank's technical preparations are very broad. In addition to developing euro facilities to service its own customers' prospective needs, the Bank is developing the infrastructure it provides for the market place as a whole, for example in the payments (RTGS) and securities settlement (CGO and CMO) field, and it is also preparing to take its full part in the ECB's future operations. The main tasks are illustrated in Chart E.

7 The first two areas are described in greater detail below. The third includes a number of projects under way with the EMI to establish the infrastructure which will be used by all NCBs participating in the ESCB's operations: telecommunications systems, data transfer networks, and systems linking NCBs for the purposes of the ESCB's money market operations, foreign exchange operations and reserves management. The Bank's systems must be consistent with ESCB requirements, and interface with the common ESCB systems. The development of both front and back office systems, procedures and policy frameworks is required. About one third of the 90 tasks fall into this area. The tasks are closely interlinked; and the timetable is tight for major IT developments. Many of the projects must be undertaken in parallel.

8 Other areas are affected too. For example an EMI system is being prepared to facilitate the transmission of statistics across the euro area. The Bank's statistical area is also revising its statistical forms to allow bank data on euro-denominated assets and liabilities to be adequately captured. The Bank's supervisory area is in the process of reviewing its policy and procedures to incorporate the single currency (although this preparatory task will now pass to the SIB). And the new monetary review procedure would need significant amendment if the Bank becomes part of the ESCB.

9 Preparations in the field of debt management will pass in due course to HM Treasury, but in the meantime the Bank is continuing with 10 tasks relating to gilts and debt issuance, including provision for the necessary systems at the Registrar's Department to operate in euro.

10 The Bank's Legal Unit is considering the legislative changes which may become necessary if the UK were to opt 'in'; and the much more limited changes required in a UK 'out' scenario. It is also providing the necessary legal input into a number of the technical projects.

Structure - who is involved?

11 The work affects the activities of almost all areas of the Bank. Reflecting this, the preparatory work has deliberately not been established as a project separate from the day-to-day work of the Bank but instead integrated into current operational responsibilities. A Steering Committee comprising senior management representatives of all areas most closely involved in the preparatory work and reporting to the Governors has been set up to oversee the work and to ensure that it is properly resourced. This Steering Committee is supported by a full-time project manager. The detailed implementation of each task remains the responsibility of the individual areas concerned. Those areas most affected have set up their own project management and co-ordination units. A high-level Bankwide plan has been drawn up to help co-ordinate the timing of each of the 90 tasks. This plan has been considered and adopted by the Steering Committee; it will monitor individual areas' progress against this plan. Current estimates are that over 200 staff

will be working full or part-time on the preparations by the autumn of this year, equivalent to over 100 full-time staff.

12 The remainder of this section describes the Bank's core internal development work on payments and settlement arrangements (which account for some 20 of the 90 projects).

Banking and Market Services Divisions' EMU preparations

13 The Banking and Market Services Divisions (B&MS) are preparing payments and settlement systems and the Bank's own banking facilities for the start of EMU. Over 60 experienced staff in the business areas are involved full or part-time on the work, together with over 70 technical IT staff, full or part-time, from the Bank's Management Services Division (MSD).

TARGET and CHAPS euro

14 The Bank has a key role in developing the UK's interface with the TARGET system, involving several discrete tasks within the Bank's EMU project: modifications to the processor which handles payment messages; upgrading the system which ensures that adequate intraday collateral is held against liquidity granted to banks; building interfaces with the ECB, the other EU NCBs and the UK settlement banks; and upgrading the Bank's own message switching system which handles the electronic data flows. Work on TARGET is being undertaken primarily by our Interlinking project team, with support from a new EMU Project team within the Customer Settlement Services area of B&MS, and IT specialists from MSD.

15 The existing RTGS processor for sterling payments is being enhanced to accommodate the euro, and to interface with the TARGET Interlinking network; it will link with both sterling CHAPS and CHAPS euro, and with the euro-denominated version of the present sterling CHAPS system, if that option is retained for the 'in' scenario (see Chapter 2). These developments involve substantial changes to Bank software; and may also involve an upgrade during 1998 of the hardware on which the current systems run, in order to cope with a prospective increase in volumes. Trialling of the new system started at the beginning of last month.

16 Interlinking allows euro payment messages to pass between pairs of EU NCBs. It involves complex electronic message structures passing through a special communication network provided by S.W.I.F.T.. A similar network will be used within the UK for CHAPS euro payments between UK commercial banks and the Bank of England. This development requires the Bank's message switching software to be upgraded. The first phase involved a hardware upgrade and was completed last April: this was necessary to enable the Bank to participate in the EMI Interlinking tests which started on schedule last month. The second phase is an upgrade of the software needed to support the S.W.I.F.T. messaging service chosen by APACS for CHAPS euro.

17 Another task is the development of the IT system which manages the collateral lodged by UK settlement banks against the liquidity advanced to them for use in CHAPS, mostly through the CGO and CMO systems. The potential introduction of a euro-denominated parallel system, and the interconnections with the rest of Europe through TARGET, complicate the way in which this collateral may be held and the liquidity advanced.

18 Finally, the Bank is examining the implications of the range of alternative ways of making euro payments and of the alternative sources of euro liquidity, as a contingency against the possibility both that the UK opts 'out' and the ECB restricts the supply of euro liquidity available.

19 As a member of CHAPS, the Bank is preparing to handle both euro and sterling-denominated payments on behalf of its own customers, and to make the changes necessary to interface with the revised CHAPS systems. If the UK does not join EMU, and possibly if it does as explained in Chapter 2, CHAPS euro and the present sterling CHAPS system will co-exist. Customers with euro accounts will be able to make and receive payments through CHAPS euro and into TARGET. To effect this, the Bank is developing a new link between the Bank's CHAPS payment system and the CHAPS euro network. The Bank will be involved in trialling the new software in line with the established industry-wide timetable. This and the associated reconfiguration of its main banking system to hold euro-denominated accounts for customers alongside sterling accounts is by far the most substantial of the tasks needed only if the UK is not a member of EMU on 1 January 1999.

20 To handle payments denominated in sterling, or where the receiving customer has only an account denominated in sterling, banks will be expected to provide conversion facilities. The Bank will do so for its own customer business.

21 In addition to the necessary development work for wholesale payments, the Bank is also preparing to incorporate for its own customer business the changes under discussion for retail payments traffic.

Settlement systems

22 The Bank has been considering the changes to settlement systems required by EMU. This work is being undertaken by a new EMU project team within the Central Gilts and Money Markets Office, which will consult users of the services on the detailed proposals as soon as practicable.

23 The same team is concerned with CMO (which unlike the forthcoming upgraded version of CGO does not have multi-currency functionality), and is investigating whether, if the UK is 'out', a clone of CMO should be established to allow settlement of euro-denominated non-fungible bearer instruments in London. If the UK is 'in', CMO will immediately become a euro-denominated service and outstanding instruments issued in sterling will be shown on the system in euro, although the instruments themselves (held in the Bank's vaults) will remain in sterling. Details of the sterling and euro CMO services will be discussed with members of CMO during the next few months.

Back office systems

24 A major part of the Bank's banking business supports the Bank's market operations in the foreign exchange, gilt-edged and money markets. Deals executed in these markets have to be settled and this work is carried out in the Customer Settlement Services (CSS) area of B&MS.

25 If the UK is 'in', *inter alia* significant changes will be required to the treatment of the UK holdings of gold and foreign exchange reserves, which the Bank currently manages on behalf of HM Government. The NCBs of participant Member States will provide the ECB with a total of up to euro 50 billion reserves which are likely to be redeposited with NCBs for custody and management. Transactions relating to the UK share of the ECB pool would need to be kept distinct from all other transactions, separately accounted for, and subject to separate risk management under ECB guidelines. CSS and MSD are currently evaluating the best way to provide the necessary facilities; as well as those which follow the Chancellor's recent decision that the Bank will have its own separate pool of foreign exchange reserves. The Bank may use these at its discretion to intervene in support of its monetary policy objective. CSS will be drawing up requirements for system changes in the near future, following which implementation will start, and continue through to the end of this financial year, with testing and trialling due to take place thereafter.

26 The Bank's systems for the settlement of open market operations are being adapted to ensure that they are capable of accommodating the methods by which the ESCB will conduct operations in the euro money market.

