



EUROPEAN MONETARY INSTITUTE

THE CHANGEOVER
TO THE SINGLE CURRENCY

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Postfach 10 20 31, D-60020 Frankfurt am Main

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EXECUTIVE SUMMARY	

The European Council meeting in Cannes on 27th June 1995 requested the ECOFIN Council to define, in consultation with the Commission and the European Monetary Institute (EMI), a reference scenario on the changeover to the single currency, with a view to reporting back to its summit meeting in Madrid in December 1995. The present document reflects the views of the EMI on the changeover strategy.

The changeover to the single currency will complete the process of Economic and Monetary Union (EMU). For there to be a successful European currency area, a high degree of sustainable convergence of economic performance in the participating countries is a necessary prerequisite. The decision on the move to Stage Three of EMU requires a strict application of the convergence criteria provided for by the Treaty, and the compatibility of national legislation, including the Statutes of national central banks, with the Treaty and the Statutes of the European System of Central Banks (ESCB), to determine which countries qualify for joining the European currency area.

The organisation of the changeover should be based on the following *five principles*, which are necessary to ensure transparency and public acceptance of the process:

- 1) there must be a clear legal framework for the introduction of the new European currency and its complete substitution for the national currencies in the Member States participating in the European currency area; this legal framework will need to be consistent with the spirit and the letter of the Treaty;
- 2) in order to make the changeover credible to all citizens it must be relatively simple and user-friendly;
- 3) the changeover has to be efficient, proceed in a cost-effective manner and aim at avoiding competitive distortions;
- 4) the changeover needs to be organised in a way which facilitates the efficient implementation of the single monetary policy which will be conducted by the ESCB from the start of Stage Three of EMU with the objective of maintaining price stability;
- 5) from the start of Stage Three, private economic agents should be free to use the European currency; on the other hand, they should not be obliged to do so before the deadline set for the completion of the changeover; as far as possible, they should be allowed to develop their own mechanisms of adjustment to the changeover; however, the implementation of these principles should take into account market practices in terms of standardisation.

To ensure that the changeover process is orderly and rapid, the authorities will need to pre-announce a chronological sequence of events organised by reference to a small number of critical benchmark dates. Once these dates have been reached, they will act as firm deadlines beyond which the changeover is consolidated in an irreversible manner for all relevant actions. In the opinion of the EMI, *four important dates* mark the process toward a complete changeover:

- 1) *About one year before the start of Stage Three* the Council, meeting in the composition of the Heads of State or of Government, is expected to decide which countries will participate in the European currency area. This will be followed by the establishment of the European Central Bank (ECB).
- 2) *At the starting date of Stage Three* the exchange rates between the currencies of the participating Member States will be replaced by irrevocably locked conversion rates. The national currencies and the European currency will become different expressions of what is economically the same currency. National banknotes will remain the only banknotes with legal tender status until the introduction of European banknotes (see below). The ESCB will start conducting its single monetary policy in the European currency.
- 3) *At the latest three years after the start of Stage Three* the ESCB will start issuing European banknotes and start exchanging the national banknotes and coins against European ones.
- 4) *Six months after the first day of introduction of the European banknotes and coins* the changeover to the single currency will have been completed for all operations and all agents. National banknotes and coins will lose their legal tender status and the European ones will become the only banknotes and coins to have the status of legal tender within the European currency area.

The intervening periods between these four dates delineate *three distinct phases* of the changeover process.

A first period extends from the decision on the move to Stage Three until its start. During this period some important final decisions must be taken with a view to completing the preparation of the start of Stage Three and the introduction of the European currency. The ECB will need to be set up so that its decision-making bodies can decide on, implement and test the framework needed for the ESCB to perform its tasks in Stage Three, announce the date for the launch of the European banknotes and start the production. The Community authorities need to adopt a series of legislative measures with a view to the start of Stage Three and Member States need to ensure that existing legislation is compatible with all relevant Treaty requirements. The private sector in the Member States designated to participate in the European currency area, notably the banking and finance industry, will have to prepare the technical and organisational adaptations needed to start using the European currency in Stage Three. All those tasks which have to be completed prior to the start of Stage Three will, in the view of the EMI, take about one year.

