

PROPOSED MODEL FOR THE
RE-ENGINEERING OF GILTS
REGISTRATION

A discussion document

HM Treasury

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Introduction

The Government is considering the future of gilts registration. Currently, transactions and records of legal title for uncertificated gilt holdings are managed electronically within the Operator System (OS)¹; the Bank of England is required to keep a full record of these transactions. Transactions and records of legal title for certificated (retail) gilt holdings are wholly administered by the Bank of England. This is a cumbersome arrangement which necessitates some costly duplication in so far as the transaction records kept by the OS and the Bank of England are in the main the same for uncertificated stock. The Government is therefore seeking to identify the necessary changes to the OS and associated systems, together with changes to market practice and legislation, which would remove this duplication. Coincidentally this is a good opportunity to consider the changes required to facilitate the settlement and registration of all gilts through the OS. If adopted, this proposal would replace the two current regimes, one for certificated gilt holdings and the other for the uncertificated holdings.

This is a discussion document only. It does not constitute formal consultation and does not represent government policy. Your answer to the questions set out on page 9 will help the Treasury and the Bank determine the feasibility of the model and the virtue of taking it forward. Responses by 27 September 2002 would be very helpful. They should be sent to:

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Background to the proposed model

Until the inauguration of Electronic Transfer of Title (ETT) on 26 November 2001, the Registrar's Department of the Bank of England (the Bank) conducted the registration of legal title for the vast majority of UK gilts (a small number of gilt holdings were and still are registered on the Belfast or Dublin registers operated by the Bank of Ireland²).

¹ The transaction system run by CRESTCo which facilitates registration and settlement of dematerialised securities.

² The holdings currently on the Belfast and Dublin registers are due to be integrated with the Bank of England register in October 2002. The legislation to facilitate this also removes the prescriptive nature of the Finance Act 1942 which states, in effect, that only the Banks of England or Ireland can hold the register of British Government Securities.

The registration function for gilts and some other public sector securities was carried out for both certificated and uncertificated holdings under the Stock Transfer Act, the Government Stock Regulations and other specific legislation for Local Authority Stocks.

Since 26 November 2001, effective registration of uncertificated holdings has taken place simultaneously with settlement, within the OS under the Uncertificated Securities Regulations (USRs). The registration of certificated gilts remains with the Bank, governed by a panoply of legislation, of which the most significant elements are the Finance Act 1942, the Stock Transfer Act (STA) 1963 and the Government Stock Regulations (GSRs).

The introduction of ETT eliminated the time gap between settlement and registration (for market transfers), but it resulted in two differing registration systems. This is because the USR's state that the "operator register", maintained within the OS, has to be mirrored by the issuer, or his agent, maintaining a "record" of all the uncertificated holdings. They also state that there needs to be 'regular' reconciliation of the "register" and "record" balances. Maintaining these two separate systems includes unnecessary elements of duplication. As things stand for gilts, every settled transaction in the OS generates a Register Update Record (RUR) which is sent to the issuer to update the "record". The balances on the "register" and the "record" are reconciled nightly to ensure the "record" has captured every transaction and that the correct balances exist, so that dividend payments can be made accurately. Under current arrangements the "record" keeper is also the Paying Agent for both certificated and uncertificated holdings.

In the case of equities, the existence of a separate "record", regularly reconciled with the "register", is currently a clear necessity - the Companies Act requires that company share ownership can be established at any time. However, it is not clearly necessary for gilts, because establishment of ownership is only required when an ownership transaction is made or when dividend/redemption monies are paid. Consequently it may be possible to eliminate this duplication and develop a more cost-effective system of registration for gilts.

Furthermore, the Treasury has been considering whether this presents a good opportunity for wider improvements to gilts registration. It may, for example, be desirable, on efficiency grounds, to find a way for all gilt holdings to be maintained within the OS in some way, which would necessitate changes to the current arrangements for certificated gilts. It may also be possible for the registration services, currently supplied en bloc by the Bank of England, to be provided more cost-effectively in the future by one or more private sector bodies, on the basis of a competitive tender. The Treasury and the Bank of England have been looking at how these changes might be delivered in practice. The rest of this document looks at one possible model, starting with what is required from a gilts registration service.

Government criteria for gilts registration

Any system for gilts registration must retain the following essential criteria:

- Provision of a secure system with absolute assurance that payments and other registration functions will be provided to stockholders in an accurate and timely manner;
- Compliance with relevant legislation (as amended if necessary) including the ability to fulfil all relevant legal obligations and provide assurance that any changes to registration procedures would not be prone to legal challenge;
- Provision of a service at a cost to government that compares favorably with existing market practice;
- Provision of a service that operates to industry standards, which is straightforward, easy to use, treats stockholders fairly and reasonably, and provides the Treasury (as issuer) with a reasonable level of management information;
- A reasonable degree of flexibility. Any service agreement or contract with registration service providers must not excessively constrain strategic options for the future, and a provider should be able to respond flexibly to developments in issuance, the market, settlement and instruments. Sufficient flexibility must also be built in to meet the operational needs of the UK Debt Management Office (DMO).