BARCLAYS

B: A CONTRIBUTION FROM BARCLAYS BANK

Introduction

27 For many customers, the euro will not be just another currency. The impact on them and on the banking system is substantive, affecting many services. Barclays has had to stand back from the obvious logistical challenges and consider how customers will take the opportunity to do things very differently, not only in 1999, but beyond.

Planning assumptions

28 The Barclays central planning scenario is to prepare now for EMU happening on time on 1 January 1999, initially with the UK 'out'. Other scenarios regarding the possible timing of UK entry are subject to continuous review. In any event, it is Barclays' position that a minimum notice period of 36 months should be given preceding UK membership of EMU. This will allow sufficient time for all parts of the UK economy, particularly retail areas, to prepare.

Group euro programme structure

29 Group leadership is provided by the Group Euro Steering Committee chaired by the Executive Director for Planning, Operations and Technology. This Committee oversees the direction of the Group euro programme and has oversight of all the key risks and issues. Its primary current focus is on preparing for UK 'out' on 1 January 1999. The EMU Co-ordination Committee below it is a sounding board for ideas and a forum for exchanging views.

30 Ad hoc working parties are convened to discuss issues of common interest such as settlement options and industry management. Short-term projects have been established to develop and deliver Group policies in critical areas such as ensuring continuity of contract. Barclays has also provided technical input into official thinking about how to implement EMU since the outset through its EU Adviser.

Business unit ownership

31 Preparation is taking place across all Business Units within Barclays with help from a small Group Euro Programme team within the Group Payments Strategy team. Necessary action, however, crosses boundaries and there are many cross-dependencies.

32 The central team has specified the scenario planning, but individual Business Units are actively responsible for impact assessment, determining requirements, and setting out implementation plans. Each has an executive accountable for euro compliance, defined processes in place and, where appropriate, dedicated resource. There is a recognition that in order to succeed, mere systems compliance will not be enough. Business considerations and opportunities must drive the technical conversion. Competition will undoubtedly intensify and relationships will become more concentrated. The catchment area for corporate and retail services requires redefinition. This will impact on business, on systems and on delivery.

The impact of EMU on our customers

33 Life in the euro world will inevitably be a good deal more competitive than is generally the case today. The elimination of foreign exchange costs and risks will benefit the corporate sector as a whole and may encourage the expansion of trade between Member States. The euro could eventually become a serious rival to the dollar and the yen as a major world currency, not only for transacting trade but also as an investment and reserve currency. More closely integrated markets will enhance finance flows to the benefit of the money markets, with short-term interest rates having been effectively equalised with effect from the beginning of EMU. Lending margins in general will be driven down as borrowers are able to raise currency loans without restriction across the euro zone. Competition will be further intensified as pricing becomes increasingly transparent. EMU will open up new opportunities for wider diversification across the entire euro zone. More investors will develop an appetite for international savings and investment products.

34 Many customers have undertaken little or no planning for the euro. Action taken by Barclays to improve understanding includes the distribution to all business sector customers of an explanatory booklet and a series of country-wide seminars. Detailed workshops have also been held to create an understanding of the potential service requirements.

The service capability being created

35 At Barclays, work is under way to evaluate the potential effects of the euro on supply chain payments and receivables. On one hypothesis, the larger UK companies with European trade flows may, even in the UK ‘out’ scenario, actively seek to impose the euro as the dominant currency for settlement down their UK domestic supply chain. Various options will be available for euro settlements on a cross-border basis, including TARGET and the EBA Clearing. Barclays executives are active in the key industry developments. Barclays is working to determine how

best to manage access to these systems and, more important still, access to euro liquidity and collateral.

36 The impact of the euro on cash and treasury management, and the consequent need for enhanced payment and information reporting capability, is self-evident. Barclays will position itself to offer sophisticated service offerings across various countries, encompassing euro netting, sweeping and pooling at Group level.

37 In addition, introduction of the single currency will give rise to significant shifts in bonds, money market and foreign exchange trading, which will require numerous process changes. Barclays aims to offer a full euro service capability across capital markets from 1 January 1999.

Allocating resources

38 Euro capability will not come cheap either in terms of IT spend or of customer and staff education; and existing revenue streams, from foreign exchange and payment traffic for example, will also be significantly reduced. To compensate, Barclays recognises the need to develop innovative solutions in order to continue to add value. By incorporating euro capability into other strategic initiatives, Barclays plans to mitigate the cost of EMU whilst continuing to move the business forward in the favoured direction.

Ensuring that developments are monitored

39 Having established the right framework and the risk management processes, it is the responsibility of the Group Programme Support Office to track all the necessary actions, risks, assumptions and issues through the progression of milestones and consolidation of reports. Through comprehensive planning and preparation, Barclays is confident of being able to offer a comprehensive range of competitive services from the outset of EMU.

HSBC

C: A CONTRIBUTION FROM HSBC

Introduction

40 While it remains uncertain whether the single currency will be introduced in January 1999, HSBC Holdings took the view some time ago that the only prudent course for a major financial organisation such as itself was to plan and prepare for the new currency and to be ready to participate actively in it from day one.

41 The HSBC Group’s wide range of products and services, delivered through some 5,000 offices in 78 countries and territories, will be affected to varying degrees by the introduction of the euro. Midland Bank, which is responsible for the HSBC Group’s retail and corporate banking activities in the UK and Continental Europe, will be impacted most heavily and is

leading the Group's EMU preparations. Operations in other parts of the world - such as HongkongBank in Asia - also need to prepare, since they generate business in EU markets and handle transactions and accounts in EU currencies.

Programme structures

42 Midland Bank has put in place the following structures to co-ordinate and manage its EMU preparations:

- *an EMU Executive Steering Committee*, chaired by the Deputy CEO, responsible for EMU strategy, programme supervision, marketing and communications plans, resource allocation and cost control;
- *an EMU Programme Management Group*, responsible for screening and prioritising EMU IT projects, identifying any gaps or inconsistencies, and keeping the programme on schedule;
- *a small number of full-time executives*, to co-ordinate overall and IT-specific preparations;
- *nominated EMU Managers* in all major business lines and functions, to identify customer requirements and to direct implementation; and
- *quarterly updates* submitted to the Board of Directors.

43 At the HSBC Holdings level, the Group Planning Department co-ordinates preparations across the Group, and submits quarterly reports to the Group Executive Committee. EMU co-ordinators have been appointed in all major subsidiaries, global product management units, and global support functions such as IT, Legal, Finance and Training. The HSBC Group, principally through Midland Bank, is also represented on a number of industry bodies.

Products and services

44 Whether or not the UK participates initially, wholesale markets and customers will be affected from the outset, and the HSBC Group's priority is to be able to meet this demand. For instance, Midland Bank is preparing to offer at least the following euro products from January 1999: current accounts; loans and deposits; payments and cash management services; documentary credits and other trade products; foreign exchange, futures, swaps and options; and corporate and government bond trading.

45 Given the uncertainty about UK participation, and the likely limited demand from retail customers during the 'no compulsion, no prohibition' phase, preparations for retail banking products and services in euro are being undertaken on a contingency basis at this stage.

Technical preparations

46 Within Midland Bank, EMU systems changes are being undertaken separately from work relating to Year 2000. Feasibility studies have been completed by business and IT managers to determine the changes required to systems to enable Midland to deliver the required products and services during and after the transition to the euro.

47 This work has also allowed an estimation of IT resource implications: it suggests that EMU work will at its peak occupy some 20% of Midland's computer programmers, if the UK is 'in', but only 5-10% if the UK is 'out'.

48 The next phase of the systems development process, external design, is now underway. In some areas this has to be an iterative process, as business managers are as yet unable to specify in full detail what is required, in part because they are still awaiting decisions by the authorities, industry bodies and others.

49 Not all business requirements need to be developed and implemented simultaneously, and they have been divided into four categories:

- changes required to load the euro as a foreign currency on to systems in advance of January 1999 to support grey/forward trading;
- changes required by January 1999 whether or not the UK joins EMU;
- changes required by January 1999 only if the UK joins; and
- changes which must or can be delayed until later in the transition period.

