

A DMO/CRESTCo CONSULTATION ON

**EURO ENTRY:  
IMPLICATIONS FOR  
ISINs UPON REDENOMINATION OF  
STERLING DEBT INSTRUMENTS**

29 NOVEMBER 2002



## ISINs - REDENOMINATION INTO THE EURO

### *Introduction*

1. This consultation paper discusses the issue of ISINs (International Securities Identification Numbers) in the event of United Kingdom's entry to EMU. It was commissioned by the City Euro Group and has been written jointly by United Kingdom Debt Management Office (DMO) and CRESTCo Ltd (CREST). It examines the issues surrounding the handling of ISINs for sterling-denominated debt instruments held within CREST in dematerialised form upon redenomination into euros, with a view to determining the preference of the market.

2. The issue covered by the paper is whether sterling-denominated debt instruments held within CREST should retain the same ISIN at redenomination or be allocated new ones. Although it deals primarily with gilts and UK Treasury bills<sup>1</sup>, some parallels with corporate bonds and other debt instruments may be drawn. The paper raises certain questions and is designed to prompt comment from market participants, which will aid the decision. Ultimately, the decision whether to change ISINs for gilts rests with the DMO, as the issuer. The "City Guide to a UK Euro Changeover", published in the November 2002 Practical Issues, states in Part II paragraph 13:

*"To date there has been a presumption that ISINs on gilts and other sterling debt instruments should not change on redenomination, as in those first-wave countries which redenominated to the nearest euro cent, on the grounds that this would create fewer difficulties for the market as a whole than changing them. It would be for market firms to consider this approach, taking the interests of their front and back offices together. The DMO and CREST will consult the market. The decision about gilts will ultimately rest with the issuer."*

3. The paper examines the following key aspects:

- fungibility;
- simplicity;
- risk limitation;

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<sup>1</sup> As part of the migration of Money Market Instruments into CREST, UK Treasury bills are due to become dematerialised instruments from July 2003. The current presumption is that Treasury bills would be redenominated on entry using the same method as for gilts.

- continuity; and
- cost efficiency.

4. In preparing this consultation document, the DMO and CREST have endeavoured to take into account the wider market perspective: rather than focusing solely on the wholesale market, consideration has also been given to the needs of the retail market and the issues faced by the custodial sector. These different sectors often have conflicting requirements, meaning it should be recognised that there is no right or wrong answer to this exercise. Irrespective of the outcome, the redenomination should be able to be completed successfully – the CREST platform is able to accommodate either option. It is a question of which is the least disruptive, least risky or least costly of the two options, and depends on the importance recipients put on each of these, taking into account their own front and back office systems. The DMO will take all comments into consideration when making a final decision.

5. To ensure consistency across the debt market, it may make sense for other sterling issuers to consider the findings of this consultation. As noted, this will be at the discretion of the issuers.

6. The DMO welcomes any comments on the contents of this consultation paper, but would find it particularly useful if respondents answered the questions posed in each section. This will allow us to assess the various pros and cons and help them make the final decision of whether ISINs should change for gilts.

7. Responses to this paper should be sent to Steve Whiting at UK Debt Management Office, Eastcheap Court, 11 Philpot Lane, London EC3M 8UD. Alternatively, comments can be sent by e-mail to [steve.whiting@dmo.gsi.gov.uk](mailto:steve.whiting@dmo.gsi.gov.uk). Responses should be received no later than 31 December 2002.

## OVERVIEW

8. By way of background, the issue is simply this – bonds are held and transferred as nominal amounts when performing back office functions (i.e. the balance of a given bond held by an investor is expressed in pounds and pence) as opposed to equities, which are expressed as units and transferred as such. Therefore, £100 nominal of a bond is represented as 100.00 nominal. Upon redenomination of a bond into euro, this balance changes from 100.00 sterling nominal to 157.51 euro nominal (using an example exchange rate). Thus, redenomination affects every balance held in a bond.

9. An obvious precedent would be how first-wave government issuers handled ISINs when they joined the European single currency. Generally, those that redenominated to the nearest euro-cent<sup>2</sup> opted to retain ISINs and, although some market participants experienced problems, particularly with reconciliation, there is no evidence to suggest this was caused by redenomination in principle rather than systems implementation in practice. Also, in the UK there was a similar exercise required for decimalisation from £/s/d. Although, on this occasion the equivalent of ISINs (ie, SEDOL codes) were not changed, the passing of 30 years does make it less comparable, especially considering the advances in technology over the same period. So, given that there is not an exact precedent to follow in the UK, it makes sense to conduct a consultation exercise to gauge the preference of those it will directly affect.

