

Practical issues arising from the euro

The Treasurer is pleased to include an excerpt from the Bank of England's *Practical Issues Arising from the Euro*, published in November last year.

The introduction of euro notes and coin at the beginning of 2002, and the withdrawal of national currency cash, will be the final stage of the transition for the first-wave countries and Greece. For the general public, the introduction of euro cash will make the new currency a reality for the first time. It is clearly important that this huge logistical exercise goes as smoothly as possible, and a great deal of planning to this end is now underway.

A number of common principles have been established at European level, forming a broad framework for the changeover. On 8 November 1999, the European Council of Finance Ministers (ECOFIN) adopted a common statement on the introduction of euro notes and coin. This contained four provisions.

- Member States will endeavour to ensure that the bulk of cash transactions can be made in euro by the end of the first fortnight of 2002.
- The period of dual circulation of the former national currencies and the euro should last between four weeks and two months, though Member States may facilitate the exchange of old notes and coin after this time.
- Financial institutions, and other key players, can be provided with euro notes and coin ahead of 1 January 2002 to facilitate the changeover. This must not, however, lead to euro being put into circulation before that date.
- Limited quantities of euro coin can be made available to the public in the Member States during the second half of December 2001, to enable them, and particularly the vulnerable groups, to familiarise themselves with the new coin.

On 3 August 2000, the European Central Bank (ECB) announced some further principles to be applied in the euro area, relating mainly to the

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financial model to be used for front-loading credit institutions.

- Credit institutions will not be debited for any euro notes and coin supplied to them in 2001. Instead, the value of this cash will be debited in three equal instalments on 2 January, 23 January and 30 January 2002, which are all settlement dates for ECB main refinancing operations.
- Front-loading of credit institutions will not require collateralisation before 1 January 2002; ownership of the euro cash will remain with the relevant central bank. Credit institutions will be required to deliver collateral by the end of the last business day of 2001 for the value of front-loaded cash delivered up to 31 December 2001. Credit institutions carry the risk of any front-loaded cash which is destroyed or stolen.
- 1 September 2001 is the earliest date for front-loading of euro cash to credit institutions, and for sub front-loading post offices, cash-in-transit companies, vending machine companies and retailers. Credit institutions are required to provide collateral to their national central banks for sub front-loading.

These statements are intended to clarify the common view on the outline of the cash changeover, whilst still allowing each Member State to tailor its imple-

mentation to its own specific circumstances. These country-specific arrangements are explained in cash changeover plans. Most countries have produced such a plan already, and the rest will do so by the end of this year.

Practical implementation of the changeover

The authorities in first-wave countries are adopting a variety of approaches to the cash changeover. *Figure 1* on page XX summarises the main elements of the changeover in the 12 countries which will introduce euro notes and coin on 1 January 2002. The precise details of the changeover in each country are influenced by factors including the structure of the country's banking sector, the mechanics of its cash distribution network and its geography.

However, it is also notable that in many countries the authorities have chosen to adopt special measures to try to accelerate the cash changeover, so that the vast majority of cash transactions come to be made in euro within two weeks. Other countries are content to let the changeover happen at its own pace within the defined dual circulation period. Countries in this latter group are reluctant to require further steps to be taken before end-2001, because they feel this would undo some of the benefit gained by shortening the dual circulation period from the up to six months initially envisaged, to two months or less.

The various technical aspects of the changeover are described below, to illustrate the different approaches countries are taking.

Front-loading, sub front-loading and starter kits

Central banks in all euro-area countries need to ensure that sufficient euro notes and coin are available to retailers and the general public in the early days of 2002. Because of the volume of cash