Objectives of the proposed model

The Treasury's objective is to devise a model for gilts registration which continues to meet the above criteria, but which removes the unnecessary duplication associated with the current arrangements, enables all holdings to be maintained in the OS and facilitates open competition for registration services in the future. The model is outlined in more detail below. It has been designed to:

- centralise the settlement and registration of all gilts transactions into one electronic system;
- eliminate the need in normal circumstances for paper certificates of title and, so far as possible, paper Stock Transfer Forms and thus the need to transport them from broker to registrar;
- provide each stockholder with a single statement of their entire holding rather than individual, piecemeal certificates;

- enable retail gilts to be held either under the existing arrangements for OS private sponsored membership or within existing nominees, or within a new Issuer Pooled Retail Account (IPRA). These latter arrangements would see the pooling of all the retail accounts that hadn't elected for private sponsored membership or existing nominee operation, into a single pooled account in the OS, backed by the Issuer's Retail Database (IRD). [In some ways this database is similar to one maintained by any large OS Nominee.];
- eliminate the need for the maintenance of the 'record' and thus the need for full reconciliation of the OS 'register' with that 'record', and greatly reduce the need for transaction and balance data to be passed from the OS to the IRD;
- facilitate and simplify the transfer of dividends and redemption monies to OS members' accounts, including the IPRA, by giving consideration to the usage of Cash Memorandum Accounts (CMA's), in the OS, for all payments; and
- develop links from the brokers to the IRD, either via an OS-approved communication network or directly. Existing OS messaging would minimize changes to systems and practices, although direct links from broker to retail database could perhaps be developed using the Internet.

Assumptions

This model has been designed on the basis that re-engineering:

- should not incur significant ongoing net costs in excess of the current registration process;
- should not make significant changes to the current legal liabilities of the main participants;
- should support existing functionality for the issuance, maintenance and redemption of holdings and any existing official operations carried out by the DMO; and
- should be broadly consistent with the overall programme of securities market modernisation, including dematerialisation of Money Market Instruments (MMI's), and with the government's desire to offer electronic access to its services.

Overview of the proposed model³

The proposed model has two principal features:

1. All retail holders would in future hold gilts in uncertificated form in the OS, either as a private sponsored member or within a Corporate Nominee (both available now) or within a new Issuer Pooled Retail Account (IPRA). Retail holders would have access to an electronic means of transfer through a broker of their choice. The change to uncertificated form would be implemented universally and not offered as a further variant on existing arrangements. (Making the proposal optional would not simplify systems for the future or reduce system costs or give stockholders the benefit of a faster and more secure electronic transfer system.);
2. An Issuer's Retail Database (IRD) would be established and maintained separately from the OS register, in order to remove the need for an issuer register or 'record'.

To make the proposal successful it is important to deal with the potential anxieties which retail stockholders might face, including:

- (i) possible discomfort from the loss of a material certificate;
- (ii) the fear that holding stock within the IPRA would give rise to the loss of legal title as in a 'traditional' nominee; and
- (iii) the fear of being tied to a specific broker.

To address these concerns it is proposed that:

1. gilt certificates are replaced by a **statement**, together with a secure Stockholder's Reference Number (SRN)⁴ which would need to be quoted in order to identify the holding and the particular stockholder on the retail database – (there would need to be separate SRNs for each holder in a joint account);
2. stockholders on an IRD retain **full legal title to their stock**, this being tantamount to an "on register" position, yet able to deal with the full benefits of the faster OS-based settlement cycle; and
3. stockholders are allowed to deal through the **stockbroker of their choice**, via the appropriate OS IPRA, using the proposed electronic access and transfer system. The OS would hold a separate IPRA for each line of stock, but all the IPRA's would be managed collectively under a single IPRA membership relating to the issuer (ie HM Government).

These basic changes, that is minimising paper, facilitating electronic transfer and access and removing the need for a "record" to be kept for gilts, would simplify the system of registration and should reduce the overall costs to the taxpayer. This proposal would see the

³ Appendix B explains in detail how the proposed model would handle current gilt operations.

⁴ Appendix C provides more detail on the proposed construction and usage of Stockholder Reference Numbers.

settlement of all transactions within the OS, whilst enabling an "on register" solution that would still give legal title to the stockholder.

The constituent elements of the overall system have been identified as follows:

- Operator System (OS), run by CRESTCo,
- Receiving Agent (RA),
- Issuing and Paying Agent (IPA),
- Issuer's Retail Database (IRD) and its Maintainer (IRDM),
- Issuer Pooled Retail Account (IPRA).

It may be that some of these elements can be better carried out together by a single body/organisation. This is particularly so where the function is dependant on the same data and where separation might lead to unnecessary duplication. Appendix E charts these functions/ roles and compares this proposal to the current arrangements.

Overall this proposal would see current uncertificated gilt holdings, with existing OS membership, remaining on the "register" within the OS, but without a requirement to be duplicated on the issuer's "record". There would be a requirement for the appropriate balance of these holdings to be made available to the Issuing and Paying Agent on the Record Date, currently 7-10 business days before the payment date. This would also apply to the continuing private sponsored accounts and corporate nominees. Additionally, this proposal envisages that the balance on the IPRA should also be notified to the Issuing and Paying Agent in the same way. Thus all gilt dividend payments would be made by the same Issuing and Paying Agent. It should be possible to credit OS members CMA's, and for Nominees and the IPRA operator to distribute monies, according to the underlying stockholder's instructions (see page 16 "Stock Dividend Payments/Redemptions").