50 Systems issues go beyond simply adding another currency to existing multi-currency systems. Banks will need to offer complete fungibility between 'in' currencies and the euro during the 'no compulsion, no prohibition' period. Systems capacity will have to allow for some duplication during this period: for instance foreign exchange systems may have to cope with all existing currency pairs plus a series of new pairs. Also, during the transition period, financial institutions may, in some cases, need to hold, transmit, and present data in dual currency form.

51 Common systems are widely used throughout the HSBC Group and the changes required to ensure EMU compliance are being developed centrally. These will be rolled out to multiple sites as a core release. A number of systems are scheduled for replacement, and these will not be upgraded: successor systems under development will be able to cope with the euro, and migration will be expedited if necessary.

52 In addition to addressing the IT implications, work is underway to establish and agree operational procedures during the transition period. The effort of redenominating outstanding transactions, securities and positions will be considerable, involving audit trails, reconciliations and confirmations. This task will extend over a considerable period because of the need to reach agreement with counterparties.

53 The introduction of TARGET, and establishment of TARGET operating days which are not compatible with national bank holidays, will require extended operating hours; new staffing arrangements are being examined to cope with these. Also, certain business areas will need to adjust to new market conventions, reference rates, price sources, settlement and clearing arrangements; these are now progressively being clarified, allowing preparatory work to get underway.

Communications

54 Many customers are looking to the banks for advice on EMU preparations, as well as for information on the euro products and services that the banks intend to offer. Midland Bank has completed the first phase of an on-going programme of EMU briefings for its customers, focusing on the practicalities of the introduction of the euro. Brochures and one-on-one meetings complement these briefings. Similar seminars have also been held by the HSBC Group in other locations around the world.

55 Internal communication has until recently been focused on staff actively involved in preparations for EMU and relationship managers responsible for large or trade intensive customers. However, the first broader training module, for Midland Bank's staff throughout the UK, has just been released.

Strategic issues

56 Beyond the simple conversion of existing activities to the new currency, the HSBC Group also seeks to address - and take advantage of - the changes to markets and competition that EMU is likely to bring. The Group is reviewing the adequacy and the configuration of operations - particularly payments, cash management and capital markets capabilities - within the likely future euro zone, and making changes where needed. In this way the HSBC Group hopes that, after bearing the costs and risks of transition, it will in the medium and longer-term derive benefits from the introduction of the euro.

MARKS & SPENCER

D: A CONTRIBUTION FROM MARKS & SPENCER

The key assumptions

57 The euro has become an issue which raises strong emotions among our customers, on both sides of the argument. Our position is a proper impartiality, which acknowledges that the economic questions have left experts divided, and that we are fortunate in having no responsibility for the difficult decisions which will affect us all in the future, but whose implications are not capable of accurate forecasting.

58 But we also have to be ready! We trade directly with the public in Ireland, France, Germany, Spain, Holland and Belgium. We also operate through franchises in Austria, Portugal, Greece and the Channel Islands. In our owned operations, many of the systems involved are clones of those we use in the United Kingdom, developed and maintained in this country for use abroad. It would be reckless to plan on the assumption that the euro will not be introduced on schedule in at least some of these countries.

59 On the other hand, no single assumption would suffice. Germany, France and the Benelux countries are the most probable 'starters', but how should we rate the chances of the other names on the list, not least the UK? In practice, we need a series of contingencies that deal with the various permutations of 'ins' and 'outs', the most critical of which will, of course, be the status of the UK itself.

60 From that point, we must make further assumptions in order to plan for the practicalities of accepting the new currency. The most important concern the timetable for introduction and the way in which the changeover is to be managed. We have to make a prudent assumption that the original timetable will hold, and that we need to be ready well before the present 2002 E-day (which most retailers pray will be deferred or brought forward from the horrendous date of 1 January, the worst possible day for a busy retailer, excepting possibly Christmas Eve!). We also have to make assumptions about how the new currency will be introduced. The present plan provides for a six-month period of dual operation, the old national currencies co-existing with the euro. We have assumed the following pattern of events:

- that the new banknotes will be dispensed primarily by the banks through ATMs, many of which will not be converted for days or weeks after E-day for practical reasons;
- that coin will be obtained primarily from the tills of the major retailers. This will mean that we have to handle some ten times or more the normal volume of coin during the early days of the handover;
- that we must accept both currencies with equal speed and efficiency, but will need to dispense change only in euro. It may be possible to handle specially those customers who want to retain the old currency until the last possible moment, but it will be impractical to dispense change in both currencies at every till point; and
- that the practical difficulties involved can be minimised but not altogether avoided, and that they will rapidly decline in importance after a peak period lasting only for the first few days or weeks. Within one month of E-day, we anticipate that declining volumes of the old currencies will be offered, and the transition will be substantially complete. Acceptance of the old currencies will not constitute a problem and can continue, irrespective of legislation, for as long as customers require it.

61 The most important assumptions are those we make about the behaviour of our customers, many of whom will be confused by and distrustful of the change. We must retain their trust and confidence, demonstrating that the change itself is not the excuse for a price increase, and giving help to all those that need it when trying to adjust to new benchmarks of value.

Planning for the change

62 The complexities are such that a euro project needs to embrace practically every area of a business, and too centralised a planning group may not grasp all the ramifications of the new currency. Our own planning group is sponsored at board level, and managed by a steering group of those most involved at divisional director level. The responsibilities of the steering group include: overall review of progress; making the decisions which cross the boundaries of different parts of the business; and ensuring that the different areas are locked in to the process and 'own' a proper sense of urgency and involvement in the outcome.

63 Below the steering group, a full time Project Manager is being appointed, supported by a central project team. They are charged with co-ordinating the plans and decisions of the key areas within our business which must implement the changes, and with monitoring their progress.

64 The key areas for Marks & Spencer include: general merchandise supply chain management; food supply chain management; store operations and management; European operations; and financial services. The list is not a complete one but it is in these areas that we will face the major threats and opportunities to our business, and it is here that the crucial commercial decisions must be taken, rather than the specific practical measures needed to put them into effect.

65 Most involved of all perhaps will be our IT department and its teams devolved to the key operating areas. Almost every aspect of the change will have a software implication, coinciding neatly with the millennium timetable and all its problems. Small wonder then that skilled IT managers are becoming a very scarce resource!

Identifying the tasks

66 The team have put together their first analysis of the work involved, listing a series of questions under the headings such as: customer service policy; pricing; display policy; store cash handling; supplier relationships; education and training; financial services customer accounting; and financial reporting.

67 For each question, a matrix will identify which areas of the business need to be involved in the decision and the implementation plan required. Assumptions to exclude other areas must be checked for infallibility! Priorities within the critical path can then be established and the role of the project team defined in either driving decisions that cross many areas or co-ordinating those which lie more specifically within a given area of specialisation.

68 How complex is the problem? We find a high level of agreement as to what the main issues are and the right solutions, not just within Marks & Spencer but among our competitors in the UK and Continental Europe. But we also have to keep our ears to the ground to follow the progress of crucial public sector debates which will shape the enabling legislation around Europe, particularly in the field of consumer protection, with all its implications for display.

69 Everyone will have their own ideas as to how the public will react and handle the change in their daily lives. Accurate anticipation of our customers' behaviour will shape our own degree of success in this involved process which will affect every individual's shopping habits. Our objectives for the project reflect this: to maintain the trust of our customers, and to minimise the disruption to them and to us.

CHAPTER 8: PUBLIC SECTOR PREPARATIONS

A CONTRIBUTION FROM HM TREASURY

1 HM Government continues to be fully involved in EU Working Group meetings on the practical and legal issues raised by the single currency. The state of preparations by public authorities varies across the EU. Most Member States have issued national changeover plans setting out the strategy that they will follow when they join the single currency. If the UK were to decide to join, the Government would need to set out its approach.

2 About half of the Member States in the EU have signalled their intention to allow companies to use either the euro unit or the national currency unit for their dealings with public authorities during the transition period. Others expect there to be restrictions on the use of the euro unit for some purposes, such as tax declarations, until the transition period ends. Member States able to offer the option to firms to use either unit for their transactions with public authorities have relatively small government systems, while those which do not expect to be able to handle the option of either unit for all purposes tend to have larger systems.

3 As part of its initiative to help businesses prepare, Government departments are expected to be involved with the work of the Advisory Group. Some departments, such as HM Treasury, the DTI, the Inland Revenue, and Customs & Excise are already beginning to discuss the technical and legal implications of EMU with business representatives.

