

SECTION 7: IMPLICATIONS FOR THE UK

1 Although the euro is a foreign currency in the UK, the completion of the changeover to the euro will also affect UK banks, other financial institutions and their customers.

Non-cash changeover

2 APACS and the BBA recommended to their members in May that the European banking guidelines should be implemented in the UK in the following way.

APPLICATION OF EUROPEAN BANKING GUIDELINES IN THE UK

Bank accounts in legacy currencies

- *Nostro accounts* Nostro agents in the participating Member States were encouraged to convert all legacy currency accounts to euro by end-September. If no instructions were received by that date, nostro agents could give one month's notice and proceed to convert.
- *SSIs* UK banks may wish to review their correspondent bank relationships for euro and their SSIs. SWIFT has proposed a new broadcast template for euro SSIs relating to correspondent bank changes designed specifically to highlight its significance to market participants and this should have been used, if appropriate, since 30 June.
- *Customer accounts* UK banks may wish to follow the practice recommended for banks in the euro area: with appropriate notice and unless the customer instructs otherwise, for accounts to be converted to euro from September onwards, and in any case by 31 December. Banks need to seek customer instructions regarding consolidation of multiple euro accounts arising from these conversions.

Legacy currency payments

- From 1 January 2002, all payments that used to be made in legacy currency must be made in euro. From August, SWIFT has rejected any settlement messages in a legacy currency with a value date beyond 31 December.
- Outstanding payments in legacy currency, originated on or before 31 December, will be applied to euro accounts in euro from the start of next year.
- Every effort should be made to discourage customers from using legacy currency after end-2001.
- Customers should be encouraged to lodge any legacy currency cheques received by 1 February 2002. (The cut-off date for legacy currency cheques submitted by cash letter is 15 February 2002.)
- Banks are expected to accept legacy currency cheques after 28 February 2002 only on a collection basis.

Legacy currency transactions

- All new transactions (deposits, loans, swaps etc) which mature or may continue after 31 December should be denominated in euro, using euro market conventions.

- Legacy currency transactions already on the books which mature or continue after 31 December will be 'read as euro'. This means that any references to a legacy currency are to be replaced by references to the euro (using the conversion rate). That can be achieved by simple redenomination, but a question remains about reconventioning, in particular the business days to be used for fixings, if this affects the economics of the transaction. It is desirable that parties to transactions should agree to full redenomination, including reconventioning, to avoid any future requirements for exception processing. But such action should not be taken unilaterally.
- It is expected that syndicated loans with, for example, three or six-month rollovers which have been drawn and remain in a legacy currency will be redenominated in euro on the last rollover date in 2001.
- The BBA will not publish its LIBOR rates in legacy currencies after 28 December and has designated euro LIBOR as the successor rate.
- Where, despite the above, an amount of legacy currency falls due for payment on or after 1 January 2002, the equivalent euro amount should be made, using the counterparty's euro SSI.

Travellers cheques

- Travellers cheques are now available in euro, and UK banks should be prepared to accept them. Issuers and euro-area banks recommend that euro travellers cheques should be used in preference to legacy currency travellers cheques from now on.

3 *Business days* Monday, 31 December will be a normal banking day for sterling in the UK. NewCHAPS will be closed for euro payments, but open for sterling. Tuesday, 1 January 2002 will be a TARGET and Bank Holiday in the UK (ie NewCHAPS will be closed for both euro and sterling), as well as throughout the euro area.

4 *Euro payments* Payments in euro in the UK are already made through NewCHAPS and BACS, and euro cheques drawn on UK banks are cleared through the euro cheque clearing in the UK.

- Cheques drawn on euro accounts with banks in other countries, including those in the euro area, will continue to be treated as foreign cheques, due to the differences in national clearing arrangements. Euro cheques drawn on UK banks used to make payments outside the UK are likely to involve collection charges for the recipient.
- UK companies need to ensure that any systems they use which carry legacy currency codes, or use legacy currency logic for payment routing, are amended in time.

5 *Legacy currency debt instruments* As in the euro area, UK companies' legacy currency bonds outstanding at the end of December will be 'read as euro' and do not have formally to be redenominated into euro. But any reporting of information about legacy currency instruments (eg on market screens or in customer statements) must be in euro, though the legacy currency amount may also be shown.