Legal Implications⁵

The main legal changes required by this proposal appear to be:

- (a) removal of the need to issue a certificate, which for gilts is enshrined within the **Government Stock Regulations (GSRs)**, and replacing it in the case of retail investors with a requirement to issue a statement which would not be *prima facie* evidence of title;
- (b) removal of the possibility to convert gilts from uncertificated to certificated form;
- (c) definition of the nature of an IPRA and the requirements for it to be maintained;
- (d) providing that evidence of legal title to gilts held in an IPRA is constituted by entry of the stockholder on the issuer retail database;

⁵ Further detail on the legal issues is attached at Appendix D.

- (e) removing from the **Uncertificated Securities Regulations (USRs)** the need to maintain a ‘record’ and thus the need for reconciliation of the ‘Operator register’ with the ‘record’;
- (f) facilitating the transfer of payment balances to the Issuing and Paying Agent on the Record Date in order to make accurate and timely dividend or redemption payments; and
- (g) permitting the setting up of IPRA in the OS and requiring the balances held on them to be reconciled with the details shown on the corresponding IRD.

These legislative changes would be designed to establish a regime where the underlying holders on the IRD would have legal title to stock held on the OS register in an IPRA. It would be essential that the aggregated total of the individual retail accounts was reconciled with the balance on the IPRA in the OS on a daily basis. Such a reconciliation could feasibly be carried out in a similar way to the reconciliation of a nominee’s client accounts to the nominee account in the OS. It would be substantially less costly than the current arrangements which require full duplication and regular reconciliation of the wholesale (uncertificated) records as well as the retail (certificated) element.

Implications for Equities

The Government is aware that this proposal, which effectively amounts to the compulsory total dematerialisation of gilts, will reasonably lead to questions about the settlement procedures for equities. The industry has put forward proposals for changes to the equities settlement arrangements, most recently in a paper from ProShare⁶. The Government will look constructively at such proposals. However, it believes there are important differences between the requirements for registration of equities and gilts, such as those set out on page 3. As a result, the Government thinks that, whilst being mindful of the links between the two, it is possible to deal with proposals for the modernisation of settlement procedures for equities and gilts separately.

⁶ See “Removing the paper - A modern share settlement procedure for the certificated shareholder”.

Matters for discussion

- Would the proposed model for gilts work in practice?.....
.....
.....
- What advantages does the proposed model for gilts offer over the current arrangements?.....
.....
.....
- What issues are not covered, or are insufficiently/inappropriately covered, by the proposed model for gilts?.....
.....
.....
- What are the principal business/commercial considerations arising?
.....
.....
- Does an SRN (which would be disclosed to intermediaries) provide a suitably secure alternative to the stock transfer form? If not, should a separate PIN also be used or should a new SRN be issued after each transaction?
.....
- Which of the constituent elements of the system, set out on page 5, could/should be provided by the same body/organisation?
.....
.....
- Would your organisation be interested in tendering for any of the constituent elements, should the Government decide to put them out to the market? Which one(s)?
.....
.....

**HM Treasury
September 2002**

APPENDIX A

Glossary of terms

Operator System (OS)	The electronic transaction system, run under the Uncertificated Securities Regulations 2001 (currently by CRESTCo) which facilitates the registration and settlement of dematerialised securities, including gilts.
Electronic Transfer of Title (ETT)	The changes that brought about the simultaneous settlement and registration of stock transfers, thus eliminating the gap between settlement and registration.
Issuer's Pooled Retail Account (IPRA)	A single OS account having a balance equal to the aggregate total of all the retail accounts on the IRD for a particular line of stock.
Issuer's Retail Database (IRD)	A database containing all the investor details for all the retail stockholders who hold their stock under the pooled arrangements in an IPRA.
Issuer's Retail Database Maintainer (IRDM)	The operator of the IRD.
Issuing and Paying Agent (IPA)	An OS membership specifically established with powers to make central dematerialised issues and the ability to create and administer issues in the OS. The IPA membership would replace the need for a Registrar's membership under this proposal. Also responsible for the distribution of the funds obtained from the issuer to each individual OS account, including the IPRA, for each dividend/redemption payment, according to the stock balances on each OS account.
Receiving Agent (RA)	Receives stock from the issuer and distributes it to OS members' accounts, including the IPRA, in accordance with the successful bids at issuance, in return for cash, which is passed to the issuer.

APPENDIX B

How the proposed model would handle current gilt operations

Issuance

• Public Auctions

1. The New Issue prospectus and application forms would be emailed by the DMO to the IRDM, who would record the issue details on the database, arrange for the documentation to be printed and dispatched to stockholders and advertise the issue in the national press. The details of the Issue would also need to be sent to the IPA who would create the stock on the OS.
2. Retail investors would return their completed application forms together with the appropriate payment to the IRDM, who would bank the payment, record the investor details on the database and inform the DMO of the total stock applied for by retail investors. Bids from wholesale investors would be returned to the DMO from the OS.
3. After the close of offer the DMO would transmit the breakdown of bids received from OS members, including the total retail figure, to the RA. The total stock issued would then be credited to the RA account in the OS by the IPA.
4. The RA would use matched transactions to credit members, including a single "retail" credit to the IPRA. The latter would be a "stock only" transaction, as the payment would have to be made outside the OS by the IRDM, through the banking system.
5. The next stage of the process would involve the RA transferring the cash received from the OS members and the IRDM to the DMO's cash memorandum account (CMA), using a cash-only simple delivery, in the OS.
6. Finally, once the stock price has been settled, the IPA will need to return any excess payments to retail investors, according to the payment instructions recorded on the IRD.

