Euroclear Ireland – Delivering continuity of Irish securities settlement post-Brexit

White Paper • February 2018
IMPORTANT INFORMATION

The proposals considered in this White Paper, and in particular the timely establishment of Euroclear Ireland, cannot be guaranteed and remain subject to a number of factors, including: the timing and terms of the UK’s withdrawal from the EU and the UK’s future relationship with the EU, ongoing legal and regulatory analysis, ongoing detailed technical analysis, legislative actions, further Euroclear internal approvals and the approval of regulators, CCPs, central banks, settlement banks and other stakeholders.

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Introduction

This White Paper sets out a proposed structure of a new central securities depository (CSD) for Ireland to be operational in March 2019. The proposed establishment of this new CSD, to be called (for the purposes of this document) Euroclear Ireland (EIR), has been approved in principle by the Boards of Euroclear SA/NV (ESA) and Euroclear UK & Ireland (EUI), but is subject to a number of internal and external dependencies, including regulatory approvals and permissions (in Ireland, the United Kingdom (UK), Belgium and in the United States (US)).

Your attention is drawn to the Important Information contained on page 2.

Our intention is that this new CSD would be based in Ireland and would be the Issuer CSD for Irish corporate securities. We expect EIR to be subject to authorisation and ongoing supervision by the Central Bank of Ireland (CBoI) in accordance with the EU CSD Regulation (CSDR).

As a consequence, EIR will need to submit an application for authorisation to the CBoI as its relevant competent authority under the CSDR. Pre-authorisation discussions with the CBoI have begun and are at an early stage; this White Paper is separate from the authorisation process. Euroclear has also begun discussions with other relevant regulatory authorities in Belgium, the UK, and the US.

We believe that establishing Euroclear Ireland in Dublin should:

- enable Euroclear to continue to support settlement of Irish corporate securities after the UK leaves the European Union
- enable the Irish corporate securities markets to continue to operate effectively post-Brexit
- meet the policy objectives established by Irish Finance Minister Paschal Donohoe on 27 July 2017 when he noted publicly that "the establishment of an Irish based CSD would best ensure the smooth continuation of settlement services to market participants and in doing so, support financial stability"

In order to minimise risks, change and costs, we propose that EIR and EUI (which would be renamed Euroclear UK (EUK)) would use a common settlement infrastructure, namely the CREST system. Currently EUI operates two securities settlement systems, the CREST UK system and the CREST Irish system, through one technical system.

Our proposal involves the continuation of two legally distinct settlement systems, the 'EIR system' operated by EIR in accordance with Irish law; and the 'EUK system' operated by EUK in accordance with UK law. In technical terms, as now, there would continue to be one instance of the CREST technical system.

This paper is divided into two sections:

- **Section A** describes the potential structure, operation and services of EIR. It is based on long, constructive and ongoing discussions both with Irish stakeholders and the Irish authorities
- **Section B** looks briefly at the consequences of Brexit upon some of the services currently operated by EUI

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1. To coincide with the withdrawal of the UK from the European Union (EU) exactly two years from the UK’s notification of its decision to leave the EU under Article 50 of the Treaty on the European Union.
To assist the reader we have included a glossary of terms used in this paper (on pages 6 and 7).

It is important to stress that, while Euroclear has made a decision in principle to seek to establish a new CSD in Ireland, the continued uncertainty over the precise nature of the UK’s relationship with the EU after March 2019 means that it is still possible that other solutions, delivered to different timelines, might also be appropriate for Ireland.

The establishment of EIR by end-March 2019 is a project which is driven (amongst other things) by the need to ensure that Euroclear is able to service the Irish corporate securities markets efficiently, and with legal certainty, at the point of a so-called ‘hard-Brexit’.

Questions or feedback on this paper should be addressed to your Relationship Manager.
### Glossary of terms and abbreviations