A second period extends from the start of Stage Three until the date when the European banknotes and coins are put into circulation. At the start of the period, the ESCB will undertake the following actions:

- all monetary policy operations will be announced and executed in the European currency by the ESCB; all accounts held by counterparties with the ESCB will be in the European currency;

- for those financial institutions which have not been able to equip themselves with the necessary conversion facilities to translate amounts from European into national monetary units and vice versa, national central banks could provide such facilities; these conversion facilities will expire at the latest when national banknotes cease to be legal tender;
- the ESCB will support the co-ordination of market participants' actions so as to ensure the smooth functioning of an area-wide money market based on the European currency; it will contribute to defining the main elements of such a market; it will offer a real-time gross settlement payment system (the TARGET system) of which the Interlinking system will operate in the European currency and the national RTGS systems will be capable of doing so right from the start;
- since the national currencies will be linked by irrevocably fixed conversion rates, there will no longer be foreign exchange markets between them but only purely arithmetical conversions. The ESCB will encourage the use of the European currency in the foreign exchange markets; its operations in these markets will be effected and settled in the European currency;
- the national central banks will exchange national banknotes at par value.

The EMI suggests that the public authorities undertake the following actions at the start of Stage Three. It is crucially important for a clear legal framework to be in place from the very first day so as to provide economic agents with certainty as to the status of the European currency and its irrevocably fixed conversion rates at which it shall be substituted for the national currencies. The EMI expects that new public debt issues will be denominated in the European currency. A public awareness campaign on the completion of the changeover to the single currency should be launched, the organisation of the changeover of the public sector announced, and the production of the European coins undertaken.

It is expected that financial markets will largely change over to the European monetary unit at an early stage; however, most private individuals and most enterprises will continue to operate in the national monetary units.

At the latest three years after the start of Stage Three, European banknotes and coins will be introduced, marking the start of the *third period*, which will extend until the day when national banknotes cease to be legal tender. European and national banknotes and coins will temporarily circulate in parallel. The use of the European monetary unit for public sector operations should occur in all participating Member States around the time at which European banknotes and coins are introduced. The time frame should be laid down in Community legislation and might leave some freedom to individual Member States. At the end of the third period, all monetary liabilities will de jure be redeemable only in the European currency. A period of six months is deemed to be appropriate to accommodate the completion of the changeover process. The national central banks will of course continue, as a service to the public, to exchange the old national banknotes for European banknotes at their counters, as is the current national practice throughout the European Union (EU) for banknotes of a series that has been withdrawn from circulation.

Any given plan will only lead to a successful outcome if the planning stage is followed up by detailed design and appropriate implementation of all the elements involved. This is most evidently the case for a matter as complex as having a group of countries with sophisticated financial systems jointly changing over to a single currency. The Treaty's insistence on the irreversibility of the move to Stage Three and the European currency area further underscores the importance of carrying through in an integrated manner all the elements required to bring the ambitious project to fruition.

1. INTRODUCTION: ADOPTING A SINGLE CURRENCY IN THE EUROPEAN UNION

By ratifying the Maastricht Treaty, the Member States of the European Union (EU) have engaged themselves further in the process of European integration; implementation of the Treaty provisions will lead to the establishment of an Economic and Monetary Union (EMU), the establishment of a European System of Central Banks (ESCB) and the introduction of a single and stable European currency.

1.1 Objectives of the adoption of a single currency and preconditions for its success

The process of economic and monetary unification will contribute to the promotion of a harmonious and balanced development of economic activities throughout the European currency area, assist in the achievement of sustainable and non-inflationary growth and thus help bring about a high level of employment. The adoption of a single European currency will add a new dimension to the existing freedom of movement for capital and financial services within the EU by eliminating exchange rate risk in monetary transactions between the participating Member States, leading to the creation of a unified financial market which will be deeper, more liquid and more competitive than hitherto. Saving and investment opportunities will be enhanced.

The adoption of a European currency will contribute to consolidating the foundations as well as enhancing the advantages of the internal market. A European currency will make it possible for households and enterprises to make a genuine cross-border comparison of prices of goods and services, thereby fostering competitive efficiency. The purchasing power of the European currency will be protected by the stability-oriented monetary policy of the ESCB.

For there to be a successful European currency area, a high degree of sustainable convergence of economic performance in the participating countries is a necessary prerequisite. The decision on the move to Stage Three of EMU requires a strict application of the convergence criteria provided for by the Treaty to determine which countries are fit to join the European currency area. The Treaty has laid down the procedure for such an assessment. The Heads of State or of Government¹ will make their decision on the basis of the recommendation of the Council of Ministers, taking due account of the reports submitted by the European Commission and the EMI.² These reports are to assess the achievement of a high degree of sustainable convergence on the basis of specific criteria provided for in the Treaty (Article 109j (1)):

¹ Meeting as the Council of the European Union.