10. This consultation document focuses on dematerialised issues of sterling-denominated debt held in the CREST settlement system, and the procedures associated with redenomination in CREST. It does not include bearer issues, nor does it include issues held in physical, immobilised form (often as a global note) in the common depositories of Euroclear and Clearstream, where the procedures for redenomination may be very different (due to the manner in which the underlying issue is held).

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<sup>2</sup> As is planned for the redenomination of sterling debt in the UK were it to join the single currency area.

## **FUNGIBILITY**

11. An important consideration is that the stock is “seen” to be the same in all respects following redenomination as the stock was when denominated in sterling. The economic value of each holding or the total amount outstanding will not change although, as previously noted, the numerical value of each holding or outstanding amount will change. The stock will have the same purchasing power before and after redenomination, regardless of the currency it is presented in.

12. The terms and conditions of each stock will remain unchanged; before and after redenomination, each will have exactly the same stock title, pay the same coupon rate on the same date, and will mature under the terms of the original prospectus. Keeping the same ISIN helps ensure that a stock denominated in euro is precisely the same way as it was when denominated in sterling, and is seen to be completely fungible in economic terms.

13. However, in back office terms, one of the important attributes of a bond is the balance held by a member that is available for transfer to another investor. In technical terms, this is a “key” piece of information used when processing securities transactions. If this balance changes to represent a nominal amount in a different denomination of the same currency, some would argue that in terms of physical (as opposed to economic) characteristics, actually the redenominated euro gilt is not fungible with its sterling predecessor, and hence should be identified separately. It also means that existing open transactions will need to take account of the new quantity – in CREST, this will be done either by the Claims Processing Unit or its open transactions conversion software (automatic transformations).

*Q1 – In systems terms, do you regard redenomination of the nominal balance a significant change in the main characteristics of a stock?*

## **SIMPLICITY**

14. Ideally, redenomination should have as little impact on the wholesale or retail markets as possible. Retaining ISINs ensures that those who regularly use ISINs are able to continue using their own sources of data without causing too much confusion. Retail holders who are likely to have ISIN references on their documentation (eg stock certificates and annual statements of interest) will be able to continue to quote

these when dealing with stockbrokers, registrars and other market participants.

15. On the face of it, retaining the ISIN would create less confusion for the market as a whole. Participants in both wholesale and retail markets can continue their business, and should be unaffected by the change with the only noticeable difference being the actual amount of the balance. However, during the transition period there may be a requirement for market participants to deal with euro nominal amounts bought and sold on behalf of retail investors still settling consideration in sterling.

## **RISK LIMITATION**

16. Changing ISINs on gilts alone would require the issue of almost 200 new ISINs (including strips). This would have to be well publicised to ensure all interested parties were made aware of the new codes. This not only involves direct market participants, (eg CREST, CREST members, DMO, Bank of England, UK Listing Authority, London Stock Exchange etc) but also a large number of data providers. To co-ordinate such a large change is almost certain to leave some gaps and/or create problems with the timing of the changes. Equally, by not changing the ISIN all participants will be required to ensure their systems took account of the new denomination.

17. In either case, it is beyond the control of the issuer to ensure databases are updated correctly – it is unrealistic to think mistakes would not happen. With the likelihood of many other static data changes required for the changeover, there may even be an increased risk of error compared to usual static data changes. How much a mistake might disrupt the market is difficult to quantify (as it depends on which systems were set up incorrectly), but there is an increased risk of unmatched or failed transfers of stock if ISINs are changed.

18. However, experience has shown that not changing the ISIN when a key attribute such as the balance changes also leads to problems matching transactions – this is a particular issue in a settlement system like CREST that accommodates (uniquely in Europe) both wholesale and retail market sectors. Given that there is retail activity in bonds, wholesale firms interacting with retail firms in government debt may encounter problems when dealing with retail firms who are still settling the consideration on a sterling basis. Additionally, the timing of the changes to client-side settlement instructions has caused problems in the past. Given that custodians act on client

instructions that may have been sent from across the world (where euro preparations may not be so high profile), there is a significant risk of instructions being “Straight Through Processed” and input into CREST with incorrect nominal amounts if the same ISIN is used, or for an invalid stock should the old ISIN be used.

19. The manpower involved in rectifying such issues could be significant, as could the market impact of either manual repairs of incorrect matches or, more worryingly, incorrect nominal amounts being settled against the same amount of cash<sup>3</sup>. Therefore, irrespective of the approach chosen, participants will have to be aware of all the changes being made, whether it be by allocation of a new ISIN, or by the amendment of an existing ISIN.