<table>
<thead>
<tr>
<th>NAME</th>
<th>ABBREVIATION</th>
<th>MEANING</th>
</tr>
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<tbody>
<tr>
<td>Bank of England</td>
<td>BoE</td>
<td>-</td>
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<tr>
<td>Brexit</td>
<td>-</td>
<td>The UK’s withdrawal from the European Union</td>
</tr>
<tr>
<td>Cash Memorandum Account</td>
<td>CMA</td>
<td>As defined in the CREST glossary&lt;sup&gt;4&lt;/sup&gt;</td>
</tr>
<tr>
<td>Central Bank of Ireland</td>
<td>CBoI</td>
<td>-</td>
</tr>
<tr>
<td>Central Counterparties</td>
<td>CCPs</td>
<td>-</td>
</tr>
<tr>
<td>CREST system</td>
<td>-</td>
<td>The technical system currently operated by EUI to provide CSD services in respect of UK and Irish securities</td>
</tr>
<tr>
<td>Crown Dependencies</td>
<td>-</td>
<td>Guernsey, the Isle of Man and Jersey</td>
</tr>
<tr>
<td>Central Securities Depository</td>
<td>CSD</td>
<td>-</td>
</tr>
<tr>
<td>European Central Bank</td>
<td>ECB</td>
<td>-</td>
</tr>
<tr>
<td>European Economic Area</td>
<td>EEA</td>
<td>-</td>
</tr>
<tr>
<td>European Union</td>
<td>EU</td>
<td>-</td>
</tr>
<tr>
<td>Euro</td>
<td>EUR</td>
<td>-</td>
</tr>
<tr>
<td>Euroclear Bank</td>
<td>EB</td>
<td>An international CSD operated from Belgium and part of the Euroclear group</td>
</tr>
<tr>
<td>Euroclear Ireland Limited</td>
<td>EIR</td>
<td>The proposed new Irish CSD</td>
</tr>
<tr>
<td>Euroclear SA/NV</td>
<td>ESA</td>
<td>The immediate parent company of Euroclear group CSDs</td>
</tr>
<tr>
<td>European Securities and Markets Authority</td>
<td>ESMA</td>
<td>-</td>
</tr>
<tr>
<td>Euroclear UK &amp; Ireland Limited</td>
<td>EUI</td>
<td>The UK CSD currently operating the CREST system</td>
</tr>
<tr>
<td>Euroclear UK Limited</td>
<td>EUK</td>
<td>The proposed new name of Euroclear UK &amp; Ireland after establishment of Euroclear Ireland</td>
</tr>
<tr>
<td>Exchange Traded Funds</td>
<td>ETF</td>
<td>-</td>
</tr>
<tr>
<td>Investor CSD</td>
<td></td>
<td>A CSD that either is a participant in the securities settlement system operated by another CSD or that uses a third party or an intermediary that is a participant in the securities settlement system operated by another CSD in relation to a securities issue</td>
</tr>
</tbody>
</table>

<sup>4</sup> [https://my.euroclear.com/dam/EUI/Legal%20information/2017-05-31CRESTGlossary-clean-SR.pdf](https://my.euroclear.com/dam/EUI/Legal%20information/2017-05-31CRESTGlossary-clean-SR.pdf)
<table>
<thead>
<tr>
<th>NAME</th>
<th>ABBREVIATION</th>
<th>MEANING</th>
</tr>
</thead>
<tbody>
<tr>
<td>Irish securities</td>
<td>-</td>
<td>Securities constituted under the law of Ireland</td>
</tr>
<tr>
<td>Irish Settlement Finality Regulations</td>
<td>Irish SFRs</td>
<td>Irish European Communities (Settlement Finality) Regulations 2010</td>
</tr>
<tr>
<td>Irish Stock Exchange</td>
<td>ISE</td>
<td>-</td>
</tr>
<tr>
<td>Irish Uncertificated Securities Regulations</td>
<td>Irish USRs</td>
<td>Irish Companies Act, 1990 (Uncertificated Securities) Regulations, 1996</td>
</tr>
<tr>
<td>Issuer CSD</td>
<td>-</td>
<td>A CSD providing CSDR core services of notary and central maintenance in relation to a securities issue</td>
</tr>
<tr>
<td>London Stock Exchange</td>
<td>LSE</td>
<td>-</td>
</tr>
<tr>
<td>Liquidity Memorandum Account</td>
<td>LMA</td>
<td>As defined in the CREST Glossary</td>
</tr>
<tr>
<td>Pound Sterling</td>
<td>GBP</td>
<td>-</td>
</tr>
<tr>
<td>TARGET2</td>
<td>T2</td>
<td>The real-time gross settlement (RTGS) system for the Eurozone, developed and owned by the Eurosystem</td>
</tr>
<tr>
<td>TARGET2-Securities</td>
<td>T2S</td>
<td>The single, pan-European platform for securities settlement in central bank money developed and owned by the Eurosystem</td>
</tr>
<tr>
<td>The United Kingdom of Great Britain and Northern Ireland</td>
<td>UK</td>
<td>-</td>
</tr>
<tr>
<td>third country</td>
<td>-</td>
<td>the term ‘third country’ is used to refer to countries which are not in the EU</td>
</tr>
<tr>
<td>UK securities</td>
<td>-</td>
<td>Securities constituted under one of the laws of the United Kingdom. For the purposes of this White Paper, UK securities include securities constituted under the laws of one of the Crown Dependencies</td>
</tr>
<tr>
<td>UK Settlement Finality Regulations</td>
<td>UK SFRs</td>
<td>Financial Markets and Insolvency (Settlement Finality) Regulations 1999</td>
</tr>
<tr>
<td>UK Uncertificated Securities Regulations</td>
<td>UK USRs</td>
<td>UK Uncertificated Securities Regulations 2001 (and, for the purposes of this definition, the USRs of the Crown Dependencies)</td>
</tr>
<tr>
<td>US Dollar</td>
<td>USD</td>
<td>-</td>
</tr>
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</table>
Section A: Proposed Irish CSD

1 Background to a new Irish CSD

This Chapter sets out the background to the requirement for a potential new CSD for Ireland and the principles which, we believe, should apply to such a CSD.