² The EMI has already produced a first assessment of the state of convergence in the EU in its 1994 Annual Report. A further assessment of the extent to which countries fulfil the convergence criteria is contained in the report produced by the EMI in November 1995 in accordance with the requirements of Article 7.1 of its Statute.

- the achievement of a high degree of price stability; this will be apparent from a rate of inflation which is close to that of, at most, the three best-performing Member States in terms of price stability;
- the sustainability of the government financial position; this will be apparent from having achieved a government budgetary position without a deficit that is excessive as determined in accordance with Article 104c (6) of the Treaty;
- the observance of the normal fluctuation margins provided for by the exchange rate mechanism of the European Monetary System, for at least two years, without devaluing against the currency of any other Member State;
- the durability of convergence achieved by the Member State and of its participation in the exchange rate mechanism of the European Monetary System being reflected in the long-term interest rate levels.

The details of the convergence criteria are spelt out in the respective Protocol to the Treaty.

The reports from the European Commission and the EMI shall also take account of other factors including the results of the integration of markets, the situation and development of the balances of payments on current account and an examination of the development of unit labour costs and other price indices. The reports shall in addition include an examination of the compatibility between each Member State's national legislation, including the statutes of its national central banks, and Articles 107 and 108 of the Treaty and the Statutes of the ESCB which provide for the independence of national central banks.

1.2 Treaty provisions related to the changeover

A three-stage process has been provided for in the Treaty to achieve EMU. At the starting date of Stage Three there will be a European currency area. The procedure for the decision on the start of Stage Three is defined in Article 109j of the Treaty.³ Before the end of 1996, the Heads of State or of Government will decide whether a majority of countries fulfil the conditions necessary for the adoption of the European currency, whether it is appropriate for the Community to enter Stage Three, and, if so, when this step will be taken. Their decision will be taken on the basis of the recommendation of the Council of Ministers, and will take due account of the above-mentioned reports from the EMI and the Commission, and the opinion of the European Parliament. If the Heads of State or of Government have not decided on a starting date prior to end-1997, Stage Three will start on 1st January 1999. The Heads of State or of Government will in that case need to confirm, before 1st July 1998, which Member States fulfil the necessary conditions for the adoption of the European currency. Those Member States are referred to in the Treaty as the Member States without a derogation.

³ Annex 7 of this document reproduces a number of Treaty provisions relating to the changeover.

Pursuant to Article 109l (4), the Council of Ministers will, at the starting date of Stage Three, irrevocably fix the conversion rates for the currencies of the Member States participating in the European currency area as well as the conversion rates at which the European currency will be substituted for the national currencies, and the European currency will become a currency in its own right. Article 109l (4) goes on to state that the Council of Ministers will also take the other measures necessary for the rapid introduction of the European currency as the single currency of those Member States.

While the move to Stage Three of EMU will involve the whole of the Community, some Member States may initially not participate in the European currency area. The future relationship between the Member States participating in the European currency area and the others will be defined prior to the move to Stage Three. The Treaty (Article 109k (2)) incorporates provisions for carrying out, at least once every two years or at the request of a Member State with a derogation, an examination of the economic and monetary situation in the Member States with a derogation to determine whether they are fit to join the European currency area.⁴

From the beginning of Stage Three, there will be a single monetary policy for the European currency area conducted by the ESCB.⁵ The ESCB will consist of the European Central Bank (ECB) and the national central banks (NCBs). Its primary objective is to maintain price stability. In order to achieve this, the ECB and NCBs as well as the members of their decision-making bodies will enjoy full independence in the performance of the tasks conferred upon them by the Treaty. This independence is guaranteed in the Treaty.

Following the start of Stage Three, it will be essential to ensure close co-ordination of the economic policies of the participating countries on the basis of commonly agreed guidelines and sustained convergence of their economic performance.

1.3 The changeover process

For the changeover to the single currency to be successful, a high degree of advance preparation will be needed in view of the complex and very particular nature of the changeover. Whereas the Treaty contains detailed macroeconomic provisions for the move to Stage Three of EMU, it is not as specific on the way to proceed with the introduction of the European currency. It is the responsibility of the authorities in general, and the monetary authorities in particular, to ensure that the benefits of the changeover to the single currency will materialise as quickly and as tangibly as possible and that the changeover will proceed in an orderly fashion allowing its benefits to be reaped by the citizens, the existing users of the national currencies.