4 The Government has also signalled its intention to raise the level of debate across the country about EMU. As part of this exercise, it has published the summary of a survey by Professor Currie about the pros and cons of joining EMU (this is referred to in Chapter 5 and available from the address shown there).

A CONTRIBUTION FROM THE SIB

5 As previously reported, the SIB has set up an EMU Working Group to assess the key practical implications that the introduction of the single currency will have on the regulation of investment business in the UK, whether or not the UK is a participant. The Group comprises representatives from the SIB, SFA, IMRO, PIA, the recognised UK exchanges and clearing houses, HM Treasury, and the Bank of England. It aims to co-ordinate work undertaken by these organisations in readiness for EMU, and will continue with its activities during the period of regulatory reform now under way.

6 Members of the Group are keeping in close touch with the financial services industry. The front-line financial services regulators intend to issue in due course guidance to assist regulated firms in their own preparations for EMU. They will also be looking at the needs of investors for information about the implications of the euro wherever it is introduced in the EU. In addition, the relevant UK regulators will issue guidance on the treatment of the euro and its participating currencies for the purposes of calculating capital adequacy requirements.

CHAPTER 9: OVERARCHING ISSUES

THE LAW

Regulations on the euro

1 There will be two Regulations to introduce the euro under the law. Their respective roles and structure are shown in Chart F. The first Regulation, under Article 235 of the Treaty, was formally adopted on 17 June, and is now in force in all the Member States, including the UK. (The UK's Parliamentary scrutiny reserve was lifted just before the Amsterdam Summit in June.) This Regulation deals with the status of the ECU, the continuity of contracts denominated in ECU and the national currencies of participating Member States, and conversion and rounding provisions.[1]

2 The other Regulation on the euro, under Article 109l(4) of the Treaty, has been substantially agreed (subject to fine-tuning of some provisions as indicated in Chapter 6), but it cannot formally be adopted until the participating Member States are chosen, since only they can vote on it.

3 Attention has recently focused on the first indent of Article 8(4), which deals with redenomination, and a new text was finally agreed at the Amsterdam Summit. The relevant part of the Article reads as follows:

> ' *Notwithstanding the provisions of paragraph 1, each participating Member State may take measures which may be necessary in order to:*
>
> *- redenominate in the euro unit outstanding debt issued by that Member State's general government, as defined in the European System of Integrated Accounts, denominated in its national currency unit and issued under its own law. If a Member State has taken such a measure, issuers may redenominate in the euro unit debt denominated in that Member State's national currency unit unless redenomination is expressly excluded by the terms of the contract; this provision shall apply to debt issued by the general government of a Member State as well as to bonds and other forms of securitised debt negotiable in the capital markets, and to money market instruments, issued by other debtors;'*

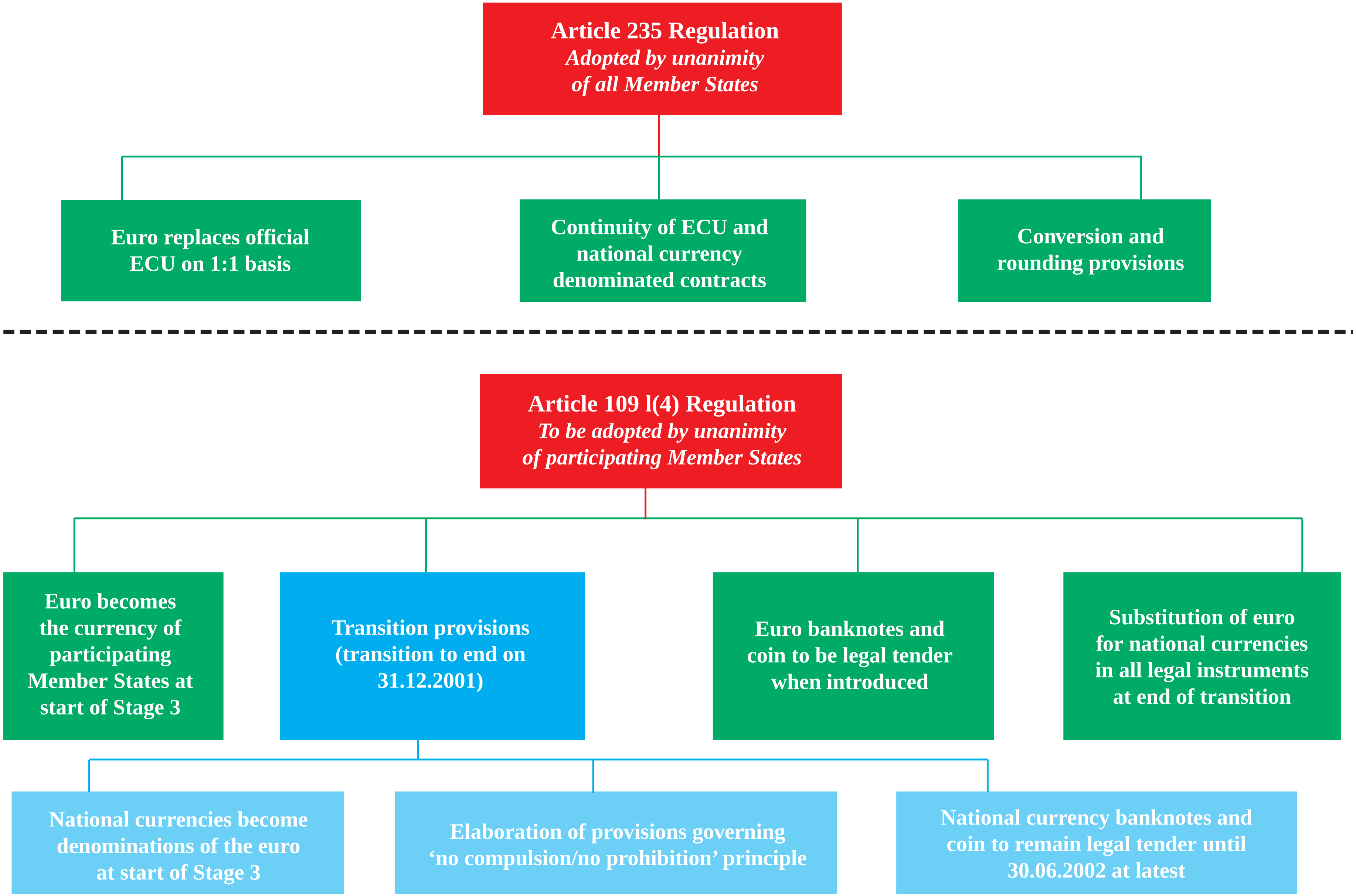
The related Recital (number 14) reads as follows:

> *'Whereas in accordance with the conclusions reached by the European Council at its meeting held in Madrid, new tradeable public debt will be issued in the euro unit by the participating Member States as from 1 January 1999; whereas it is desirable to allow issuers of debt to redenominate outstanding debt in the euro unit; whereas the provisions on redenomination should be such that they can also be applied in the jurisdictions of third countries; whereas issuers should be enabled to redenominate outstanding debt if the debt is denominated in a national currency unit of a Member State which has redenominated part*

1 The conversion and rounding part of the Article 235 Regulation was described in detail in the December 1996 *Practical Issues*, page 51.

THE BUILDING BLOCKS OF THE REGULATIONS ON THE EURO

CHART F



or all of the outstanding debt of its general government; whereas these provisions do not address the introduction of additional measures to amend the terms of outstanding debt to alter, among other things, the nominal amount of outstanding debt, these being matters subject to relevant national law;...'

The term 'redenominate' is defined in Article 1 as follows:

'"redenominate" shall mean changing the unit in which the amount of outstanding debt is stated from a national currency unit to the euro unit, as defined in Article 2, but which does not have through the act of redenomination the effect of altering any other term of the debt, this being a matter subject to relevant national law.'

4 The intention of this Article is to provide an exception to the principle (set out in Article 8(1)) that contracts denominated in a national currency unit or the euro unit should be performed in those respective denominations. Article 8(4) allows each participating Member State Government issuer to redenominate unilaterally its own debt denominated in its national currency unit and issued under its own law. If, and only if, a Member State Government has done so, other Government or private sector issuers may also redenominate their own issues in that national currency unit, unless there is express provision to the contrary in the terms of the contract. In this context only simple redenomination is envisaged (as is made clear in the definition given in Article 1 of the Regulation).