1.1 Introduction

Euroclear has provided post-trade services for Irish securities for over 20 years. Irish corporate securities and Exchange Traded Funds (ETFs) are currently settled in the CREST system operated by EUI, a UK-incorporated CSD. Irish government securities are settled in Euroclear Bank, an International CSD (ICSD) incorporated in Belgium.

The CREST system:

- provides a single harmonised service in respect of both UK securities and Irish corporate securities. EUI operates two legally distinct securities settlement systems (the CREST UK system and the CREST Irish system) in one technical infrastructure known as ‘the CREST system’
- settles transactions against a multi-currency choice of central bank money Pound Sterling (GBP) and Euro (EUR) and currently commercial bank money US Dollar (USD)
- provides ‘name on register’ legal title ownership, integrated Irish and UK stamp duty assessment, a full range of corporate action functions and a paper interface (for those investors who continue to hold corporate securities in certificated form)

We recognise that Brexit may make the current arrangements between EUI and the Irish corporate securities market untenable. This is because, in her letter to the President of the European Council which triggered the Article 50 notification, Prime Minister Theresa May stated that the UK would not seek membership of the Single Market. This implies that when the UK leaves the EU, UK firms (such as EUI) will no longer be able to passport their services across the EU under Single Market Directives, such as CSDR. EUI had intended to passport its services as Issuer CSD for Irish corporate securities into Ireland from the UK, under Article 23 of CSDR.

Since March 2017, there has been increasing focus on so-called ‘equivalence provisions’ in certain pieces of EU legislation (including CSDR) that would give third country firms some access to the EU. The relevant third country provisions for EUI (post-Brexit) are contained in Article 25 of CSDR and would require ESMA to recognise EUI as a third country CSD and for the European Commission to recognise that EUI was subject to domestic regulations equivalent to those in CSDR. Our current view is that the equivalence process does not, for a variety of reasons, offer sufficient certainty to be the preferred option for continuing to service Irish corporate securities.
1.2 The Irish Capital Market

The Irish capital market is dynamic and growing:\n
- 51 companies listed on Irish Stock Exchange (ISE) Main and Enterprise Securities Markets
- over 200 listed ETFs
- over 35,000 security listings on the ISE
- total market capitalisation of equities listed on the ISE was around EUR 120bn (end-2016)
- the market capitalisation of the Irish Government bond market on the ISE was around EUR 120bn (end-2016)
- ~ 88% of ISE quoted securities are dual-listed in Dublin and London; nine of which are UK companies
- seven Irish companies are part of the FTSE100 or FTSE250 Indices, four of which are only listed on the London Stock Exchange (LSE)

This complex web of cross-listing and index inclusion means that the Irish capital markets rely on multi-currency trading and settlement services. For example, for a security to be included in the FTSE100 requires it to have a GBP price quote (because the index is a GBP index) which in turn leads to a requirement for GBP settlement. In addition, as many ETFs track USD indices, transactions often settle against USD consideration. Where most domestic CSDs in the EU settle only against their domestic currency, EUI has provided multi-currency settlement to the Irish market for many years.

Euroclear currently supports the Irish capital markets in three main ways:

1. issuer CSD services for securities constituted under the law of Ireland (Irish securities) are provided by EUI, using the CREST system. Securities settle:
   - in central bank money in GBP (via arrangements with the Bank of England (BoE)
   - in central bank money in EUR, with EUI having an ‘ancillary system’ connection to the ECB’s TARGET-2 system through arrangements with the CBoI\(^6\)
   - in commercial bank money in USD\(^7\)
2. issuer CSD services for Irish government bonds are provided by Euroclear Bank in commercial bank money
3. Irish funds settlement services are offered by EUI and by Euroclear Bank

Brexit should not directly affect the services in Irish government bonds and Irish funds offered by Euroclear Bank.

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\(^7\) Ancillary system status is currently contingent, under Eurosystem rules, on establishment in the EU or the EEA.

A service which we plan to upgrade to central bank money settlement ahead of the creation of EIR.
1.3 Settlement activity in Euroclear UK & Ireland

The total value of Irish securities (corporate securities and ETFs primarily) which are held in EUI is currently around EUR 182bn.

The multi-currency nature of the Irish capital market described above however, is demonstrated by EUI’s settlement statistics (see table below covering the period July 2016 – June 2017). Only around a third of transactions in Irish securities are settled against EUR. Two thirds of transactions are routinely settled against GBP and USD.