• Tap Issues/Standing Repos

A Tap or standing repo issue⁷ would involve the IPA crediting the RA account in the OS with the total amount of additional stock for onward delivery by matched transfer.

⁷ A further injection of an existing New Issue stock, whether permanent or cancelled the same day.

- **Switch Auctions**

The process for members relinquishing a nominal amount of one stock (the source stock) at a given price and bidding for an amount of another stock (the target stock), to be purchased at a price determined by the DMO based on the bids received, could remain largely unchanged. The injection of stock to the RA's account in the target stock would be performed by the IPA. The two legs of the auction would still be linked using a "many to many" transaction type – the first leg debiting the member's account in the OS and crediting the RA account in the source stock; the second leg debiting the RA account and crediting the member's account in the target stock. Traditionally these types of auction are only available to retail investors through a market maker, therefore the IPRA would not be involved.

- **Reverse Auctions**

Used by the DMO to buy stock back at a price determined by a bid process, the stock would be delivered to the RA account in return for cash using OS simple deliveries. The stock could then either be cancelled using a negative OS adjustment (by the IPA) or delivered back to the DMO. Currently, the cash is refunded to the RA outside the OS; under the re-engineered proposal this could take place within the OS using a cash-only delivery.

Purchases

1. The investor would approach the broker of his choice (who would normally, but not necessarily, be a member of the OS) with an instruction to purchase stock, and would agree the purchase price. If the investor is already known to the broker he/she may get faster settlement by already having funds on deposit, or the broker would insist on forward dated settlement whilst payment clears. Responsibility must lie with the broker to establish the identity of the customer.
2. The broker⁸ would input investor details (or the SRN if adding to an existing account) via OS messaging using simple delivery messages. As well as containing the investor details the message would also contain matching instructions debiting the broker's OS account and crediting the IPRA. This transaction would require matching with the IPRA operator before settlement could take place. The SRN and investor details would be put into existing shared-party details on the OS.
3. The IRDM would be searching the OS throughout the day to pick up any transactions made against any of the IPRA's (ie the IPRA for each line of stock).

⁸ It is possible that some brokers would be willing to handle retail transactions entirely off-market. They would need to match a purchaser with a seller, or be prepared to carry a float in the line of stock being transacted. It is hard to see how these transactions could be profitable for the broker, but there would be nothing to prevent them taking place.

4. On receipt of the simple delivery message, the IRD would be updated (ie the investor account would be created - or an existing account added to - providing there were no restrictions on the account preventing registration, and the investor details did not contravene the GSRs).
5. Once the simple delivery message had been validated, matched instructions would be sent by the IPRA operator to allow settlement in the OS. If there was a problem with either the SRN or the investor details, the transaction would not be matched by the IPRA operator. When the broker viewed his unmatched transaction list he would need to be able to identify which transactions the IPRA had rejected in order that they could be corrected and re-submitted – the detail of this would need to be discussed with the OS managers.
6. If the IPRA operator matched the transaction, settlement would take place when the stock moved from the broker account to the appropriate IPRA.
7. Brokers and Gilt-edged Market Makers (GEMMs) would use existing messaging to move stock from the GEMM to the Broker in return for the cash.
8. Stock and cash would settle in the OS via a simple delivery in the usual manner.
9. A statement including the SRN would be sent to the investor, at his registered address, as proof of purchase. In the case of a joint holding a statement and unique SRN would be sent to each named stockholder.

Sales

1. The investor would approach the broker of his choice (who would normally, but not necessarily, be a member of the OS) with an instruction to sell stock, and would agree the sale price. Responsibility must lie with the broker to establish the identity of the customer. The investor would produce the SRN previously sent to him when the stock was purchased. Joint holdings would require the production of each unique SRN as confirmation that the sale had been agreed with all parties.
2. The broker⁹ would input a new OS enquiry message using the investor's unique SRN. This message would be picked up by the IPRA operator polling and return information relating to the investor's holding. The exact make-up of this response remains to be determined - it could either give a positive or negative response or return the name and address of the investor, plus confirmation that sufficient stock was available (or not) for sale. The IRDM system would have to ensure that sufficient checks were carried out on the account, ie that there were no restrictions such as probates pending or court orders,

⁹ See footnote 8.

before the response was sent. The checks should not incur any delay to the response, as they would be immediate and would not require any user intervention.

Alternatively, direct access to the IRD could be made available to the broker via a secure website, in order to send the investor's SRN, rather than using OS messaging.