5 Any steps to achieve renominalisation or reconventioning could only be undertaken in accordance with the terms of individual contracts, themselves subject to national contract law. This may be how the recent French Government announcement, that French franc Government securities will be redenominated to the nearest euro rather than euro cent, will be effected.

6 Article 8(3) provides another exception to the general principle set out in Article 8(1). Some of its implications appear to be as follows:

- a bank in a participating Member State receiving a payment denominated in that Member State's national currency unit for the account of a creditor during the transition period is obliged to convert the amount into the euro unit, if that is the denomination of the creditor's account, and vice versa;
- the obligation applies to cross-border payments received for the account of a creditor at a bank in a participating Member State, as well as domestic payments;
- the obligation does not apply to payments into and within non-participating Member States and third countries, but payments from these countries are covered in the same way as cross-border payments;
- if a creditor accepts a cheque denominated in the national currency unit of the participating Member State where his account is located and the cheque is paid into his bank account, the bank is obliged to convert the amount into the euro unit, if that is the denomination of the creditor's account, and vice versa; and
- apart from the obligation to convert payments received for the account of a creditor, banks are not obliged to offer payment facilities or accounts in any particular denomination during the transition period under Article 8(3).

7 This is consistent with the preliminary assessment which we provided in the December edition.

Application of the Article 109l(4) Regulation in the UK

8 If the UK opts out, the Article 109l(4) Regulation will not apply directly in the UK by virtue of paragraph 5 of the UK Protocol to the Maastricht Treaty. However, certain provisions would almost certainly apply indirectly because they are part of the 'law' of the euro area, and would therefore be recognised by the English courts. Such provisions would include Articles 2, 3 and 6(1), which introduce the euro as the currency of the participating Member States in substitution for their existing currencies and provide for the continued existence of national currency units as non-decimal denominations of the euro. The question arises as to whether it would be to the benefit of the UK to introduce into UK law through national legislation any of the provisions of the Regulation which will not otherwise apply. Preliminary soundings from market groups such as the City of London Joint Working Group (CLJWG) suggest that there is no compelling case for legislation. The Bank is continuing to seek market views on this issue. It would be a matter for the Government to consider, if there were arguments in favour of national legislation.

Continuity of contracts

9 The April edition suggested that specific continuity clauses in *bond* contracts were probably not necessary, given the terms of the Article 235 Regulation. However ISDA considers that, in the context of privately negotiated *derivative* transactions, there may be some benefit in addressing the issue of continuity by way of an express contractual term.

10 As foreshadowed in the December edition, ISDA has therefore drafted a continuity provision for use in existing and future ISDA Master Agreements where the parties wish to confirm that EMU will not give either party the unilateral right to 'walk away from', or modify, the terms of any transaction governed by such an agreement. The intention is that the inclusion of this provision will not be inconsistent with the Article 235 Regulation, or with actual or proposed US legislation on similiar lines in the States of New York, Illinois and California; but it will provide guidance on all the matters covered by the parties' written contract. The provision also contemplates parties agreeing and expressly providing for the settlement or modification of particular transactions. The ISDA continuity provision (see box) is already being used in new contracts.

11 Meanwhile the Financial Law Panel (FLP) recently published a Report on the effects of EMU on continuity of contracts under the law of Japan. This was generally reassuring: the likelihood is that the Japanese courts would uphold the concept of contract continuity where a participating Member State's currency is used for payment, or is the reference point or object of a contract, although the FLP emphasised that contracts need to be examined individually. Studies following the same format and dealing with the same issue will be published separately in relation to the law of Hong Kong, New York, Singapore and Switzerland.

12 The FLP's study of continuity of contract issues under English law is also nearing completion. This will examine in detail the implications of the economic changes consequent upon introduction of the euro for individual financial markets in London; and set the legal

ISDA EMU CONTINUITY PROVISION

[16]. EMU; Continuity of Contract[1.]

(a) The parties confirm that, except as provided in subsection (b) below, the occurrence or non-occurrence of an event associated with economic and monetary union in the European Community will not have the effect of altering any term of, or discharging or excusing performance under, the Agreement or any Transaction, give a party the right unilaterally to alter or terminate the Agreement or any Transaction or, in and of itself, give rise to an Event of Default, Termination Event or otherwise be the basis for the effective designation of an Early Termination Date.

"An event associated with economic and monetary union in the European Community" includes, without limitation, each (and any combination) of the following:

(i) the introduction of, changeover to or operation of a single or unified European currency (whether known as the euro or otherwise);

(ii) the fixing of conversion rates between a member state's currency and the new currency or between the currencies of member states;

(iii) the substitution of that new currency for the ECU as the unit of account of the European Community;

(iv) the introduction of that new currency as lawful currency in a member state;

(v) the withdrawal from legal tender of any currency that, before the introduction of the new currency, was lawful currency in one of the member states; or

(vi) the disappearance or replacement of a relevant rate option or other price source for the ECU or the national currency of any member state, or the failure of the agreed sponsor (or a successor sponsor) to publish or display a relevant rate, index, price, page or screen.

(b) Any agreement between the parties that amends or overrides the provisions of this Section in respect of any Transaction will be effective if it is in writing and expressly refers to this Section or to European monetary union or to an event associated with economic and monetary union in the European Community and would otherwise be effective in accordance with Section 9(b).

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1 This clause on European Monetary Union may be (i) included in Part 5 of the Schedule to a 1992 Multicurrency-Cross Border ISDA Master Agreement or in Part 4 of the Schedule to a 1992 Local Currency-Single Jurisdiction ISDA Master Agreement, in each case as an additional Section in the Master Agreement, or (ii) added as an amendment to an existing 1987 or 1992 Master Agreement. If the parties would also like to confirm in their Agreement the allocation of responsibility for assessing and understanding the risks associated with EMU, they may consider adding the Representation Regarding Relationship Between Parties released by ISDA on March 6, 1996, where that representation accurately reflects how the parties are acting, their capabilities and the nature of their relationship. Different language should be used, for example, if one of the parties has agreed to act as an adviser to the other party.

analysis against the combination of facts which are likely to exist, in order to identify the practical legal issues and to suggest courses of action, if necessary.

ACCOUNTING

13 The guidance on financial reporting issues referred to in previous editions has now been published by the European Commission. The paper *Accounting for the Introduction of the Euro* is available from the Department of Trade and Industry (tel: 0171-215 0232) or at http://europa.eu.int/index.htm on the internet.

14 The paper has been produced following a round of consultations within the Commission, with the Contact Committee (comprising officials from Member States) and with the Fédération des Experts Comptables Européens (FEE). The main thrust of the paper reflects the broad agreement of the Contact Committee but, since it has not been through any formal approval procedure, it remains guidance and is not mandatory.

15 The paper is concerned with external financial reporting issues arising within participating Member States rather than the internal accounting of undertakings. It covers the effective date of the introduction of the euro, the implications for foreign currency translation, comparisons with pre-EMU amounts, and the treatment of the costs associated with the changeover.

16 The three key conclusions set out by the Commission are:

- the introduction of the euro can be treated within the existing framework of European accounting legislation;
- no amendments to the existing Directives are required, nor any additional Directive; and
- Member States can use existing accounting practices to accommodate the changeover to the euro.

17 The Commission argues that, in respect of financial years ending 31 December, the most common date within the EU, the fixing of parities between euro and national currency units to be effective from 1 January 1999 should be reflected in balance sheets drawn up as at 31 December 1998.

18 The Commission also argues that any gains arising on the translation of incomplete transactions expressed in one participating currency into another participating currency will constitute realised gains. This is because the fixing of the parities means that the outcome may be assessed with sufficient certainty. The Commission recognises, however, that immediate recognition of gains in the profit and loss account may not be appropriate, particularly in the case of hedges. The Commission also recognises that, because it has not been the practice in some Member States to recognise translation gains until transactions mature, the immediate recognition of accumulated translation gains may be dealt with by spreading those gains over a period of years.

19 In respect of comparative amounts included in the first set of accounts expressed in the euro, the Commission states that the only logical method is to use the fixed conversion rates to change amounts expressed in national currency into euro. Nothing more complicated is justified.