<table>
<thead>
<tr>
<th>CURRENCY</th>
<th>GBP EQUIVALENT VALUE</th>
<th>%</th>
<th>TXNS</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR</td>
<td>~205bn</td>
<td>31.8%</td>
<td>~961,600</td>
<td>35.5%</td>
</tr>
<tr>
<td>GBP</td>
<td>~165bn</td>
<td>29.2%</td>
<td>~1,229,500</td>
<td>45.3%</td>
</tr>
<tr>
<td>USD</td>
<td>~287bn</td>
<td>39.0%</td>
<td>~521,700</td>
<td>19.2%</td>
</tr>
</tbody>
</table>

We, therefore, consider it vital for this currency flexibility to be preserved post-Brexit, if possible.

1.4 The principles supporting a future CSD in Ireland

Euroclear recognises the wishes of the Irish authorities to establish a CSD within Ireland to support the Irish capital markets and the regulatory uncertainty created by Brexit. As a consequence, we currently intend, in principle (and subject to a number of factors, including regulatory approvals) to establish such an infrastructure, in line with the requirements of CSDR and the views of Finance Minister Donohoe.

The principles which Euroclear considers such an infrastructure must support include:

- the CSD must be located in Ireland, and be fully operational to meet the potential for a so-called hard-Brexit in March 2019
- the CSD must offer multi-currency (EUR, GBP and USD) settlement for Irish corporate securities by March 2019
- the CSD must minimise operational disruption and technical change for Irish issuers and CREST participants settling Irish securities
- implementation of the new CSD must also minimise risks and minimise operational disruption and technical change for EUI, UK issuers and CREST participants settling UK securities
- a connection to TARGET2-Securities is not required within this timetable
- the CSD could be scalable over time to cover Irish government securities and Irish funds (and potentially other non-Irish securities) if so desired by issuers and holders of such instruments, subject to economic viability
- the CSD must provide economically attractive services to the users
- the CSD must be economically viable and attractive to the Euroclear group
2 Structure of Euroclear Ireland

This Chapter describes the proposed structure of a potential new CSD in Ireland. The services that it might offer are described in Chapter 4.

2.1 General structure and staffing

It is intended that EIR would be incorporated as an Irish company under the Irish Companies Act. It is currently envisaged that EIR would be a wholly-owned subsidiary of Euroclear SA/NV (ESA), and would be a sister company to the other CSDs of the Euroclear group. This structure aligns EIR with the corporate structure for other Euroclear group CSDs, including that currently present for EUI.

It is intended that EIR would have a board of directors, management and the supporting staff necessary to provide sufficient capacity and expertise for EIR, in line with the requirements of the CSDR and with the requirements of the CBoI.

2.2 Services provided by EIR

Our current aim is that EIR would:

- act as an issuer CSD for Irish corporate securities, providing CSDR core services (notary service, central maintenance service and settlement service) in respect of Irish corporate securities
- provide a similar, although potentially more limited, range of asset servicing and other CSDR ancillary services as currently offered in EUI. EIR would not provide any CSDR banking-type ancillary services (indeed, EUI does not provide such services)
- enter into arrangements with the Irish Revenue Commissioners to take over EUI’s responsibilities to assess and collect stamp duty in relation to relevant transactions in Irish securities settling in the EIR system
- provide central bank money settlement in EUR (please see paragraph 3.3 on page 14)
- provide central bank money settlement in GBP and USD through the mechanisms described in paragraph 3.4 on page 14
- replicate existing transaction feeds from CCPs to EUI so as to provide a feed to EIR. This should enable continued settlement in EIR of securities trades conducted on the ISE, LSE and other trading venues (this is subject to the agreement of the CCPs)
Whilst EIR might in the future provide investor CSD services (i.e. the ability to settle non-Irish securities through link arrangements with other CSDs) such services would not be available by March 2019. Existing investor CSD services would continue to be available to participants in EUK.

We intend that there would be limited or no technical impact for issuers and their agents (registrars). Irish securities settlement should continue to operate in accordance with the Irish Uncertificated Securities Regulations (USRs), with the legal register continuing to be maintained as now by issuers (or their agents) in Ireland.

2.3 Regulatory

Our intention is that, subject to obtaining relevant approvals, EIR would be:

- an authorised CSD in accordance with CSDR, authorised and regulated by the CBoI
- an ‘Operator’ in accordance with the Irish USRs, enabling EIR to hold and transfer electronic ‘name on register’ title to Irish securities
- a designated system in accordance with the Irish Settlement Finality Regulations (implementing the EU Settlement Finality Directive (SFD)), protecting the integrity of settlement in the event of e.g. a participant default

We do not expect that EIR would be subject to any CSD passporting or any ‘third country’ arrangements which may be implemented by the UK post-Brexit. EIR would not initially provide issuer CSD services in respect of non-Irish securities and therefore, would not initially passport issuer services into other EU27 countries.

