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EUROCLEAR BANK (EB) AS LONG-TERM CENTRAL SECURITIES DEPOSITORY (CSD) FOR IRELAND POST BREXIT

Report of the Irish Working Group (WG) 5 Held on 12 MARCH 2019

Below is a summary report of the main conclusions of the WG5 meeting. Representatives of the Irish Revenue Commissioners and of the Dept. of Finance attended this meeting.

PART I: WG GOVERNANCE

- The minutes of WG3 had been circulated recently before the meeting and suggestions for amendment would be taken by email by the end of the week.
- The report of WG3 would be available shortly after the meeting.

PART II: TAX

Withholding tax

- In order for the beneficial owner (BO) to benefit from Relief at Source (RAS), any intermediary in the chain would need to qualify as a Qualified Intermediary (QI). As EB was already a QI, every intermediary down the chain would also need to be in order for the BO to benefit from RAS.
- Every QI would need to have the necessary information about their underlying client and on record date (RD), they would advise EB of the split of how much income needs to be paid at the default 20% tax rate and how much would need to be paid with RAS.
- EB would inform the Registrars on RD of this. EB had one nominee account, Euroclear Nominees, on the register. EB would advise the Registrar of how much of the total position would need to be paid at the default tax rate of 20% and how much should be paid with RAS. This was subject to approval from the Registrars and the Revenue Commissioners (RC).
- EB would have 1 nominee account in the register and would in turn inform the Registrars who would do the filing with the RC based on the total holding in one single account.
- The Registrars would pay EB on PD. Any CDIs held in EUI would be treated as foreign instruments and therefore would be taxed at the 20% tax rate. The CDI service does not currently include tax services. This is something that Euroclear is looking into however it was not something that could be added to the critical path of the EB solution. Ms. Mestdagh reiterated that RAS was only possible for those securities held in EB.
- For any pending transactions over RD, a market claim would be generated.
- The overview provided by EB to the Registrars on RD-2 is for information only. The position to be taken into account was the actual position on RD.
- It was not necessary to lodge the paperwork with EB. It was the responsibility of the QI to hold the information and provide the split of amount to be paid at RAS and amount to be paid with default WHT.
- EB would check whether the Participant was a QI. The client of an intermediary who did not have the QI status would not benefit from RAS.

PART III: MIGRATION FROM EUI TO EB

Legal Considerations of Migration

- A single event migration was the proposed approach. The market would migrate over one weekend.
- A bespoke legislative mechanism would be far preferable to individual schemes of arrangement (SoA) or bonus issues, to minimise systemic risk and to allow for the market migration to be effected in a coordinated manner with manageable system and market risk.
- The relevant legislative amendment would need to be in place by end of Q4 2019 in order to be ready for the usual AGM cycle in spring 2020.
- One of the numerous risks of any SoA approach was the workload for the High Court. There would be a very large number of schemes going through in a short space of time and would represent a significant additional workload for the High Court as well as the timing and other risks associated with attempting to coordinate all those applications.
- In case any Issuer did not obtain the required approvals as per the SoA process, that security would need to be removed from CREST and shares held in certificated form.
- Approval by shareholders would be by way of a vote on a special resolution at a general meeting. Dissenting shareholders would be able to “opt out”. It was believed that the level of safeguards was an appropriate balance against the risk we were trying to mitigate of a disruptive, uncoordinated and risky migration.
- The issuers’ representative indicated that all of the company secretaries of the largest 16 issuers were strongly in favour of a legislative mechanism. To them, the alternative (SoA) was not a realistic option.
- It was noted that there had previously been migrations carried out by some of the large ETF Issuers migrating from EUI to Euroclear Bank, which had taken between six and eight months and involved a high level of risk, particularly the process of getting shareholders’ votes, the legal process, as well as significant cost and operational effort. This view was supported by the Registrars.
- The AFME Board would be approached to confirm their views on the migration.
- The Brokers and the CCPs indicated that the legislative change was the only workable solution.
- **All stakeholders in the WG formally confirmed that they were in favour of the “bespoke” legislative mechanism for the migration.**