20 The Commission argues that the costs associated with the changeover should be treated as part of the costs of ordinary activities and not as extraordinary items. It also argues that it would be appropriate to set up provisions for these costs in advance only if some obligation to a third party had been created. The costs should be written off as they are incurred. It would be appropriate to capitalise only those costs which create an identifiable future benefit during the whole of the transition phase.

21 Copies of the Commission paper have been circulated to all national standard setting bodies and other organisations known to be considering the issues so that its content may be taken into account in framing any guidance which those organisations are considering whether to issue.

22 There are no significant developments to report in respect of EMU-related activity by domestic groups of accountants. However, the Europe-wide projects being undertaken by FEE, foreshadowed in the April edition, are well under way. These include a database (accessible at http://www.euro.fee.be), newsletters, checklists, surveys, and conferences. There are also help-desks in six Member States, including the UK (tel: 0181-667 1144; e-mail noel.hepworth@ipf.co.uk). Research is also being undertaken into the impact on software of the introduction of the euro and on company treasury management.

TAXATION

23 A paper identifying UK tax issues arising from EMU was prepared by ISDA's EMU Accounting, Tax and Capital Task Force, and submitted to the Inland Revenue in early July. The Task Force also included representatives of LIBA, BBA, IPMA, ISMA and ABSAL. The paper argues for continuity and certainty of tax treatment following the introduction of the euro. The paper seeks to separate tax issues which will only arise if the UK is 'in' from those which would also arise if the UK remains 'out'. Specific issues are identified in respect of financing, loan relationships, equities, foreign exchange, and financial instruments, with analysis of the impact of EMU and proposals for remedial action if needed. A meeting is being arranged to explain the proposals to the Inland Revenue; subsequently the Bank will arrange a broader discussion.

24 The BBA held a meeting with the Inland Revenue in June to clarify the tax treatment of software development expenditure associated with the introduction of the euro.

INFORMATION TECHNOLOGY

IT implications of the euro

25 The Bank has continued to raise awareness of the IT implications of the euro, through discussions with a range of interested bodies and participation at conferences discussing this subject.

26 There is a growing appreciation of the considerable IT implications of the euro for a large number of businesses, whether or not the UK joins at the outset. It is clear that all businesses will be affected if the UK joins. The April *Practical Issues* contained a summary of action required by companies on IT systems, and the December edition contained a list of questions about IT that Chief Executives need to address.

27 The BCS is to publish in August a booklet discussing the IT implications of EMU, similar to that on the Year 2000 problem. It has been produced with assistance from the Bank. It discusses the IT implications for business entities of all sizes, ranging from one-person businesses to international conglomerates, and considers the differing implications for IT according to whether the UK joins EMU at the outset or not. It should be of interest to both general management and

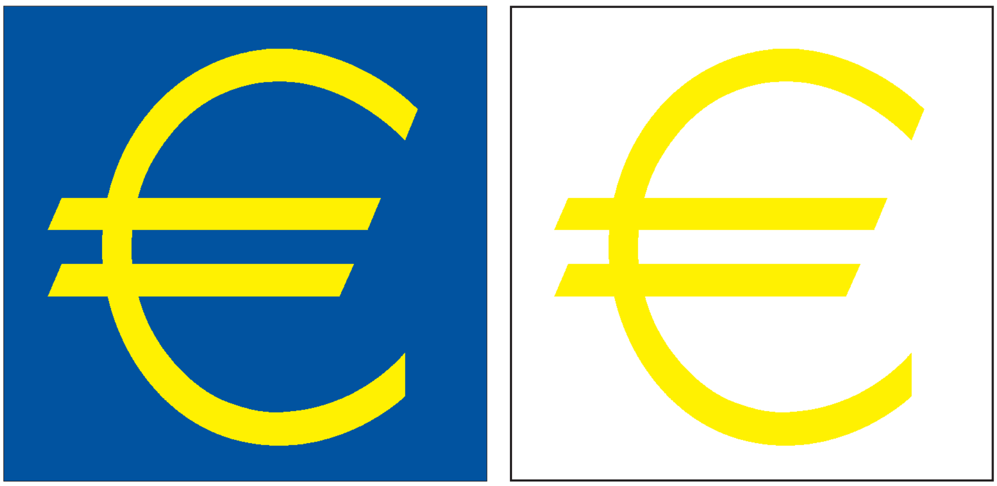
IT specialists. It will be available, at a charge, from the British Computer Society at FREEPOST, Publications Department (Euro), Swindon, Wiltshire, SN1 1BR (tel: 01793 417424, e-mail ijones@bcs.org.uk).

28 BASDA and CSSA are also jointly producing a paper on IT preparations.

A symbol for the euro

29 The ISO 4217 Maintenance Agency adopted the currency code ‘EUR’ for the euro on 21 April with immediate effect. The European Commission and the EMI welcomed this step.

30 The proposed symbol for the euro (shown below) was originally unveiled by the Commission at the Dublin Summit last December. The Council of the EMI gave its support for the symbol at its meeting in July. The Commission has now published a Communication setting out the technical specifications for the euro, announcing its own intention to use it and inviting others to do the same.



CHAPTER 10: MONETARY AND FISCAL POLICY

MONETARY POLICY IN STAGE 3

1 The EMI published in January the main features of the operational framework for monetary policy operations in Stage 3[1], which were summarised in previous editions of *Practical Issues*. A much more detailed account of the monetary policy instruments and procedures planned for Stage 3 is due to be published in a further Report by the EMI this autumn. This new Report should be studied carefully by all potential counterparties of the ESCB.

2 In areas where the ECB may impose burdens or penalties, it may do so only within parameters set down by the EU Council of Ministers. Draft texts of EU Council Regulations forming a framework for the operation of minimum reserves, the collection of statistics and the ECB's powers to impose sanctions were all published in the January EMI document. These drafts have been discussed in the EU Monetary Committee (on which both Governments and NCBs are represented) on behalf of the EU Council of Ministers and will now go back to the EMI for further consideration.

3 Further discussion of the EMI's plans for monetary policy instruments and procedures has led to some amendments as well as further elaboration. A number of these amendments relate to the handling of underlying assets ('collateral') used in monetary policy operations, reflecting renewed consideration of the extent to which settlement arrangements in different Member States (and the NCBs' own back offices) can or cannot be adapted by the start of Stage 3.

4 The largest change is to the margining arrangements envisaged for eligible paper included in the ECB's tier 1 list. The *Framework Report* envisaged only the use of initial margins for such paper. Initial margins, especially for longer-term operations, would have had to be set very high adequately to control market risk (the risk that the market price of the underlying asset might fall in the course of the three months for which these longer-term operations will be outstanding). It is now accepted that underlying assets should be revalued at least weekly and that margin calls should be made if the revaluation reveals a material discrepancy between the market value of the assets and the required value. This will enable lower initial margins to be set than would have been the case under the original plan, both for the main (two-week maturity) operations and for the longer-term (three-month) operations. The precise level of margins will however be decided later by the ECB.

5 Another change relates to the settlement of the ESCB's operations; it is now accepted that, at least at the beginning of Stage 3, securities settlement systems will not be sufficiently harmonised for settlement to take place at precisely the same time of day in every participating Member State. On the other hand it has become clear that the cross-border use of eligible paper can in nearly all cases be undertaken using the 'Correspondent Central Banking Model' - described in the April edition of *Practical Issues* - and that a variation on that model will be needed only to deal with some specific types of non-marketable tier 2 paper.

1 *The Single Monetary Policy in Stage Three - Specification of the Operational Framework.*

6 As public holidays across the euro area are unlikely to be harmonised, the proposal is now that the timetable for the ESCB's main and longer-term open market operations should be adapted so these operations take place on days on which counterparties in all participating Member States can take part - both as regards the trade day and the day on which the operation is settled (now normally T+1, or the business day after the trade day). The ECB would publish in advance an annual calendar of these operations. Fine-tuning operations could take place on any day on which trade and settlement would be possible in at least one Member State. Fine-tuning operations would normally be settled on the trade day itself (T+0). Access to the ESCB's standing facilities would be possible on any day on which the relevant NCB, and national RTGS and settlement systems, were operating.

7 More work is being done to prepare the legal documents that will govern the ESCB's monetary policy operations. Given continuing differences between the legal systems of Member States, national documentation may be needed in many cases. But in some areas it will be possible to draw up standard documentation to be used with only minor local variations in many, if not all, jurisdictions. Where this is possible, notably in the case of a Standard Master Repurchase Agreement, the Bank of England would plan to make use of such standard documentation.