3. The broker would input investor details (or the SRN if adding to an existing account) via the OS messaging system using simple delivery messages. The message would also contain matching instructions crediting the broker's OS account and debiting the IPRA. This transaction would require matching with the IPRA operator before settlement could take place. The SRN and investor details would be put into existing shared party details on the OS.
4. The IRDM would be searching the OS throughout the day to pick up any transactions made against any of the IPRAs.
5. Once the simple delivery message had been validated, matched instructions would be sent by the IPRA operator to allow settlement in the OS. If there was a problem preventing registration then the transaction would not be matched by the IPRA operator. When the broker viewed his unmatched transaction list he would need to be able to identify which transactions the IPRA had rejected in order that they could be corrected and resubmitted - the detail of this would need to be discussed with the OS managers.
6. If the IPRA operator matched the transaction, settlement would take place when the stock moved from the appropriate IPRA to the broker account. The IRD would be updated accordingly.
7. The broker and the GEMM would use existing messaging to move stock from the broker to the GEMM in return for cash.
8. Stock and cash would settle in the OS via a simple delivery in the usual manner.
9. A new statement, showing either the account closed or the new balance, would be sent to the investor as confirmation that the sale was complete. In the case of a joint holding statements would be sent to each named stockholder.

Conversions

1. Once a decision to make a conversion had been made by the DMO, the entire amount of source stock available for conversion would be credited to the RA account in the OS by the IPA. The total amount of stock in issue can be viewed on the OS.

2. Investors would be invited to convert, and retail application forms would be returned to the IRDM for input onto the IRD. Completed forms would transfer the accounts to “assented” stock.
3. On the close of offer day, the IPRA operator would input a message debiting the IPRA and crediting the RA account in the operator system with the total amount of stock assented by retail investors.
4. OS members who assent to the conversion offer would also carry out (3) above for the total amount of the stock that they wished to convert.
5. At the close of business on the day before the conversion date the IPA would draw down the assented stock member balances (including the IPRA), from the operator system. The member balances would be scaled by the IPA in accordance with the conversion rate and scaled credit adjustments would be credited to the operator system member accounts (including the IPRA) in the target stock.
6. The assenting retail stockholders accounts would be scaled by the conversion rate and new holdings created in the target stock by the IRDM.
7. The RA would distribute the replacement stock using another operator system message, crediting the assenting member’s account (including the IPRA) with the appropriate amount.
8. An extra credit to the IPRA may be necessary to bring the account into line, with respect to the “rounding fractions”, with the retail accounts on the IRD, as they would have been merged individually.
9. A balance enquiry would be required to reconcile the balance on the OS IPRA account with the converted retail accounts on the IRD.

Cancellations

Stock cancellation is achieved by a special operation (ie a switch auction, standing repo, reverse auction etc.). This involves removing the stock from the OS using a “stock withdrawal” transaction, thus reducing the amount of stock in issue. Although under the re-engineering proposals stock would not be permitted to be re-materialised, functionality still needs to be in place to allow for stock cancellation. This could be achieved by using an OS negative adjustment (by the IPA), which would effectively reduce the capital outstanding in the OS.

Stock Dividend Payments/ Redemptions

These proposals assume that all payments would be made in the OS: dividend and redemption payments would be made by the IPA using the existing transaction type "cash only" unmatched stock events. On the dividend/redemption record date, the IPA would draw down the member balances from the OS, which would also include the balance for the IPRA, and make one payment to each member account – the payment made to the IPRA would have to be gross and the difference paid back to the Inland Revenue by the person maintaining the IPRA. The distribution to the underlying retail stockholders would be made by the IRDM (by BACS or warrant) based on their individual account balances and recorded payment instructions. The intention would be to preserve the option for individual stockholders to receive payments either gross or net of tax, with information and tax deducted being passed to the Revenue accordingly. The total of these payments should agree with the payment made by the IPA to the IPRA in the OS. This proposal assumes that the OS members receive their payments into their CMA, and that their settlement banks are able to pass 'real' money, received via the settlement cycle intra-day, on to the members' accounts for immediate use. This should be feasible, but not necessarily achievable, in the settlement banks' systems at present.

Alternatively, if settlement banks were unable to make the CMA cash available at the time of settlement, these proposals would require the individual member to hold and maintain BACS payment instructions within his OS account. The IPA would pull down these instructions on the Record Date together with the OS account balances.

APPENDIX C

The Stockholder's Reference Number

A secure Stockholder's Reference Number (SRN) would need to be quoted in order to identify an individual holding and the particular stockholder on the Issuer's Retail Database (IRD). The SRN would be an alphanumeric string consisting of two parts - the first part of the SRN would be the stockholder's account number unique to the Issuer's Retail Database Maintainer (IRDM) with the field size set to current maximum account number length. The account number would be needed to identify the actual retail account on the IRD. The second 3/4 characters would be unique to the stockholder and would be generated by the IRDM. The SRN would be used by the broker as authority to sell or add to existing holdings. The IRDM would accept the SRN as authority to register retail transactions.