6 *Legacy currency share capital* UK companies with legacy currency share capital should take professional advice on the implications of Regulations 974/98 and 1103/97, as there is no UK legislation specifically on what method of redenomination to apply and whether

rounding is mandatory. Such companies are recommended to redenominate their share capital from legacy currency to euro before 1 January 2002 or, failing that, before the next date on which they issue new shares, alter the amount of their share capital, or pay or account for a monetary amount referable to it (eg by paying a dividend or adopting audited accounts). A top-down method of conversion should be used, by converting at the level of the total nominal amount of each class of shares and rounding to the nearest euro cent. Where this would mean rounding down, even by the smallest amount, it could technically require a Court order. UK companies should be able to avoid this outcome by increasing their share capital, through capitalising reserves on or before redenomination, to give a convenient round number in euro. In addition, if a company has preference shares, convertibles, options or warrants, it will need to consider how these may be affected by redenomination and what changes may be necessary.

Cash changeover

7 *Frontloading* Under the ECB's principles for frontloading euro notes outside the euro area (see Box), UK credit institutions have since 1 December been able to obtain euro banknotes to meet customer demand from 1 January 2002 and to sub-frontload them in the UK. UK credit institutions are arranging to obtain sufficient supplies of frontloaded notes from national central banks and commercial banks in the euro area.

8 To meet the ECB's guidelines on frontloading, UK banks seeking to frontload supplies of euro notes have needed to: determine the volume required for each denomination of euro note on 1 January 2002 and subsequently in the early part of January; identify a source of supply; and agree a contract covering safe transport, delivery and insurance, the provision of collateral, and payment. Within the bank, they have also needed to: review their own internal systems and procedures; identify the branches to which supplies are to be delivered, giving them clear instructions not to put euro notes into circulation before 2 January; make arrangements for processing legacy currency notes, including prompt remittance to a central point to facilitate repatriation; and train staff, including on procedures for suspected counterfeit notes.

9 *Handling legacy currency notes* Unlike banks in the euro area, UK banks are not obliged to exchange legacy currency notes and coin for euro. However, in normal circumstances, they accept foreign currency notes, and where customers bring in legacy currency notes and ask for the sterling proceeds to be deposited into their bank accounts, or directly exchanged for sterling cash, the banks will normally do so. A number of UK banks will exchange legacy currency notes for euro notes in certain of their branches from 2 January 2002 until at least the date on which the relevant cash exchange period ends.

10 *Handling legacy currency coin* As UK banks do not normally accept foreign currency coin, there is no natural outlet for legacy currency coin in the UK. However, the UK clearing banks are running schemes to collect legacy currency coin as charitable donations (similar to the practice on some airlines), as follows: Barclays (for Macmillan Cancer Research); Co-operative Bank (for Christian Aid); HBOS (for Age Concern); HSBC (for UNICEF); Lloyds TSB (for Cancer Research); and RBS Group (for Save the Children). Similarly, Travelex and Thomas Cook are collecting for Children in Need.

ECB GUIDELINES ON FRONTLOADING EURO NOTES OUTSIDE THE EURO AREA

To ensure that credit institutions outside the euro area can participate in the euro note pre-distribution, the ECB set out on 14 December 2000 how frontloading may extend beyond the euro area, including to the UK.

- Any distribution of frontloaded euro banknotes outside the euro area may not commence before 1 December.
- Credit institutions located within the euro area will be allowed to distribute frontloaded euro banknotes to their branches or headquarters located outside the euro area, where these are part of the same legal entity. This will be subject to the frontloading conditions which will apply within the euro area. Any such UK institutions would not therefore be required to provide collateral against the notes received.
- Credit institutions with their main place of business inside the euro area will be allowed to sub-frontload euro banknotes to their subsidiaries which are also credit institutions and are located outside the euro area, or to other credit institutions which have neither their registered, nor their head, office inside the euro area. In this case, the delivery of euro notes would be to a separate legal entity and would technically be sub-frontloading. So any such UK institutions would be required to provide collateral.
- All credit institutions outside the euro area that receive frontloaded banknotes may not further sub-frontload euro banknotes to third parties.

On 5 July, the ECB further agreed that euro-area national central banks may frontload central banks in the rest of the EU, the accession countries and other countries, on the following basis.

- Frontloading of central banks outside the euro area is allowed only from 1 December.
- Frontloaded central banks outside the euro area will have to settle the payment for frontloaded amounts on the first business day of 2002.
- In order to cover credit risks, frontloaded central banks outside the euro area will be required to provide the euro-area national central bank with collateral from the moment of frontloading and for the amounts frontloaded. Central banks outside the euro area will have to provide assurances that subsequent sub-frontloading of credit institutions by them will be carried out in accordance with the rules laid down in legal documentation.