The national central banks, as the issuers of money, as well as the EMI, seen as the precursor of the ECB, have an overwhelming interest in safeguarding the confidence of the holders of money during the changeover. Consequently, the EMI Council, consisting of the President of the EMI and the Governors of the national central banks of the fifteen

⁴ In the case of Denmark this procedure will only be initiated at the request of this country.
⁵ Annex 6 contains a glossary of technical terms and definitions used in this document.

Member States, has for the past two years been considering the main issues to be addressed in the process towards the adoption of a European currency. The EMI and the national central banks have been actively examining the main aspects of the changeover with the aim of assessing the comparative advantages and disadvantages of different approaches. This examination has been conducted against the background of an increasingly intensive dialogue with the banking community.

The European Council meeting in Cannes on 27th June 1995 requested the ECOFIN Council to define, in consultation with the Commission and the EMI, a reference scenario on the changeover to the single currency, with a view to reporting back to its summit meeting in Madrid in December 1995. The present document reflects the views of the EMI on the changeover strategy.

The framework scenario presented does not cover all aspects of the changeover process. Many elements involved in switching over to the European currency will need to be dealt with by private agents themselves, whereas others require co-ordination with the public authorities. This document mainly addresses the core issues of relevance for the financial sector which fall within the sphere of competence of national central banks. It attempts to provide benchmarks which may assist in removing uncertainties regarding the process of changing over to the European currency. It offers indications of how the ESCB intends to proceed with its changeover strategy and makes suggestions for certain courses of action by governments and other public authorities.

In making this document public, the EMI intends to contribute to the debate and the reflection and active preparation of all those involved in creating a European currency area.

1.4 Outline of the document

This document is organised as follows. The next chapter (Chapter 2) offers some general considerations on the organisation of the changeover. Chapter 3 outlines the preparations which need to be undertaken following the decision on the move to Stage Three. Chapter 4 describes the changeover actions which will be undertaken by the ESCB and those which are suggested to the public authorities at the start of Stage Three. Chapter 5 indicates which actions need to be carried out during the final six months of the changeover process. A concluding Chapter 6 underscores the need for all parties involved in the changeover to join forces in order to offer the best guarantee of a successful undertaking.

Expanding on the analysis offered in the various chapters, a number of more technical annexes have been included in this document. Annex 1 presents a brief summary of the dialogue with the banking sector on the issue of the changeover. Annex 2 discusses the use of conversion facilities to translate between the European and the national monetary units. Annex 3 illustrates how to make use of the European currency in the conduct of the single monetary policy right from the start of Stage Three. Annex 4 expands on questions relating to the production of the European banknotes. Annex 5 presents an overview, in table format, of the changeover actions which will be undertaken by the ESCB and those

which are suggested to governments and other public authorities. Annex 6 contains a glossary of technical terms used. Annex 7 reproduces some articles of the Treaty relevant to the changeover.

2. ORGANISATION OF THE CHANGEOVER: GENERAL CONSIDERATIONS

This chapter first addresses some of the technical constraints faced by economic agents in preparing for the changeover and subsequently elaborates on the basic principles which need to underlie the changeover process. The interaction between the technical constraints faced by economic agents and the underlying principles points to a number of desirable features for the organisation of the changeover; these are highlighted in the third section. The fourth section deals with the overall timing of the organisation of the changeover.

2.1 Technical constraints on the changeover

For all parties involved, including in particular all users of money in the participating Member States, the changeover to the single currency will constitute a considerable change, requiring careful preparation. How much time is needed in order for all economic agents and institutions to be ready is difficult to estimate with a high degree of precision. Two broad considerations have to be kept in mind: first, the estimated preparatory time is measured in months or years, rather than days or weeks, although due account should be taken of the fact that in a number of areas preparatory work can start as soon as the reference scenario is defined; second, the speed of adaptation to the changeover will differ among groups of economic agents or institutions.

The EMI and the national central banks have undertaken investigations, covering not only the time needed by central banks to make the technical preparations for the changeover, but also involving a dialogue with the commercial banking community and the manufacturers of banknote and coin-operated machines. The results of a large-scale survey among the EU banking community, conducted by the EMI with the assistance of the national central banks, have become the basis for a more extensive dialogue with the banking industry at the national and European level (see Annex 1). This dialogue has led to new insights in the banks which in many cases have led them to adjust their opinions and planning strategies.

The EMI's enquiry, as well as many other studies on the preparation for the changeover, point to a differing speed of adjustment among economic agents. In some cases, the difference is related to the level of acquaintance with transactions in monetary units other than the national one. In other cases, it is linked to the type of the transaction. In others still, it is associated with the structure of the financial system and the organisational environment.