Issuing SRNs

It is envisaged that prior to the cut-over weekend stockholders would have the opportunity to obtain their SRN, but they would not be usable until after the cut-over had taken place. Stockholders would receive a separate SRN for each of their accounts whether sole, joint or designated and these would be printed on a statement showing the stockholder's entire portfolio of gilts. The SRN for joint stockholders would be distinguishable by the unique 3/4 character string at the end - the first part comprising the retail account number would be the same for all of the holders. Replacement SRNs would be issued (perhaps for a fee) once the IRDM had confirmed the identity of the applicant(s) - the original SRN would then be cancelled irrevocably. SRNs would be valid throughout the life of the account ie, the same SRN could be used for any number of partial sales against the same account until the account balance reached zero.

Using SRNs

- **Sales**

Investors would be able to deliver SRNs by hand to the broker, or if already a known customer, by phone. The broker would use a new OS enquiry message comprising the International Securities Identification Number (ISIN), quantity and SRN to access the IRD. On receipt of the enquiry the IRDM would check the account for quantity, legal restrictions etc. and return either a positive or negative response to the broker (exact detail to be agreed). If the response was negative, a reason would also be returned such as "insufficient stock" or "invalid SRN". In these circumstances the investor or broker would need to contact the IRDM for guidance. If stock was earmarked after a positive response to a broker's enquiry had been sent, and the subsequent sale did not happen (highly unlikely), then the earmark would have to be removed, which would involve more OS messaging. If the IRDM received a second enquiry against the same account within a 7 day period, then the broker would

receive a message stating that an enquiry had already been made of that particular account, and the IRDM would need to be contacted for guidance.

If the response to the enquiry was positive the broker would continue with the sale virtually guaranteed that registration would be successful. Having arranged the sale with a GEMM the broker would input the OS message which would include the SRN. On receipt of the transaction the IRDM would debit the relevant retail account and issue a new statement to the stockholder.

For joint holdings all SRNs would be needed by the broker as confirmation that all stockholders were party to the sale and were content to proceed with it. In addition all SRNs would need to be input in the balance enquiry otherwise a negative response would be received from the IRDM requesting the outstanding SRNs.

- **Purchases**

If the investor did not have an existing account in the stock that he wished to purchase and therefore did not have an SRN, the broker would input the appropriate OS message and include the investor details. On receipt of the transaction, the IRDM would create a new account and generate an SRN, which would be sent to the investor's registered address along with a statement. The statement would show the stockholder's entire holdings in all stocks, if the system found a match, and replace any previous statement.

If the investor already had an SRN for the stock that he wished to purchase and wanted to add to his existing account, the broker would quote the SRN instead of supplying the investor details. This would ensure that the existing account was credited when the OS message was received by the IRDM. A new SRN would not be generated for this transaction - only a new statement.

- **Off-Market Transactions**

If a stockholder wished to transfer his holding off-market (ie through an off-market broker or through a direct transaction with another retail stockholder) then the SRN would need to be surrendered to the IRDM together with the new investor's details. A new SRN would be issued to the transferee together with a statement after the transfer had taken place. There would not be an OS movement, as the total stock on the IPRA would not have changed.

APPENDIX D

Amending the USRs and other legislation for the proposed model

At present there are two ways of registering UK Government stock (gilts)¹⁰ under two different sets of legislation. Legal title to certificated gilts is established by their entry on a register maintained by the Bank of England and administered under the Government Stock Regulations 1965 made under the Finance Act 1942; and such gilts are transferred by written instrument in accordance with the Stock Transfer Act 1963. Legal title to uncertificated gilts is established by their entry on an “operator register of public sector securities” maintained in the OS under the USRs 2001 made under section 207 of the Companies Act 1989, and such gilts are transferred electronically through the OS under the USRs. The GSRs are largely disappplied in relation to uncertificated gilts – see regulation 52(1) of the USRs, paragraph 12(2) of Schedule 4 and paragraph 14 of Schedule 7 – but regulation 21(2) of the USRs and paragraph 13 of Schedule 4 require the Bank to keep a “record of uncertificated public sector securities” mirroring the details of uncertificated gilts shown on the operator register.

The principal legislative changes necessary to implement the proposals for re-engineering are likely to be as follows:

- **Removal of the requirement for a “record” kept by the Bank** – The obligation on the Bank to maintain a “record” of uncertificated gilts (currently held by the Bank’s Registrar’s Department in Gloucester) would be removed by amending or deleting regulations 21(2) and (3) of the USRs and paragraph 13 of Schedule 4.
- **Provision for the creation of IPRA**s – The USRs would be amended to define the nature of an IPRA (broadly speaking, an account holding in dematerialised form so much of a given line of stock as is not held in the name of a “system-member” of the OS) and the requirements which would have to be met in order to set one up. It is thought that the function of maintaining an IPRA probably need not be a regulated activity under the Financial Services and Markets Act 2000, because the person maintaining it would be acting on behalf of the issuer (in the same way that acting as a company registrar is not a regulated activity, because registrars act on behalf of the companies whose registers they maintain). However, the USRs will need to specify requirements to be met by a person maintaining an IPRA, to ensure that it remains compatible with the OS, operates correctly and efficiently and is reconciled with the details on the corresponding IRD. Further consideration will be needed about other such requirements, though some might correspond to requirements which have to be met for a person to be approved as an Operator under Schedule 1 to the USRs. So far as the role of a person maintaining an IPRA would correspond to that of a system-member or participating issuer, that person

¹⁰ This note does not deal with local authority securities, which are the other form of “public sector securities” as defined in the USRs. However, there is no reason in principle why the same approach should not be taken in relation to them.

would also have to be required to comply with the rules of the OS applicable to system-members and participating issuers.