8 Among the issues covered by the draft EU Council Regulation on minimum reserves is the definition of the potential reserve base ('eligible liabilities' in UK terminology). The current draft still includes the power to impose reserve requirements on off-balance sheet items. However reserve requirements, if imposed at the start of Stage 3, will be based on regular statistical reports to the ESCB, plans for which do not currently include off-balance sheet items. ISDA has submitted to the EMI a paper on reserve requirements which sets out their significant dislocation effect, even if they are set at a very low level and largely remunerated, and the numerous technical difficulties which would be involved in applying them to derivatives.

9 Another issue in the definition of the reserve base is the treatment of interbank transactions (transactions with other institutions subject to minimum reserves). It is agreed that interbank transactions should be excluded, so that for the system as a whole only liabilities to non-banks should (potentially) be subject to reserve requirements. The issue is whether interbank transactions should be excluded from the reserve base of the institution whose liability they are, or deducted from the reserve base of the institution whose asset they are. The EMI's current plans are based on the first of these alternatives, whereas the Bank continues to prefer the second alternative. The problem arises in the case of tradable interbank claims (eg CDs) where the issuer may well not know whether its liabilities are held by banks or non-banks, whereas banks do know how many CDs of other banks they hold.

THE ECB'S FOREIGN EXCHANGE AND RESERVES MANAGEMENT

10 The EMI and NCBs have continued with their preparations for the systems to support the decentralised management of the foreign reserves to be pooled with the ECB. Reserves management operations will be conducted, at least at the start of Stage 3, by NCBs acting on behalf of the ECB, the latter being responsible for overall investment policy. Earlier this year a support system was specified which would link the dealing and settlement functions to be conducted by NCBs with the risk and performance monitoring functions to be located at the ECB. The tender process, launched in February, is now nearing its final stages as the short-listed

systems are subjected to detailed testing. A package will be selected before the end of this year: installation of the core system at the EMI will commence shortly thereafter, followed by preparations at NCBs to construct interfaces with their dealing rooms and settlement operations.

11 In parallel with this technical work, the EMI and NCBs are developing the policy framework for reserves management, including investment benchmarks, the measurement and monitoring of market and credit risk, and documentation relating to the markets and instruments to be used by the NCB reserve managers.

EXCHANGE RATE POLICY

12 At the Amsterdam Summit in June, the European Council reached agreement on a Resolution setting out the institutional features of a new exchange rate mechanism (ERM2) to replace the existing European Monetary System. The main features of ERM2 have been described in previous editions. The EMI and the NCBs are in the process of drafting the operating procedures of the mechanism, which will take the form of an agreement between the ECB and the NCBs outside the euro area, whether or not they decide to participate in ERM2.

13 No decisions have yet been taken on the modalities for the irrevocable fixing of conversion rates between national currencies and the euro, or about the timetable for making announcements about the fixing process. Discussions among officials have commenced on the way in which Article 109 of the Treaty, which deals with the exchange rate policy of the euro zone, could be implemented.

FISCAL POLICY

14 As foreshadowed in the last edition, the Stability and Growth Pact was agreed at the European Council in Amsterdam. This consists of a Resolution laying down the firm commitment of the relevant parties regarding its implementation, together with two Regulations on strengthened surveillance (under Article 103) and on speeding up the excessive deficit procedure (under Article 104c). It was agreed at Amsterdam that any sanctions levied under the latter Regulation would be distributed only to 'in' Member States not having an excessive deficit. In addition to the Resolution on the Stability and Growth Pact, the European Council also adopted a separate Resolution on Growth and Employment 'laying down the firm commitments of the Member States, the Commission and the Council to give a new impulse for keeping employment firmly at the top of the political agenda of the Union'.

15 Within the context set by the Stability and Growth Pact, following a request from the European Council, Member States are discussing economic co-ordination after the start of Stage 3.

STATISTICAL PREPARATIONS

16 The EMI will publish shortly a provisional list of monetary financial institutions (MFIs). Its availability during 1997 was anticipated in the EMI's July 1996 Implementation Package; it contains information necessary to enable reporting agents in Member States to put systems in place correctly to identify MFI counterparties in other Member States. The individual names which have been submitted by the NCBs represent credit institutions as defined in Community law which, in the case of the UK, covers all the banks and building societies.

17 In the foreword to this provisional MFI list, the EMI anticipates the publication later this year of an addendum to the list which will cover institutions other than credit institutions, most notably money-market funds. Further work is being undertaken to ensure that these institutions are identified throughout the Member States in as homogeneous a manner as possible, bearing in mind that there is no Community-wide definition of a money-market fund.

18 Within the UK, the Bank recently held a second meeting with a working party of representatives of the BBA to discuss the additional statistical reporting requirements which would be needed to meet the UK's obligations if it joined EMU.

DESIGN OF EURO BANKNOTES AND COIN

19 The EMI has released revised versions of the design sketches selected by the EMI Council in December 1996: see illustration overleaf. The modifications will facilitate production (including the incorporation of security features) and ensure the avoidance of any national bias.

20 Although other members of the EMI Council have agreed a common design to both sides of their euro banknotes, the Bank of England has made clear that it wishes to preserve the option to include a national feature on euro banknotes issued in the UK if the UK were to participate in EMU.

21 The Test Banknote Project is designed to determine the extent of differences in visual appearance between notes printed to the same technical specification but in different printing works and on paper from different suppliers. The first samples have now been produced, and any differences are currently being analysed.

22 The Scottish and Northern Irish note-issuing banks are keen to ensure that they can continue to issue their own notes if the UK is ‘in’. The ESCB Statute allows for this possibility, and their banking associations have been keeping closely in touch with both the Bank and the EMI so that, if and when appropriate, they can make formal application to the ECB Governing Council (which alone can authorise the issue of notes in the euro area).

23 Preparations are already under way in the Bank on the mechanisms for exchanging and repatriating national banknotes during Stage 3A: Article 52 of the ESCB Statute requires the ECB Governing Council to take the necessary measures to ensure that banknotes denominated in currencies with irrevocably fixed exchange rates are exchanged by NCBs at their respective par values. If the UK is ‘in’, the Bank will be ready to exchange other participating national currency banknotes for sterling notes at their respective par values. Discussions are continuing with banks and bureaux de change about their potential involvement in this process. The Bank will also arrange for any necessary repatriation of national banknotes to the issuing central banks of other countries participating in EMU.

24 The European Council in Amsterdam agreed on the designs for the common European side of the euro coins. The designs were selected after a competition. The other sides are expected to show national symbols. The Commission has proposed a set of technical specifications for coins, following work by National Mint Directors.

DESIGNS TO BE USED IN THE PREPARATION OF EURO BANKNOTES

PRACTICAL ISSUES ADDRESSED IN PREVIOUS EDITIONS

A number of issues have been explained in previous editions which remain relevant and readers may wish to refer back to them, using this list.

EMU timetable		
Madrid changeover scenario explained	Sep 96	after p46
Payments arrangements		
A brief explanation of RTGS and TARGET	Sep 96	p9
TARGET, including access to intraday liquidity	Sep 96	pp14-16
	Dec 96	pp10-12
	Apr 97	pp8-13
Securities settlement systems		
A ‘minimal change’ approach to the Bank’s systems	Apr 97	pp14-17
CREST	Apr 97	pp18-19
EMI’s work on securities settlement	Apr 97	pp20-22
Markets and exchanges		
Report of the Working Group on the Gilt Market After EMU	Dec 96	pp33-47
Report of a Working Group of market practitioners on Redenomination and Market Conventions in International Financial Markets after EMU	Apr 97	pp25-51
Practical steps necessary in the money and foreign exchange markets	Apr 97	pp54-55
Equity market (and the London Stock Exchange)	Apr 97	pp55-58
Business preparations		
The Hundred Group report: managing the changeover within a company	Apr 97	pp64-65
Retail preparations		
Retail payment systems	Apr 97	pp66-68
Other retail preparations	Apr 97	pp69-70
Overarching issues		
The Regulations on the euro	Dec 96	pp50-54
Questions about IT	Dec 96	p56
Rounding (explanation of provisions and practical examples)	Dec 96	pp57-59
Transfer of foreign reserves to the ECB: some facts	Apr 97	p74
Accounting and taxation	Apr 97	pp74-76
Monetary and fiscal policy		
Monetary policy operations in Stage 3	Dec 96	pp60-62
	Apr 97	pp78-81
Euro banknotes	Dec 96	pp62-66