Finally, on 13 September the ECB decided the following, as from 1 December.

- National central banks in the euro area may frontload non-euro area credit institutions specialising in the wholesale distribution of banknotes, on request and subject to certain terms and conditions. All operational and practical arrangements for such frontloading are to be handled bilaterally by the euro-area national central bank approached and its respective counterparty.
- Central banks outside the euro area may sub-frontload credit institutions having their head or registered office in their jurisdiction; and non-euro area credit institutions specialising in the wholesale distribution of banknotes may, from the same date, sub-frontload euro banknotes to other credit institutions outside the euro area. This sub-frontloading is subject to certain conditions.

11 *Charging* The 1103/97 Regulation applies throughout the EU, including in the UK, and obliges banks to convert legacy currency to euro at the conversion rate. However, UK banks are not obliged to exchange legacy currency notes and coin for euro free of charge during the cash exchange period. It is a commercial decision for UK banks what services they offer and any fees they charge, but any fee must be kept distinct from the conversion rate.

12 *Testing* With ECB agreement, the Bank of England has established a test site at its Printing Works for those organisations which have a legitimate need to test euro notes, subject to a confidentiality agreement.

13 *Counterfeiting* Under the new anti-counterfeiting regime for the euro, which has been extended to the UK, a National Analysis Centre (NAC) for counterfeit euro notes has been established in the UK at the Bank of England Printing Works. A Coin National Analysis Centre (CNAC) has been established at the National Criminal Intelligence Service (NCIS). Banks and other professional cash-handlers (such as bureaux de change) are obliged to withdraw from circulation euro notes and coin which they 'know or have sufficient reason to believe' to be counterfeit, and to hand those counterfeits over to the Bank of England (for notes), the NCIS for coins, or the police authorities (for notes or coin). This requirement is not dissimilar to the current arrangements for counterfeit sterling notes and coin.

14 *Money laundering* The 1993 *Money Laundering Regulations* in the UK implement the *First EU Money Laundering Directive*. A new regulatory regime for bureaux de change and other money services' businesses was introduced on 12 November.

15 *Training* Staff of UK banks need to be well informed about the practical implications of the cash changeover in the UK so they can advise customers accordingly. In addition, a smaller number of employees at UK banks have needed to be trained to identify counterfeit euro banknotes to enable these to be passed to the relevant authorities. In response to an ECB request, the Bank of England has helped train over 60 representatives from the UK financial, retail and travel industries in identifying the public security features of euro banknotes and coin. They are passing this information on to their own cash-handlers. To assist them in doing so, the Bank is providing copies of the ECB's official training kit (containing a booklet, video and CD-rom), which are all designed to help cash handlers distinguish between genuine and counterfeit euro notes and coin. APACS is also a source of information about training kits.

16 *Information* HM Treasury, with the FCO and DTI, has produced a leaflet with key facts for business and holiday travellers on the introduction of euro cash. This is being made available through major UK airports and ports. APACS, Thomas Cook and Travelex are participants in the ECB partnership programme for disseminating information about the euro. In addition, APACS and the BBA have published a leaflet, *You and the Euro – Notes and Coin*, to provide advice to their member banks' personal customers about the euro cash changeover and its implications, including that legacy currency notes will not be accepted after the end of the cash exchange period. ABTA has produced a very similar leaflet for customers of travel agents. The British Retail Consortium has produced a leaflet, *A Retailers' Guide to Accepting the Euro as a Foreign Currency*. A number of UK banks have produced their own leaflets for customers.

IMPLICATIONS OF THE CHANGEOVER FOR NORTHERN IRELAND

Alongside sterling, the Irish pound circulates freely in Northern Ireland (NI) as a means of exchange. It is widely used in retailing, and in the agricultural sector, mainly (but not exclusively) in the border areas. Although retailers will not usually display prices in Irish pounds, they will typically accept them at an exchange rate advised by their own banks; 'pound for punt' offers or promotions are not uncommon, which would imply discounts of 25% or more.

It is impossible to estimate accurately the total value of Irish pound cash in circulation in NI: remittances through the banks' cash centres amounted to IEP23 million in the quarter to end-June 2001 (compared to an average sterling circulation of about £1.2 billion), but the Irish pound figure can only be a fraction of the total in circulation and takes no account of cash-in-hand or informal savings.