2.4 Migration and billing

Our current intention is that migration arrangements will need to be implemented to require current CREST participants (who will continue as participants in the renamed EUK) to become EIR participants. Participation in both systems enables the continuity of existing services.

It is also envisaged that migration arrangements will ensure that EUI sponsors/users (who provide technical connectivity for participants to the CREST system) continue as EUK sponsors/users and also become EIR sponsors/users.

Issuers of Irish securities would be migrated from EUI to EIR.

Clients would be billed by both EIR and EUK.

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8 Our intention is that EIR apply to the CBoI as the Irish competent authority (Irish European Union (Central Securities Depositories) Regulations 2016) in accordance with the CSDR for authorisation as a CSD. CSDR authorisation would, among other approvals, be required prior to the commencement of services by EIR by March 2019. The CBoI would have up to six months from submission of a complete application to decide whether to authorise the CSD. EIR would subsequently be subject to oversight as a CSD by the CBoI.


10 We expect that amendments to the Irish USRs will require to be implemented to align with CSDR.

11 Irish European Communities (Settlement Finality) Regulations 2010.

3 Shared settlement arrangements

This Chapter describes how we envisage that EIR would operate using the settlement information technology infrastructure of the CREST technical system.

3.1 Use of a common settlement infrastructure

To minimise change and maximise efficiencies between Ireland and the UK, EIR and EUK will use a common settlement infrastructure, the CREST system.

Consequently, it is intended that EIR and EUK will work closely in operating the CREST system and would continue to leverage the strength of operating as part of the Euroclear group. EIR and EUK will have in place appropriate joint working, cooperation and governance arrangements to govern the joint operation of the CREST technical system by the two CSDs. The arrangements would ensure that each CSD remains fully responsible for its own services and for meeting its own obligations.

In legal terms, as there is now, there would be two separate systems:

- the ‘EIR system’ operated by EIR in accordance with the Irish USRs
- the ‘EUK system’ operated by EUK in accordance with the UK USRs

In technical terms there would be one instance of the CREST system without separate technical partitions. Using the same technical platform should:

- greatly reduce the need for technical change by CREST participants and issuers, reducing risks and costs of migrating to the new arrangements
- enable use of a single technical account, giving a view of securities held by a participant in EIR and EUK (i.e. viewing both Irish securities held in the EIR system and UK securities held in the EUK system, as today)
- enable the retention of existing participant and user IDs, with a single common ID being used for participation in both systems
- provide continued functional support for Irish settlement services substantially as they are available currently, including Irish legal title direct holding, registrar interface, paper share certificate interface, stamp duty assessment and collection, corporate actions functions etc.
- enable a single credit pool (referred to as the CREST ‘cap’ and ‘Cash Memorandum Account’ (CMA)) for participants for the settlement of both Irish and UK securities, as today, through the mechanisms described below
- enable single liquidity pools (single central bank arrangements and single ‘Liquidity Memorandum Accounts’ (LMA)) for settlement banks for the settlement of both Irish and UK securities, as today, through the mechanisms described below
- enable EIR and EIR participants/issuers to continue to benefit from the significant economies of scale of sharing a technical infrastructure with EUK and EUK participants/issuers
3.2 Common participation, rules and contractual terms

We currently envisage that:

- contractual arrangements would provide that a participant or user of EIR is also a participant or user of EUK (and a participant or user of EUK would also be a participant or user of EIR)
- that the documentation of the two CSDs would be very closely aligned for ease of understanding and reduction of potential conflicts of law and would be based on the existing CREST documentation. Each CSD would remain responsible for its own rules and arrangements
- clients would access the single technical system through one technical user ID and participant ID, which in legal terms would constitute their two participants (i.e. a participant in the EIR system and a participant in the EUK system)
- existing settlement banks in EUI would become (subject to their agreement) settlement banks in both EUK and EIR, supporting the payment arrangements detailed below

3.3 Settlement against EUR in EIR

It is intended that central bank money settlement against EUR would be offered by EIR for Irish securities settlement.

To do so EIR would require to connect to the Eurosystem’s TARGET2 system as an ‘ancillary system’. This would require arrangements with the CBoI. Our intention is that EIR would fully meet Eurosystem requirements to act as an ancillary system in compliance with TARGET2 Guidelines.

The arrangements would involve minimal technical change for the CREST system and participants. Support would be required from settlement banks for the creation of EIR’s TARGET2 connection, as an ancillary system. Legal changes would be minimal with the intention being that EIR replicates existing arrangements.

3.4 Settlement against GBP and USD in EIR and EUK – joint liquidity model

As indicated in Chapter 1, we recognise the importance of preserving multi-currency settlement (i.e. not only in EUR but also in GBP and USD) for Irish securities and participants. We are proposing a solution which minimises technical change and operational disruption for users with the intention to enable continued GBP and USD settlement of Irish securities alongside EIR EUR settlement capabilities.