- **Giving legal effect to entries on IRDs** – The Issuer’s Retail Database would, in effect, be a direct replacement for the register of certificated gilts. New provisions would therefore be required, either in the GSRs or the USRs, requiring an IRD to be set up and maintained for each line of stock held in an IPRA and specifying, for example:
 - the details required or authorised to be kept on the IRD;
 - that the IRD would be prima facie evidence of the matters required or authorised to be kept on it;
 - how title to the units of stock to which the entries on the IRD relate may be transferred, so as to cover not only transactions which involve the movement of such units out of or into the relevant IPRA, but also off-market transactions between retail holders both of whom hold the stock through the IRD – for example, where there is a transfer by operation of law upon insolvency or the granting of probate; and
 - the requirements which would have to be met by an IRDM.

As to the last of these, it is again thought that the role of IRDM probably need not be a regulated activity under the FSMA 2000 because the IRDM would be acting on behalf of the issuer (and the same person may in practice be both IRDM and maintainer of the IPRA). But again, it will be necessary to specify requirements to be met by a person both before and while operating as an IRDM, to ensure that the IRD operates correctly, efficiently and coherently with the relevant IPRA; and once more, these requirements may to some extent mirror some of those which have to be met for a person to be approved as an Operator under Schedule 1 to the USRs. The obligations on an IRDM would include duties to issue statements of holdings and SRNs, with appropriate security measures, and to reconcile the details on the IRD with the balance shown on the corresponding IPRA.

- **Certificated gilts as a residual category only** – For all gilts normally to be held in future in uncertificated form on the OS, including (in IPRA) those owned by persons who do not themselves use the OS (by direct or sponsored membership or through a nominee), the provisions of the USRs enabling securities to be converted from uncertificated to certificated form - primarily regulation 32 and in part paragraphs 18 and 25(b) of Schedule 1 - would need to be disapplied in relation to gilts. Gilts would then normally be issued only in uncertificated form and there would be no means of changing that form. However, the Treasury need to retain the ability to issue gilts in certificated form, in case an issue was required in an emergency when the OS was out of operation. Therefore:

- the provisions of the GSRs and other legislation enabling the issue and “paper” transfer of certificated gilts would need to remain in force, for use if necessary; and
- the provisions of the USRs enabling the conversion of securities to uncertificated from certificated form - primarily regulation 33 - would still apply to gilts, so that any gilts issued in certificated form in an emergency could be dematerialised and brought into the OS once the emergency was over.

Transition

At least two kinds of transition have already been used to bring securities within the USRs. For equities, a two-stage process was used. First each line of stock separately became capable in principle of transfer within the OS - ie became a "participating security" - by each issuer signing the necessary OS forms and the Operator admitting that line of stock. Then each holder had to take action to put his own holding of stock into the OS, if he so wished, by sending a special form and relinquishing his certificate to the registrar and having his holding moved onto what was then the uncertificated part of the register (now the “Operator register of members”).

For gilts a "Big Bang" approach was taken, whereby all stock held by persons who wished in future to carry out gilts transactions through the OS, together with outstanding transactions concerning them, were moved from the Central Gilts Office (CGO) into the OS over one weekend in July 2000. Members had been required to tidy up their holdings in the CGO and open equivalent accounts in the OS. These actions were permitted by regulations 2(2) and (7)(c) of the USR (Amendment) Regulations 2000, and by provisions in the GSR (Amendment) Regulations 2000. This was done because there were thought to be market difficulties with a gradual approach.

For TAURUS, governed by the Uncertificated Securities Regulations 1992, once the issuing company and the Operator had agreed to admit the security, share certificates were no longer evidence of title (regulation 48 of the 1992 USRs); no action was needed by holders, but publicity was required to ensure that those holding certificates as collateral could take the necessary action to secure their charges.

Other miscellaneous legislation

A host of other detailed amendments will be required beside the main changes outlined above, both to the USRs and to the other legislation currently governing gilts. For example, the definition of “stockholder” in section 3 of the National Debt Act 1870 (which determines to whom the dividends on gilts are payable, and which has already been amended by paragraph 1 of Schedule 7 to the 2001 USRs) will need to refer to a person entered as the holder of gilts on an IRD rather than on a register kept by the Bank.

APPENDIX E

Roles and responsibilities now and under the proposed model

FUNCTION	ACTIVITIES
The Issuer	<ul style="list-style-type: none">• Current <p>The Issuer's function (in relation to gilts registration) can be defined as:</p> <ul style="list-style-type: none">- Production of forms for all special operations and liaison with the Registrar to arrange distribution;- Sending details of special operations to the Registrar;- Receiving total new issue retail applications from the Registrar;- Sending breakdown of all new issue market bids to the Registrar; and- Receiving daily update and final total of retail and market conversion assents from the Registrar. <hr/> <ul style="list-style-type: none">• Future <p>The issuer's role would remain largely unchanged. However, if the functions currently undertaken by the Bank of England Registrar were performed by different bodies, the issuer would need to interface/communicate with all of them:</p> <ul style="list-style-type: none">- Production of forms for all special operations and liaison with the IRDM to arrange distribution;- Sending details of special operations to the IRDM, RA & IPA;- Receiving total new issue retail applications from the IRDM;- Sending breakdown of all new issue market bids to the RA;- Sending total of all new issue bids (market & retail) to the IPA;- Receiving daily update and final total of retail conversion assents from the IRDM; and- Receiving daily update and final total of market conversion assents from the RA.