Some 12-15,000 NI businesses may trade regularly in the Republic of Ireland (RoI) and have borrowings, receivables and costs in Irish pounds; all the NI banks offer loan and deposit facilities in legacy currencies, and some offer access to the RoI clearing system with the same value cycle. Others encourage such active accounts in Irish pounds to be opened at branches of their RoI counterparts: relationship management is typically retained by the NI bank. Consolidated accounts are invariably in sterling; all NI listed companies are also listed on the Dublin Stock Exchange and, although they are only listed in sterling, their shares are traded in both sterling and euro.

The number of applications by NI bank customers for euro and Irish pound accounts for cross-border business has increased recently: this may be related to the changeover or simply reflect growth in cross-border trade. These accounts are typically held in RoI branches; very little interest has so far been shown in the euro account facilities offered by NI banks, with less than 1% of the business market, and almost no individuals have taken up such facilities.

The changeover will be straightforward. Accounts denominated in Irish pounds at most banks were converted to euro on 1 October unless the account holder specifically requested otherwise: the few which have remained in Irish pounds have largely reflected a concern that their RoI customers are not ready to convert from the legacy currency. Cheques drawn in Irish pounds up to and including 31 December will only be accepted until 15 February 2002, although in practice such cheques are likely to be honoured on a collection basis until towards end-June 2002.

Arrangements for the supply of cash are also clear. NI banks will be sub-frontloaded during December by their RoI parents or partners, who will lodge collateral with the Central Bank of Ireland to an equivalent amount; euro notes will not be issued to customers or to the very few ATMs capable of handling them before 2 January 2002. NI banks may charge for exchanging Irish pound for euro notes. They will not be receiving euro coin and will not be prepared either to handle or exchange it; retailers will therefore give change in sterling. NI banks are being trained by their RoI counterparts in the recognition of euro notes and passing their knowledge on to their customers.

It is probable that the use of the euro will increase in NI, especially in the border and tourist areas. The co-circulation of three currencies for a short period will require greater care on the part of cash handlers, but should not cause serious problems. Although there is every intention to make border retail centres as receptive to the euro as to the Irish pound, there are few indications yet that retailers will display prices in sterling and euro; the hotel and tourist sector is more likely to do so, perhaps expressing euro tariffs as a range to accommodate exchange rate fluctuations.

Use of the euro in the UK

17 Use of the euro in the UK outside the City has remained very low, but it will increase automatically as the euro substitutes for the legacy currencies. It remains unclear, however, how far UK businesses involved in external trade will use the euro in pricing, invoicing and payment, where they have to date used sterling. It is also unclear how extensively tourists to the UK will be able to use the euro in UK shops. Some retail chains have said that they will offer such a facility in the most popular tourist areas, but a much more widespread service is unlikely. A rather greater use of the euro may be expected in Northern Ireland, at least close to its border with the Republic of Ireland (see Box).

USE OF THE EURO IN THE UK BEYOND THE CITY

Monitoring the use of the euro in the UK beyond the City is important, particularly to discover the extent to which the euro might replace other currencies such as sterling and the US dollar in UK companies' activities.