Our intention is that EUK’s existing GBP and planned USD payment arrangements should be extended (subject to relevant Central Bank and Settlement Bank review and agreement) to include EIR under a ‘joint liquidity’ model for GBP and USD settlement of both Irish and UK securities.

Under the joint liquidity model for GBP:

- settlement banks would continue to operate a single set of CREST RTGS accounts for the provision of GBP liquidity into the CREST system. The liquidity provided by settlement banks would be used on a joint basis to support GBP settlement in both EIR and EUK. As such, liquidity at the BoE, as mirrored into the CREST system into a single ‘liquidity memorandum account’ (LMA) of each CREST settlement bank, would provide a joint limit on liquidity use by a settlement bank in both CSDs. EIR and EUK would separately undertake to settlement banks not to settle a transaction if to do so would breach the joint LMA limit
- at the end of each GBP settlement cycle, a single transfer of funds would take place to or from a CREST settlement bank at the BoE to discharge intra-cycle payment obligations incurred in both EIR and EUK
• CREST participants would continue to operate based on a single joint credit limit in their single technical CMA. EIR and EUK would separately undertake to CREST participants and settlement banks not to settle transactions if to do so would breach the joint CMA limit. At the end of each settlement day, the CREST participant would, in relation to all GBP settlement that day in both EIR and EUK, owe or be owed by its settlement bank the net amount of the relevant CMA

• trilateral (BoE, EUK and EIR) and multilateral (BoE, EUK, EIR and settlement banks) contractual arrangements would require to be implemented to support the provision of liquidity by settlement banks from a single joint liquidity pool to facilitate GBP settlement in EIR and EUK

EUI will require to discuss this model in detail with the BoE and CBoI, who will need to be satisfied from a risk, regulatory and policy point of view that the proposed arrangements are appropriate. The BoE would need to agree to operate GBP liquidity-related services for EIR GBP settlement on the same basis it operates GBP liquidity-related services for EUI GBP settlement today. In addition, settlement banks would have to agree to this model.

As stated above the CREST USD arrangements are currently being revised and this paper is based on the revised model. Under the joint liquidity model for USD:

• settlement banks would continue to provide a single GBP payment into a trust account held by EUK. US correspondent banks would continue to input a single USD settlement limit. USD settlement in both EIR and EUK would then take place based on a joint USD liquidity limit (i.e. being the lower of the USD value of GBP funds held in the trust account or the USD settlement limit of the settlement bank’s USD correspondent)

• at the end of each USD settlement day, both EIR and EUK related inter-bank payment obligations would be discharged through a single payment by the US correspondent of each settlement bank in the US Federal Reserve’s National Settlement Service (or in the event NSS settlement is not possible a through a single GBP distribution to the settlement bank from the GBP trust fund held by EUI)

• CREST participants would continue to operate based on a single joint credit limit in their single technical CMA. EIR and EUK would separately undertake to CREST participants and settlement banks not to settle transactions if to do so would breach the joint CMA limit. At the end of each settlement day the CREST participant would, in relation to all USD settlement that day in both EIR and EUK, owe or be owed by its settlement bank the net amount of the relevant CMA

• the USD payment arrangement agreements, including the GBP Trust Deed would be modified so as to act for the benefit of both USD settlement in EIR and USD settlement in EUK

These proposed changes to the USD payment arrangements would need to be further discussed with the BoE, CBoI and US Federal Reserve Bank of New York. In addition, correspondent banks and settlement banks would have to agree to this model.

In the event that the joint liquidity model could not be implemented for GBP and/or USD at the launch of EIR, due to technical, legal or regulatory issues, EIR would operate, at least initially, in EUR only (assuming appropriate EUR arrangements are in place).
3.5 Joint Liquidity Model and Settlement Finality

The SFD seeks to reduce the risks associated with participation in payment and securities settlement systems by minimising the disruption caused by insolvency proceedings against certain participants in such a system.

The CREST UK system has been designated in the UK by the BoE pursuant to the UK implementation of the SFD and the CREST Irish system is currently designated in Ireland for the purposes of the Irish implementation of the SFD.

As mentioned above, SFD designation should, subject to regulatory approvals, be obtainable by EIR from the Irish authorities going forward.