Operational Aspects of Migration

- Staggered migration had been assessed and discounted because it would represent too much risk for the market. The migration would happen over a single weekend.
- The migration date would need to be outside of any corporate action period or other time of a major market adjustment or event (e.g. settlement discipline implementation).
- During a certain period of time before migration date there should not be any corporate actions.
- In the month leading up to the migration date there would be a full reconciliation done on a weekly basis by the Registrars to make sure there were no discrepancies between the holdings in EUI and with the Registrars.
- The date on which EUI would stop stock withdrawals and deposits had yet to be set, likely to be the week before migration. In case shareholders wanted to hold their securities directly on the register it would need to be done by that date.
- DBV for Irish securities would be forced to close out a few days prior to migration.
- Any IPO in the pipeline should not happen during the “whiteout period”.
- Prior to actual migration, all Registrars have to complete a full reconciliation with EUI. Any reconciliation issues would need to be resolved within 1 hour. The migration could not start until all discrepancies in the reconciliation were resolved.
- The Registrars would need to have the authority to debit the CREST members’ account and credit the EB nominee account by effect of law. EB is investigating if there is a legislative mechanism under Irish law to reflect change of legal title in the register from name on register to EB nominee without the need for a stock transfer form.
- EB would reconcile the movements it saw on the account with the statements that EB received from Registrars.
- EUI would be able to reflect all domestic Irish securities as international securities in the form of CDIs.

- EB would credit the whole position of EB Nominee into the account of CREST International at EB. As far as Participants were concerned, they maintained their positions as they did today.
- On the Monday morning, in the event a Participant did not want to hold these securities as a CDI in EUI as the Participant would rather have them in EB, the Participant would need to enter cross delivery instructions. The WG noted that it was the underlying Participant who needed to enter those instructions, not the Registrars.
- Stock loan and pending transactions could remain outstanding during migration.
- Some members of the WG expressed reservation on the proposed migration process as the default position was to remain in EUI as CDI.
- The process whereby the CREST members would transfer their holdings to EB would be extremely difficult to coordinate and that all the members would do it at a different time. It would require the mapping from every CREST member to which EB accounts the holdings would need to go to.
- There would be a dedicated meeting focus on the migration approach, with the objective of reviewing in detail and comparing the possible options.
- The proposed migration date, in the present circumstances, is 27th November '20 which implied being ready by the end of summer 2020. The WG noted that this posed a very challenging timeline.
- The Authorities for the time being had indicated the market should work to a migration completion by end 2020 in view of Brexit timelines.
- The market wide considerations and external factors would be added to the implementation timeline.

PART II: TAX

Stamp Duty (SD)

- Today gross trades were sent to EUI. There were rules in the CREST settlement system to identify Irish securities trades. The trades were assessed for SD that was calculated, withheld and paid to the Irish Revenue Commissioners (RC).
- Going forward EB would play a role in the assessment, calculation and payment of the SD.
- For OTC and on-exchange uncleared transactions, EB would calculate the SD as EUI did today as EB received the gross trades.
- Euroclear had done a sample check on a typical day of activity in EUI. Based on the volume on that day, 95% of the SD was generated by gross trades in OTC and on-exchange uncleared transactions.
- The challenge was for the cleared transactions as the CCP sent net settlement transactions. Without receiving the underlying gross settlement trades, it was not possible for EB to calculate the SD. There had been discussions with the CCPs to define a solution.
- One of the options initially considered was to stop netting agency trades and send them to EB on a gross basis. This option had been rejected by the CCPs.
- The RC indicated that it was important for them to have the dataflow for all trades in order to be able to tell whether the correct stamp was withheld.
- The WG discussed the option of paying SD on the client leg. The Participant would pay the SD on the client leg directly to the RC. EB would not be involved in the SD payment for these transactions. The CCPs side would continue to work as it did today. The Participant would apply the SD flag on the settlement instruction of the client leg. This option might require the CCPs to create a file with the gross purchases as principal.
- A dedicated workshop with representatives of both the Department of Finance and the RC, the CCPs, Mr. Stewart, Mr. O'Carroll and EB would be organised to address the cleared transaction issue and discuss the SD on client leg option.
- A considerable block of the RC work was in the management of refunds. In last year alone, the amount that was repaid was significant. There was now an opportunity to make the process for cleared transactions more efficient.
- Participants would need to use a specific code or flag on stock loan transactions for EB to automatically report as being exempted.

Next Steps:

- There were still some material gaps in the content of the White Paper pending completion of further market workshops and input from the Authorities on certain

points. Once they were complete and agreed, Euroclear would circulate to the WG a draft of the White Paper for input and for onward circulation and discussion with each member's market constituency with a view to sign off by all members and constituencies within a week. In parallel the WP would also be provided to the Authorities.

- WG6 would be organised to look at migration again and to review the White Paper, timing likely to be end of March.