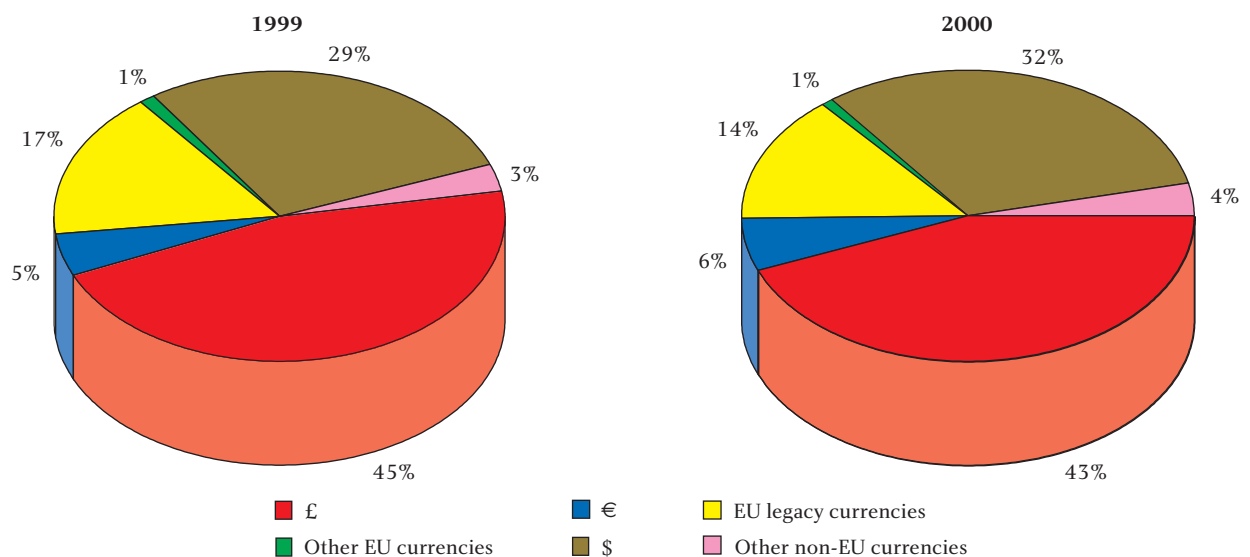
Customs & Excise sample data

In November 2001, Customs & Excise, in conjunction with ONS, published further results from its 'currency of invoicing' exercise in respect of exports and imports. Customs & Excise estimate, on the basis of limited sample data, that in 2000 almost 60% of UK imports and over 50% of UK exports were invoiced in foreign currencies. Of these currencies, the US dollar was the most widely used, accounting for some 34% of UK imports and 29% of UK exports. Taken together EMU currencies (former national currencies and the euro) were used to invoice 19% of UK imports and 21% of exports, with the euro itself accounting for 5% and 7% for imports and exports respectively.

The charts below compare the estimates for 1999 with those for 2000. There was a modest decline in the use of legacy currencies, which must drop to zero by end-2001, but a smaller increase in the euro than would have fully compensated. In addition, the use of sterling fell and the dollar rose. These trends may reflect the strength of the dollar relative to both the euro and sterling during 2000, and an increase in UK trade with the US in 2000. But it is important to note the small size of the sample.

It will be interesting to see whether the use of the euro increases significantly in future. Some increase will in any event occur automatically at the end of this year as it is substituted for the legacy currencies. But it may increase further subsequently, displacing other currencies. Customs & Excise will publish future analyses annually.

CURRENCIES USED ON AVERAGE IN IMPORTS AND EXPORTS BY VALUE OF TRADE



Source: Customs & Excise

Bank of England exercise

The Bank's Agents have continued to monitor UK corporate use of the euro (for external trade as well as domestic transactions) through their regular contacts. Results from the past six months show the following.

Some 15% of firms' purchases, and the same proportion of their sales, were invoiced in euro or the legacy currencies taken together, compared with 12% and 10% of purchases and sales respectively in the previous six months. These figures are naturally lower than the Customs & Excise data reported above, since they relate to firms' total business rather than only their international trade.

Around half of the firms consulted expected to increase (to perhaps 20%) the proportion of their purchases and sales invoiced in euro, displacing sterling and other foreign currencies. The majority expected to do so during 2002, once euro notes and coin were introduced. In relation to just UK-based suppliers and customers, those consulted naturally expected a lower proportion (around 15%) of their invoices to be in euro.

UK retail payment volumes in euro

The volume of retail payments made in euro within the UK remains very small, in relation to sterling, but has continued to rise, with the vast majority being business-related payments.

UK RETAIL PAYMENTS IN OCTOBER 2001				
	Euro		Sterling	
	Value	Number	Value	Number
Cheques	€285 million	33,000	£119 billion	157 million
BACS (direct credits)	€95 million	1,300	£138 billion	96 million

Source: APACS

APACS continues to monitor use of the euro by UK businesses and their future intentions, through a monthly survey. The results for September show continuing steady growth in the number of cross-border payments made and received in euro. By end-Q3, around 96,000 UK businesses were making or receiving euro payments, with around 400,000 cross-border payments per month, approximately double the number being made and received a year ago. These volumes will increase further once the legacy currencies disappear, from end-2001.

The vast majority of UK accounts previously denominated in legacy currency have now been converted to euro, or closed and consolidated into other euro accounts. The latest survey suggests that nearly 65,000 businesses have euro accounts. Nearly half of these businesses do not have accounts denominated in any other foreign currency and the number of businesses with euro accounts is now slightly higher than those with accounts in US dollars. As at end-September, there were over 133,000 euro denominated accounts at UK banks held by both business and personal customers.