It is, in our current view and further to ongoing analysis, essential for the operation of the joint liquidity settlement arrangements described above, that there is recognition as a matter of both Irish and UK law of the finality of settlement in both EIR and EUK:

- it is our expectation that the UK authorities will need to ensure a continuing UK finality regime based on the existing UK SFRs is implemented in the UK and that EUK continues to be designated under that regime. HM Treasury is already considering this issue. Furthermore, such a UK regime should continue to recognise regimes designated under the EU SFD to enable recognition as a matter of UK law of the finality of settlement in EIR
- Irish law should also continue to recognise the finality of settlement in EUK. The SFD provides a mechanism (referred to as ‘recital 7’) for individual EU member states to apply SFD provisions to third-country systems.15

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13 UK Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (UK SFRs).
14 European Communities (Settlement Finality) Regulations, 2010 (Irish SFRs).
15 See SFD recital 7: "Whereas Member States may apply the provisions of this Directive to their domestic institutions which participate directly in third country systems and to collateral security provided in connection with participation in such systems".
3.6 Technical changes to the CREST system

In technical terms, there would be one instance of the CREST system without separate technical partitions. Clients would access the single technical system through one technical gateway computer with one user ID and one technical participant ID, which in legal terms would constitute two users and two participants (i.e., a user and a participant in the EIR system and a user and a participant in the EUK system).

An example of settlement of Irish securities against EUR

This single technical access involves little or no technical change for participants from how they access the CREST system today and will give a single view on securities held in both EUK and EIR.

Whilst our intention is that settlement will, to the extent possible, take place as today with minimal changes to the existing processes, a number of technical changes would be required to the CREST system to support shared operation by EIR and EUK. For example, transaction types that have the possibility of containing more than one security within a single transaction (for example, Delivery By Value or Complex Delivery transactions) will need to be amended to prevent a single transaction containing both EUK and EIR securities. We will be consulting further with stakeholders on these technical changes.

The CREST system will distinguish between securities settled in EUK and securities settled in EIR so that transactions and holdings are segregated correctly to either EUK or EIR. Potential impacts of securities being segregated to different CSDs, include:

- we envisage that this basic identification of securities will form the basis for billing participants for their relevant activities in both CSDs
- there may need to be changes to the existing settlement discipline regimes for each CSD (although our intention is that this would not be the case initially)
- additional segregation being implemented for reporting client activity to regulators. Transactions that take place within the EUK system will be reported to the BoE, whilst activity that takes place within the EIR system will be reported to Irish regulators. Participants will need to identify activity based on the security
If regulatory approval was not obtained for continued access to GBP and/or USD central bank money settlement in EIR, additional technical change would be required to ensure no settlement or asset servicing of Irish securities could take place against GBP and/or USD.
4 Economics of a new Irish CSD

The Irish securities markets have long benefited from the economies of scale and scope of utilising the settlement infrastructure of a large adjacent capital market. The establishment of a new CSD for Ireland, with its associated dedicated fixed cost base of services, property and staff, will change the economics of settlement of Irish securities.

On the assumption that Euroclear builds an Irish CSD based on the structure and services in the previous chapters, we believe that the costs incurred will be in the following main areas:

- initial set-up costs (such as establishing new premises, recruitment of staff, legal/regulatory costs for setting up the new entity, etc.)
- IT development costs to cover any technical system changes required
- annual running costs (such as ongoing costs related to staff salaries and facilities/premises, any recharge for running the shared CREST system, etc.)
- meeting ongoing capital adequacy requirements

Work is continuing internally in relation to these costs. However, while the model described in the preceding chapters is specifically designed to minimise the costs of the new Irish CSD, as far as is practical, it is clear that such ongoing costs will need to be recouped by EIR. The full economies of scale and scope of using a single company and its services to support the combined volumes of the UK and Irish securities markets will be lost with the establishment of a new CSD for servicing Irish corporate securities alone, as additional Irish specific costs will be incurred.
5 Conclusion

We believe that the creation of a new CSD in Ireland providing issuer CSD services for, and the settlement of, Irish corporate securities should provide users of the Irish capital markets with a viable and sustainable solution to the potential challenges of Brexit. The model should also be in line with the policy objectives established by Irish Finance Minister Paschal Donohoe on 27 July 2017.

The timely establishment of EIR set out in this White Paper is, as we have said throughout, subject to a variety of internal and external factors, some of which are beyond Euroclear’s control (see pages 4, 5 and 8). In particular, EIR will need to submit an application for authorisation to the CBoI as its relevant competent authority under the CSDR. Euroclear has begun discussions to this end with the CBoI.

However, even if EIR is established and authorised by March 2019, the structure or services offered by EIR may differ from those set out in this White Paper. For example, multi-currency payment models described above are contingent upon a number of factors, including the support of the relevant Settlement Banks and National Central Banks (the CBoI, the BoE, and the Federal Reserve Bank of New York). If these discussions are not completed within the timeframe of the UK leaving the EU, Euroclear would have to amend the proposals set out in this White Paper so that the proposed CSD in Ireland offered EUR settlement services only (assuming EUR settlement is established).

In addition to the various dependencies directly applicable to EIR and its status, given that the proposals will affect EUI (including through use of the shared technical platform, joint liquidity models and outsourcing arrangements), there is a dependency that the implementation of the proposals be approved by EUI and discussed with the BoE.