20. The approach taken to redenomination will also affect the processing route adopted by CREST in terms of its handling of open transactions. In the event of the ISIN changing upon redenomination, CREST will delete all open deliveries, stock loan returns, DBV returns and repo returns<sup>4</sup> and recreate them to ensure that the transactions reflect the new ISIN and quantity details. When the new transactions settle, they will do so on the basis of full delivery of the correct amount of stock against payment. This transformations process can be run on more than one occasion, taking into account any late matched trades (resulting from, for example, late client instructions).

21. If the approach taken is simply to scale the existing balances, to permit the late matching of transactions following redenomination, it is likely that open transactions will not be transformed and that the Claims Processing Unit will be utilised. There is a risk associated with such processing in that the Claim transaction is independent of the underlying delivery, stock loan return, repo return etc. Hence it is possible that the underlying transaction will settle and deliver stock of significantly less value than the consideration being transferred – the remainder of the stock will be transferred on the claim transaction. This means that full Delivery-versus-Payment (DvP) settlement is not attained for redenominated transactions in this scenario.

22. The CREST environment is not used just for settlement purposes – there is an additional requirement on members to perform transaction reporting to the London

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<sup>3</sup> The “City Guide to a UK Euro changeover” (Part II paragraph 30) states that CREST would allow outstanding sterling transactions to settle in sterling for 25 days after UK entry.

<sup>4</sup> The “Repo” transaction type is due to be introduced in July 2003.

Stock Exchange and the Financial Services Authority via CREST. Incorrect transaction reports are not inconceivable if the ISIN is retained, for the same reasons as above (i.e. incorrect nominal amounts being input).

*Q2 – On balance, do you feel that the risks are greater with retaining the same ISINs or allocating new ones?*

*Q3 – Briefly, what are the system implications for your firm of either option?*

*Q4 – What risk is there of experiencing reconciliation problems using either option?*

## **CONTINUITY**

23. Retaining the same ISIN allows historic information to be accessible through a single identifier. Changing the ISIN during the life of a stock could cause problems with linking historic information in the old ISIN with the new one. It is likely the two ISINs would have to be linked in some way, which may require system enhancements for some firms.

24. This is particularly relevant to the reconciliation of interest payments, which is likely to affect not just the paying agent, but also nominee companies and others who have to distribute and account for payments.

*Q5 – If ISINs changed would you need to link the old and new ISINs in your systems and, if so, would this raise any particular problems or concerns?*

*Q6 – How would changing the ISIN affect historical reporting for your firm, as described here?*

## **COST EFFICIENCY**

25. Costs associated with keeping ISINs the same are difficult to judge, as it depends largely on the set up of the individual front and back office systems that hold the information. However, many systems use the ISIN as the main identifier and changing it results in having to set up a completely new line of stock. The same static data would have to be created for the hundreds of lines of stock that would be affected. On the other hand, not changing the ISIN requires every line of stock to be



amended – it is generally supposed to be easier to cancel and recreate an entry than to amend an entry related to a key field, and it is understood that most firms have such a mechanism automated in their back office.

26. Then there is the cost of carrying out the necessary corporate action or scaling to alter balances of so many systems. The actual redenomination of CREST holdings will be carried out between CREST and the relevant registrar; although comparative costs of this process could be estimated for each of the options, it is not possible to gauge the total cost to the wider market for all “in-house” systems.

27. Redenomination will require the set up and processing of many hundreds of corporate actions to convert, if the ISIN is changed, one holding into another line of stock and to transform open transactions in either scenario. If the ISIN does not change, the market will be using non-standard processes to perform this database update, which would bring its own risk, and might increase costs, both in terms of preparation costs and actual cut-over costs.

28. On balance, in terms of cost there are advantages and disadvantages to both options. But without the additional information this consultation seeks, it is not conclusive which would cost less.

*Q7 – What difficulties might arise from updating your static data in respect of either option?*

*Q8 – If ISINs were to change how long in advance would you need to know the details of the new ISINs?*

*Q9 – If applicable, what preference would your clients have and why?*

*Q10 – How would new ISIN details be passed on to your customers/clients? Is this automated in any way?*

*Q11 – From your perspective, how do the costs compare for implementing each option?*

## **SUMMARY**

29. It should be noted that the general presumption from the DMO is that ISINs should not change upon redenomination. However, as outlined in this paper, there

are reasons for and against retaining ISINs. The views of the market are therefore welcomed to help the DMO determine the best way of handling ISINs during the redenomination of gilts into euros, in the event that the UK were to join the single currency area.

*Q12 – What is your preference – to change ISINs or not?*

*Q13 – What are the main reasons, mentioned in this paper or otherwise, for you making your preference in your answer to Q12?*

**Questions**

*Q1 – In systems terms, do you regard redenomination of the nominal balance a significant change in the main characteristics of a stock?*

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*Q14 – Please give any further comments?*

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