APPENDIX E

Roles and responsibilities now and under the proposed model

FUNCTION	ACTIVITIES
Investor	<ul style="list-style-type: none"> • Current The investor buys and sells stock either direct from the issuer (for new issues), through a broker or the Bank of England's brokerage service. He can take part in a number of special operations including outright auctions, conversions, reverse auctions and redemptions. The Registrar sends a certificate for every purchase but nothing for a sale. A sale requires a stock transfer form to be signed and backed by a stock certificate. <hr/> <ul style="list-style-type: none"> • Future The investor's role would change in a number of ways but all should be marketed as improvements and be seen as beneficial: <ul style="list-style-type: none"> • Retail stock would be held in a pooled account in the OS but the equivalent of “name on register” status would be achieved through on the IRD; • The stock certificates would be replaced with a single statement showing all holdings. A new statement would be issued against every sale and purchase giving advance notification of transfer fraud; and • A stockholder’s reference number (SRN) would be issued on the statement which would be accepted by all brokers for sales and purchases.
Issuing & Paying Agent (IPA)	<ul style="list-style-type: none"> • Current This role is currently performed electronically in the OS under a Registrar's membership. Stock is credited to the Receiving Agent's account in the OS and reconciled daily against the overall stock balance held on the Bank of England Register. Cash to meet dividend and redemption payments is drawn down from HMT and reconciled annually. All redemption/dividend payments are made by warrant or BACS. On an annual basis the paying agent is responsible for reporting to the Inland Revenue all payments made to individuals including any amounts of tax, under section 17/18 Taxes Management Act 1970. <hr/> <ul style="list-style-type: none"> • Future Under the re-engineering proposal the IPA would still retain all of the above responsibilities, but the role would be simplified if all payments were made in the OS including one payment to the Issuer's Pooled Retail Account - as a result there would not be any returned payments to deal with. In order to make the payments the IPA would need to pull down the IPRA and member balances from the OS on the record date.

APPENDIX E

Roles and responsibilities now and under the proposed model

FUNCTION	ACTIVITIES
Receiving Agent	<ul style="list-style-type: none">• Current <p>The Receiving Agent (RA) receives stock from the Registrar and delivers it to the members in return for cash. The cash is paid back to the issuer through the OS. As well as all New Issues the RA also has responsibility for corporate actions - the only gilt corporate action is the conversion where members deliver stock to the RA in return for a like amount of assented stock - on the evening before the conversion date OS members receive scaled amounts of the target stock from the Registrar.</p>
	<ul style="list-style-type: none">• Future <p>The role of the Receiving Agent would remain unchanged other than receiving stock from the Issuing and Paying Agent instead of the Registrar.</p>
Issuer's Retail Database Manager (IRDM)	<ul style="list-style-type: none">• Current <p>Holds the database of all retail stockholders and is responsible for the creation, maintenance and closure of all retail accounts. The maintenance includes registration of death, court orders, powers of attorney and the registration of transactions (electronic and off-market). In addition to keeping the retail register, the registrar is legally obliged to keep a record of all OS member accounts and to update all account movements intra-day by picking up OS transactions across a secure network.</p>
	<ul style="list-style-type: none">• Future <p>Under the re-engineering proposal this role would be greatly reduced in that there would no longer be a legal requirement to keep a duplicate record of the full OS Register. The IRDM would only retain responsibility for maintaining the retail database (IRD) and reconciling it with the IPRA. The distribution of all retail dividend and redemption payments would have to be made by the IRDM, if all payments were made in the OS by the IPA. Stock certificates would no longer be issued, instead the IRDM would issue statements and SRNs.</p>

APPENDIX E

Roles and responsibilities now and under the proposed model

FUNCTION	ACTIVITIES
Settlement System	<ul style="list-style-type: none">• Current <p>To provide a real-time settlement system for UK and International shares, UK government bonds and other corporate securities. It enables participants to hold securities in uncertificated form and transfer them electronically with full delivery versus payment.</p>
	<ul style="list-style-type: none">• Future <p>The role of the OS under the re-engineering proposal would not change although all British Government Stock would be held in the settlement/registration system with the consequence that stock would not be available for deposit or withdrawal - this would mean the introduction of a new broker enquiry message.</p>
Broker	<ul style="list-style-type: none">• Current <p>The broker currently has to complete a stock transfer form over the signatures of the stockholders and obtain the stock certificate before sending the transfer to the OS counter services. Without access to the retail database the broker has no assurance that the transaction will not be rejected by the registrar.</p>
	<ul style="list-style-type: none">• Future <p>Instead of accepting stock certificates as proof of ownership, brokers would use the new stockholder's reference number (SRN) to enquire of the issuer's retail database via the OS. The response from this enquiry would determine whether or not the transaction would be accepted by the IRDM.</p>