TABLE 1

Introduction of euro notes and coin in different countries

	Front- loading: start date in 2001 period			End of dual circulation	ATMs			Exchange of 'legacy 'notes and coin after end of legal tender	
	Banks	Retailers	Starter kits to the public (coin only)		Period until all ATMs dispense euro	Policy for ATMs not converted	Denominations from ATMs in early 2002	Banks/ post offices	Central Banks/Mints
Austria	Coin: 1 September Notes: November/December	Coin: 1 September Notes: November/December	17 December	28 February 2002	Overnight	Withdrawn from use	Generally €10 and €100	Probably until end-2002 Charges likely	Indefinitely
Belgium	Coin: 1 September Notes: 1 November	Coin: 1 December Notes: 1 December	15 December	28 February 2002	Overnight	Withdrawn from use	Generally €20 and €50 Some €5	Until end -2002	Notes: indefinitely Coin: until end-2004
Finland	Coin: 1 December Notes: 17 December	Not envisaged	Not envisaged	28 February 2002	Two weeks	Continue to provide NCU	€20 and €50	Voluntary Charges likely	10 years
France	Coin: 1 September Notes: 1 December	Coin: 1 December Notes: 22 December	15 December	17 February 2002	10 working days	Probably continue with NCU	€10, €20 and €50	Until 30 June 2002	Notes: 10 years Coin: 3 years
Germany	1 September	1 September	17 December	28 February ¹ 2002	Overnight	Withdrawn from use	Probably €5, €10, €20 and €50	Until 28 February 2002	Indefinitely
Greece	1 October	1 December	Not envisaged	28 February 2002	2 weeks to 1 month. Under discussion	Preference for no further NCU	Generally €5, €10, €20 and €50	Possibly free	Notes: 10 years Coin: 2 years
Ireland	Coin: September Notes: October	Under discussion	Not envisaged	9 February 2002	Bank ATMs overnight. 2 days for the residual	Under discussion	Mainly €10 and €20	'Household' amounts for some time	Indefinitely
Italy	Coin: to be decided Notes: 15 November	Final days of 2001	Not envisaged	28 February 2002	1 week	Withdrawn from use	€10 and either €20 or €50	On a voluntary basis	10 years
Luxembourg	1 September	1 September	15 December	28 February 2002	1 day	To be decided	Mainly €50 and €100	Post offices and some banks until 30 June 2002	Notes: indefinitely Coin: until end-2004
Netherlands	1 December	17 December	17 December	28 January 2002	Overnight	Withdrawn from use	Around half will provide €5. Otherwise €10, €20 and €50	Until end -2002, free of charge to customers until at least April 2002	Notes: 30 years Coin: 5 years
Portugal	Coin: 1 September Notes: 1 October	1 December	Not envisaged	28 February 2002	5 or 6 days	Continue to provide NCU	€20, and some will provide €5 and €10	Banks until 30 June 2002	Notes: 20 years Coin: to end -2002
Spain	Coin: 1 September Notes: 1 December	September (large) December (small)	15 December	28 February 2002	Two weeks	Continue to provide NCU	€20 and €50 (€10 where possible)	Until 30 June 2002	Indefinitely

¹The Deutschmark will cease to be legal tender in Germany on 1 January 2002

Source: relevant Member State authorities

required, this can only be achieved by distributing notes and coin to the key players beforehand. These key players are the banks and post offices, cash-in-transit companies, vending machine companies and retailers. The precise starting dates for the front-loading of banks and the sub front-loading of the other groups is determined partly by capacity constraints: either in the trans-

portation network, which requires distribution to start early; or in storage facilities at banks and retailers, which points towards later distribution. In most countries, coin will be distributed to banks from September 2001, because it is bulky to transport and its lower value means that the risk for banks is less than for notes. Only Germany and Luxembourg will begin to front-load

notes at the same time (on 1 September 2001); most other countries will delay the distribution of notes until November or December 2001.

Whilst the process for front-loading of banks is principally dictated by logistical concerns, the arrangements for sub front-loading of retailers and the public seem to reflect more the overall national approach to the changeover. Most

countries believe that if, at the start of 2002, retailers have adequate stocks of euro notes and coin and members of the public already have some euro coins, it will be easier for everyday transactions to move quickly to euro. In many countries, retailers will not be sub front-loaded until December. Certain countries have elected to provide retailers with standardised 'starter kits' of notes and coin containing a mixture of denominations. These packs are intended to make the ordering, storage, transport and charging simpler for both banks and retailers. Only Finland has chosen not to extend prior distribution beyond banks and cash-in-transit companies.

Smaller packs of coin will be made available to the public in the second half of December 2001. By aiming to put coins directly into the hands of the public, authorities hope both to increase awareness of the new physical currency and to ease the pressure on retailers in the first days of 2002, by ensuring that at least some customers have small change in euro. However, there are currently no plans to sub front-load the public in Finland, Greece, Ireland and Italy. These countries believe that the possible benefits of supplying the public with coin do not outweigh the costs and the risks of premature circulation of euro.