Furthermore, while this White Paper envisages a so-called ‘hard-Brexit’ in March 2019, Euroclear believes that a transitional period extending beyond March 2019 would be in the best interests of financial services firms, their clients and wider markets. Such a transitional period, if it were to arise, could impact the timings and proposals discussed in this White Paper.

It is envisaged that we will publish a range of consultations and other information in relation to the establishment of EIR. We envisage that this process will begin in early Q2 2018, and we encourage interested parties to visit our webpage (http://www.euroclear.com/euroclearireland) for further information.
Section B: EUI Impacts

1 Background

As described above, the CREST system, currently operated by EUI, provides a single harmonised service in respect of both UK securities and Irish corporate securities and settles transactions against a multi-currency choice of central bank money GBP and EUR and currently commercial bank money USD.

With implementation of a new Irish CSD, our intention is that EUI (renamed as EUK) would:

- continue to be authorised as a CSD by the BoE under the UK implementation of CSDR
- continue as issuer CSD for UK securities
- no longer provide services in respect of Irish securities and therefore would not require CSDR equivalence recognition as a third country CSD providing services into Ireland
- continue to operate its existing CSD links and settle a range of international securities
- continue to provide central bank money settlement in GBP and operate its USD payment arrangements

Whilst a separate exercise is being undertaken to assess generally the impacts of Brexit upon EUI (and other members of the Euroclear group), there are two key potential consequences which we would like to highlight in the context of this White Paper:

1. settlement of Irish securities in the CREST system operated by EUI post-Brexit
2. settlement against EUR in the CREST system operated by EUI post-Brexit

The implications of the proposed establishment of EIR upon EUI is subject to further detailed analysis and we will be engaging further on this with EUI’s stakeholders in due course.

2 Settlement of Irish securities by EUK

EUI had intended to passport its services as an issuer CSD for Irish corporate securities into Ireland from the UK, under Article 23 of CSDR. However, we understand that the UK will not seek membership of the Single Market and that this implies that when the UK leaves the EU, EUI will no longer be able to passport its services across the EU.

EUI has considered the relevant ‘third country’ provisions which are contained in Article 25 of CSDR and would require ESMA to recognise EUI as a third country CSD and for the European Commission to recognise that EUI was subject to domestic regulations equivalent to those in CSDR. However, our current view is that the equivalence process does not, for a variety of reasons, offer sufficient certainty to be relied upon.

The effect is that, from the time of the UK’s departure from the EU, in the absence of any arrangement to the contrary, EUI is likely to no longer be able to act as an issuer CSD for Irish corporate securities.

Our preferred solution for continued servicing of Irish corporate securities in this scenario is the establishment of EIR. However, although we are actively engaged in this solution, timely establishment cannot be guaranteed and therefore other contingency options are also being considered.
3 Settlement in EUR by EUK

EUI currently offers EUR central bank money settlement to all of its clients for all securities as a result of its status as a TARGET2 ancillary system, which is currently contingent, under Eurosystem rules, on establishment in the EEA. Accordingly, continued Eurosystem ‘ancillary system’ status for EUK, a company incorporated in the UK, appears unlikely at the point that the UK leaves the EU and the EEA.

Our assumption therefore, is that EUK will not be able to continue to offer EUR central bank money settlement after a so-called ‘hard-Brexit’ in March 2019.

Following the launch of EIR, it will not be possible to input transactions which require either:

1. the movement of UK securities against EUR or
2. both UK securities and Irish securities movements

Additionally, any such transaction which was input prior to the launch of EIR but remains unsettled at launch, will no longer be put forward for settlement and will have to be cancelled.

The table below (covering the period July 2016 – June 2017) shows the split of settlement against these three currencies for UK securities including corporate actions denominated in EUR. This indicates that EUR is not a significant currency for clients of EUI settling UK securities.

<table>
<thead>
<tr>
<th>CURRENCY</th>
<th>GBP EQUIVALENT VALUE</th>
<th>%</th>
<th>TXNS</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR</td>
<td>~32bn</td>
<td>0.02%</td>
<td>~33,700</td>
<td>0.08%</td>
</tr>
<tr>
<td>GBP</td>
<td>~158,618bn</td>
<td>99.88%</td>
<td>~44,604,000</td>
<td>98.66%</td>
</tr>
<tr>
<td>USD</td>
<td>~266bn</td>
<td>0.10%</td>
<td>~570,100</td>
<td>1.26%</td>
</tr>
</tbody>
</table>

Although volumes and values of EUR settlement activity against UK securities are extremely small, there are potential impacts on holders of international securities (CDIs) that participate in corporate actions through the CREST system and those that take advantage of cross platform netting (where a UK security might be traded in EUR on one of the trading platforms that serve the UK securities market).

We will discuss the potential impact of the removal of EUR settlement with EUK participants and with relevant exchanges and CCPs in due course.