ORGANISATIONS INVOLVED

Wholesale payments and settlement

Association for Payment Clearing Services (APACS)
BACS Ltd (BACS)
Cedel Bank
Clearing House Automated Payment System (CHAPS)
CREST
ECU Banking Association (EBA)
Euroclear
London Clearing House (LCH)

Financial markets and exchanges, and other market associations

Association of British Insurers (ABI)
Association of Corporate Treasurers (ACT)
Association of Unit Trust and Investment Funds (AUTIF)
Baltic Exchange
Bloomberg Financial Markets
Bridge Information Systems
British Bankers Association (BBA)
British Venture Capital Association (BVCA)
Building Societies Association (BSA)
Council of Mortgage Lenders (CML)
Dow Jones
EBS Dealing Resources
ECHO
EFFAS European Bond Commission
Federation of Commodity Associations (FCA)
Finance and Leasing Association (FLA)
Foreign Banks and Securities Houses Association (FBSA)
Futures and Options Association (FOA)
Futures Industry Association (FIA)
FXNET Ltd
Gilt-Edged Market Makers' Association (GEMMA)
Institute of London Underwriters (ILU)
Institutional Fund Managers' Association (IFMA)
International Money Market Trading Association (IMMTA)
International Petroleum Exchange (IPE)
International Paying Agents Association (IPAA)
International Primary Markets Association (IPMA)
International Securities Markets Association (ISMA)
International Swaps and Derivatives Association (ISDA)
Lloyd's of London
London Bullion Market Association (LBMA)
London Discount Market Association (LDMA)
London Investment Banking Association (LIBA)
London International Financial Futures and Options Exchange (LIFFE)
London International Insurance and Reinsurance Market Association (LIRMA)

London Metal Exchange (LME)
London Stock Exchange (LSE)
National Association of Pension Funds (NAPF)
Reuters
Tradepoint Financial Networks

Legal groups

City of London Joint Working Group (CLJWG)
City of London Law Society (CLLS)
Financial Law Panel (FLP)

Accounting

Accounting Standards Board (ASB)
Consultative Committee of Accounting Bodies (CCAB)
Fédération des Experts Comptables Européens (FEE)
International Accounting Standards Committee (IASC)
Institute of Chartered Accountants in England and Wales (ICAEW)
Institute of Public Finance Ltd

Business and retail

British Chambers of Commerce (BCC)
British Retail Consortium (BRC)
Confederation of British Industry (CBI)
Consumers in Europe Group
Institute of Directors (IoD)
The Consumers' Association
The Hundred Group
The Simpler Trade Procedures Board (SITPRO)

Regulators and Government

Building Societies Commission
Export Credits Guarantee Department (ECGD)
Department of Trade and Industry (DTI)
Government Actuary's Department (GAD)
Inland Revenue
Securities and Futures Authority (SFA)
Securities and Investments Board (SIB)
HM Treasury

Information Technology

British Computer Society (BCS)
Business and Accounting Software Developers Association (BASDA)
Computing Services and Software Association (CSSA)
Securities Industry Software Association (SISA)

ABBREVIATIONS AND ACRONYMS

ABI . . . . .Association of British Insurers
ABSAL . . . . . . .American Banking and Securities Association of London
ACT . . . . .Association of Corporate Treasurers
ANNA . . . . .Association of National Numbering Agencies
APACS . . . . . . .Association for Payment Clearing Services
ASB . . . . .Accounting Standards Board
ATM . . . . .Automated Teller Machine
AUTIF . . . . .Association of Unit Trusts and Investment Funds
BASDA . . . . . . .Business and Accounting Software Developers Association
BBA . . . . .British Bankers' Association
BCC . . . . .British Chambers of Commerce
BCS . . . . .British Computer Society
BSA . . . . .Building Societies Association
CCAB . . . . .Consultative Committee of Accounting Bodies
CCBM . . . . .Correspondent Central Banking Model
CD . . . . .Certificate of Deposit
CGO . . . . .Central Gilts Office
CHAPS . . . . . . .Clearing House Automated Payment System
CLJWG . . . . . . .City of London Joint Working Group
CML . . . . .Council of Mortgage Lenders
CMO . . . . .Central Moneymarkets Office
CP . . . . .Commercial Paper
CSDs . . . . .Central Securities Depositories
CSSA . . . . .Computing Services and Software Association
DGII . . . . .Directorate General II of the European Commission (economic and financial affairs)
DGXV . . . . .Directorate General XV of the European Commission (Single Market and financial services)
DGXXIV . . . . .Directorate General XXIV of the European Commission (consumer policy)
EBA . . . . .ECU Banking Association
EBF . . . . .European Banking Federation
ECB . . . . .European Central Bank
ECGD . . . . .Export Credits Guarantee Department
ECOFIN . . . . . .Council of Finance Ministers of the European Union
ECSDA . . . . . . .European Central Securities Depositories Association
EFFAS . . . . .European Federation of Financial Analysts' Societies
EIB . . . . .European Investment Bank
EMI . . . . .European Monetary Institute
ESCB . . . . .European System of Central Banks
EURIBOR . . . . .European Inter-bank Offer Rate (proposed)
EUROSTAT . . . .Statistical Office of the European Communities
FBSA . . . . .Foreign Banks and Securities Houses Association
FEE . . . . .Fédération des Experts Comptables Européens
FEFSI . . . . .Federation of European Investment Funds
FESE . . . . .Federation of European Stock Exchanges
FLA . . . . .Finance and Leasing Association
FLP . . . . .Financial Law Panel
FTSE . . . . .Financial Times Stock Exchange (indices)
GEMMA . . . . . .Gilt-Edged Market Makers' Association
HSBC . . . . .Hongkong and Shanghai Banking Corporation
ICAEW . . . . . . .Institute of Chartered Accountants in England and Wales
ICSDs . . . . .International Central Securities Depositories (Euroclear and Cedel)

IFMA . . . . .Institutional Fund Managers' Association
ILU . . . . .Institute of London Underwriters
IMMTA . . . . . . .International Money Markets Trading Association
IMRO . . . . .Investment Managers Regulatory Organisation
IPAA . . . . .International Paying Agents Association
IPMA . . . . .International Primary Markets Association
ISDA . . . . .International Swaps and Derivatives Association
ISIN . . . . .International Securities Identification Number
ISMA . . . . .International Securities Markets Association
ISO . . . . .International Standards Organisation
LCH . . . . .London Clearing House
LIBA . . . . .London Investment Banking Association
LIBID . . . . .London Inter-bank Bid rate
LIBOR . . . . .London Inter-bank Offer Rate
LIFFE . . . . .London International Financial Futures and Options Exchange
LIRMA . . . . . . .London International Insurance and Reinsurance Market Association
LME . . . . .London Metal Exchange
LSE . . . . .London Stock Exchange
MICR . . . . .Magnetic ink character recognition
MFI . . . . .Monetary Financial Institution
NAPF . . . . .National Association of Pension Funds
NCB . . . . .National Central Bank
NNA . . . . .National Numbering Agency
ONS . . . . .Office for National Statistics
OTC . . . . .Over-the-counter
PIA . . . . .Personal Investment Authority
PIBOR . . . . .Paris Inter-bank Offer Rate
PSA . . . . .Public Securities Association (New York)
RIE . . . . .Recognised Investment Exchange
RPI . . . . .Retail Prices Index
RTGS . . . . .Real-Time Gross Settlement
SIB . . . . .Securities and Investments Board
SISA . . . . .Securities Industry Software Association
SITPRO . . . . . . .The Simpler Trade Procedures Board
SONIA . . . . . . .Sterling Overnight Index Average
SROs . . . . .Self Regulating Organisations
SSI . . . . .Standard Settlement Instructions
STIR . . . . .Short-term interest rate (LIFFE contracts)
S.W.I.F.T. . . . . . .Society for Worldwide Interbank Financial Telecommunication
TARGET . . . . . .Trans-European Automated Real-time Gross settlement Express Transfer system
WMBA . . . . . . .Wholesale Markets Brokers' Association

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