Hoarded coin

The return of hoarded national currency coin presents one of the greatest logistical challenges for the changeover, given its bulk and weight. Research indicates that a large proportion of the national currency coin in issue is no longer in circulation. Much of this may be lost, but large amounts are probably currently hoarded in homes around the euro area. A number of countries are planning specific measures to encourage people to release their hoarded coin at a time and in a manner that is least disruptive to the changeover.

ATM conversion

The ATM is the principal means of distributing notes to the public. The speedy conversion of ATMs will therefore be an important factor in ensuring a smooth changeover: banks in particular want the public to be able to obtain euro notes through ATMs, so that branches do not face greater than normal demand for counter withdrawals or a flood of

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requests for the exchange of national currency. The precise speed at which ATMs can be converted will depend partly on their design (for example, whether software updates can be made centrally) and partly on the geography of the country (since euro notes must be physically placed in the machines). Some ATMs can be pre-loaded with cassettes containing euro, which will be blocked from use until 1 January 2002. This is not possible everywhere, and most countries cannot convert and fill all ATMs during the night of 31 December 2001. In some countries, typically those which are more relaxed about the pace of the changeover, the few remaining machines will continue, for a short time in early 2002, to dispense national currency until they can be converted. Other countries want to avoid more national currency passing into circulation, and so ATMs will be taken out of service until they are ready to dispense euro notes.

The far-reaching use of the ATM network makes it a potentially attractive means to ensure that lower denomination notes are delivered directly into the hands of the consumers, to lower the demand for change in shops in the first weeks of 2002. However, banks in most countries are opposed to the idea of stocking ATMs with low-denomination notes, since this would increase the frequency with which machines would have to be filled. In some countries, banks have nonetheless agreed to special arrangements for the dual circulation period. In Italy, for example, all banks will distribute the €10 note through their ATMs (alongside the €20 or the €50) and, in the Netherlands, all ATMs will carry the €10 note and about half the €5 note. In other countries, such as Belgium, Germany, Greece and Portugal, some banks may provide €5

notes. In Ireland, banks will typically supply €10 and €20 notes through the ATMs. While it is through retail transactions that euro coins and low-value notes will mainly be put into circulation, there is also a helpful agreement in Ireland that the first cash welfare payments in 2002 will contain at least four €5 notes.

During and after the dual circulation period

Some countries have chosen a dual circulation period which is shorter than the maximum two months recommended by ECOFIN. In practice, there may be little difference between countries in the speed at which euro cash takes over from the current national cash. However, the legal position is not the same in all countries.

In the Netherlands, it was decided to shorten the period to only four weeks as a spur to the population to make the changeover quickly. However, the banks have agreed to continue changing guilder notes and coin for their private customers free of charge until 1 April 2002. In combination, this is intended to achieve a swift changeover of transactions, without logging the banking system with people wanting immediately to change their savings into euro. Ireland and France are the only other countries to opt for a dual circulation period shorter than two months (until 9 and 17 February respectively).

In Germany, the Deutschmark will cease to be legal tender at end-2001. However, under a joint declaration of professional associations made in October 1998, the so-called 'modified reference date arrangement', the Deutschmark may be used for transactions until 28 February 2002. The joint declaration thus has the effect of creating in practice a two-month dual circulation period. During that time, banks and shop-keepers will be permitted to give out Deutschmark coins from their available stocks, but these will not be replenished. In all countries, it is envisaged that wherever possible retailers will give change only in euro. After the end of the dual circulation period, all National Central Banks (NCBs) will continue to exchange their own currency. Some NCBs will limit the exchange of notes to a 10-year period, but others will undertake to exchange notes indefinitely; for coin, the minimum period is two years.

Also, the ECB Governing Council has

agreed to extend until 31 March 2002 the arrangements for the exchange at the official conversion rate and repatriation at NCBs of national banknotes of other euro-area countries. Under these arrangements, it will be possible to exchange the currencies of any Member State for euro notes and coin at least one NCB location in each country.

The arrangements for the exchange of previous national currencies at commercial banks after the withdrawal of legal tender status are not yet clear in every country. A range of outcomes is likely.

Overall, each country is adopting a solution which meets its own requirements dictated by logistical, geographical and cultural considerations. However, there is a discernible bias towards encouraging a fast cash changeover in France, Ireland and the Netherlands, and to some extent in Austria, in contrast to the approach chosen in Finland and Portugal, where extra measures are not considered necessary.

Changeover costs

Costs associated with the changeover are likely to be material. Who will bear them is yet to be decided in every case. Following an informal ECOFIN meeting in September, it was indicated that the cost of the changeover should be borne by the community as a whole, and that governments should not be required to provide compensation. Discussions continue at national level between the authorities and the banking community.

Alongside discussions between the authorities and banks, there are also negotiations taking place between banks and retailers over the costs of sub front-loading. Retailers are aware that banks will not be debited for front-loaded cash until the beginning of 2002, and then initially only for one-third of the total, and are pressing for similar arrangements to be applied to them. The banks argue in return that they have to collateralise sub front-loading and cover the risks entailed. This is not an area where the authorities are likely to intervene: individual banks will be left to negotiate arrangements directly with their customers.

Issues for countries outside the euro area

There are several issues relating to the supply of euro notes and coin to countries outside the euro area, and the withdrawal of old national currency cash. A

number of UK institutions have asked the Bank of England how the ECB intends to approach these issues, not in order to seek special treatment, but so that they can prepare properly. The Bank recognises that it would be helpful to have clarity in this area, and has invited the ECB to consider the following questions.

- Will any specific arrangements be made to enable banks outside the euro area to pre-order and obtain stocks of euro banknotes and coin in advance of 31 December 2001 (and if so, when) in order to enable physical euro cash to be provided to those banks' customers from 1 January 2002? If so, what would be the associated financing arrangements?
- Would agencies be able to serve as 'depots' for euro banknotes, or not? And if so, could they do this before the introduction of euro notes into circulation, or not?
- Would banks in the UK or other countries outside the euro area be under any legal obligation to provide only euro, rather than old national currency banknotes, to their customers from 1 January 2002? What if in practice they only have such old national currency notes?
- For how long would it be permissible for non-euro area banks to continue to provide old national currency notes after 1 January 2002? Is the position effectively determined by the legal tender status of the old national currency notes (so, for example, banks would not be expected, or allowed, to continue selling Deutschmark notes after 31 December 2001, but could continue in practice for a few weeks to sell other old national currency notes, if they proved still to be in demand, until they ceased to be local legal tender)?
- Would non-euro area banks be able to maintain existing links with their euro-area commercial bank correspondents for the repatriation of old national notes and/or exchange for euro notes?
- Would non-euro area banks and other agencies in the commercial sector be expected to exchange old national currency notes for euro notes and for what time period?

Final decisions in this area will be taken by the ECB Governing Council,

probably later this year. In advance, the ECB has helpfully provided the following preliminary information.*

- It is probable that euro-area credit institutions will be permitted to distribute euro notes to their branches or subsidiaries outside the euro area before 1 January 2002. Any amounts front-loaded in this way would be subject to the same debiting model applicable to credit institutions within the euro area. Front-loading outside the euro area would not extend beyond credit institutions.
- Credit institutions outside the euro area will be able to legally distribute national currencies for so long as those currencies are legal tender. However, in practice, the ECB would prefer them to distribute euro cash as far as possible from 1 January 2002.
- Credit institutions outside the euro area will be able legally to maintain existing links with their euro-area commercial bank correspondents for the repatriation of old national notes and/or exchange for euro notes. Also NCBs or their agencies will continue to offer a service for the exchange and repatriation of national banknotes in all currencies until 31 March 2002.
- It is expected that there will be demand for the exchange of national currencies for euro in countries outside the euro area. Credit institutions will need to consider how they purpose to redeem national currency banknotes once these have ceased to be legal tender. ■

* *Editor's note:* The general sense of this final section was subsequently confirmed by the ECB Governing Council last December, after "Practical Issues" was published. The Bank of England will publish a further edition of "Practical Issues" in early June 2001 which, *inter alia*, will bring up to date all of the material which is set out in this excerpt.

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