Appropriate preparation by economic agents requires adequate information on the precise nature of the changeover. Although the main characteristics of the changeover are expected to be announced following the Madrid summit of the European Council at the end of 1995, some essential information will not become available until approximately one year before the start of Stage Three. This is notably the case for the selection of the Member States that will be able to join the European currency area at the start of Stage

Three. A number of decisions can only be taken following the establishment of the ECB and the ESCB (which has to await the decision on the move to Stage Three), in particular those relating to how the ESCB will conduct its monetary policy from the start of Stage Three. Since these decisions are of major importance for key measures on the organisation of the changeover to be carried out by a number of economic agents, including in particular the banking industry, and since there are lead times involved, a complete and instantaneous changeover to the single currency at the start of Stage Three has to be ruled out.

2.2 Basic principles of the changeover

To be successful, the organisation of the changeover needs to achieve a number of objectives, reflecting at once the concerns and the priorities of the public authorities and the private sector, since both are intricately involved in the process. In order to achieve these objectives, the EMI has singled out the following basic principles as important determinants of a preferred changeover strategy.

First of all, it is important to provide all economic agents with a *clear legal framework* for the use of the new European currency. This legal framework will need to be in conformity with the provisions and principles provided for in the Treaty, including the irreversibility of the move to Stage Three, the rapidity of the introduction of the single currency, and the fact that from the beginning of Stage Three the European currency will become a currency in its own right.

Second, the changeover to the single currency will affect all sectors of the economy and the public at large. Care must be taken that the changeover process is *relatively simple*, user-friendly and thus *credible to all citizens*.

Third, feasibility cannot be seen in isolation from the preparatory time and cost for economic agents, institutions and market infrastructure to cope with the required adaptations. In other words, the changeover has to be efficient and *proceed in a cost-effective manner and aim at avoiding competitive distortions*.

Fourth, the changeover to the single currency needs to be organised in a way which facilitates the efficient implementation of *the single monetary policy* which will be conducted by the ESCB from the start of Stage Three with the objective of maintaining price stability. Credibility of the newly-established ESCB and of the single monetary policy requires in particular that monetary conditions are homogeneous throughout the European currency area.

Fifth, from the start of Stage Three, private economic agents should be *free to use* the European monetary unit. On the other hand, they should *not be obliged* to do so *before the deadline* set for the completion of the changeover and should be able to continue using the national monetary units. As far as possible, they should be allowed to develop their own mechanisms for adjusting to the changeover. However, the implementation of these principles should take into account market practices in terms of standardisation.

The above principles are necessary to ensure transparency and public acceptance.

2.3 Characteristics of the changeover

The interaction between, on the one hand, the technical constraints faced by private economic agents and public authorities alike, as outlined in Section 2.1 above, and, on the other hand, the basic principles for a successful changeover, as evoked in Section 2.2, calls for a certain staggering of the changeover process within the pre-set final deadline.

Practical considerations make inadvisable a near-instantaneous changeover following a sufficiently long preparatory period. Awaiting the full preparation of every category of economic agent would delay reaping the benefits of the use of the European currency in those areas where a more rapid changeover could be accommodated. It is even questionable whether financial markets would wait to make use of the European currency until such time as all agents were ready to start using it. Moreover, a complete changeover which is highly concentrated in time might give rise to last-minute congestion problems, possibly setting in motion cascading delays, and thus ultimately leading to a disorderly process which could put the credibility of the new currency and its issuer, the ESCB, at risk.

Accordingly, the general objective is to promote the framework for the immediate changeover of market operators' transactions. In so doing, it is appropriate to accommodate those parts of the private sector which need longer to adapt to the use of the European currency.

As a consequence, the changeover will necessarily be characterised by a temporary co-existence in each participating country of *two monetary units, a European and a national one*. Financial markets in general and the banking industry in particular have a clear interest in creating an environment of continuous and easy conversion and interconnection between the two units: it will allow them to serve all of their customers in the unit they need for their transactions. If particular economic agents were not ready from the outset to organise the necessary conversion themselves, the authorities should assist them in coping with their particular situation.

2.4 Phasing of the changeover

To ensure that the changeover process is orderly and rapid, the authorities will need to pre-announce a chronological sequence of events organised around a small number of critical benchmark dates. Once these dates have been reached, they will act as firm deadlines beyond which the changeover is consolidated in an irreversible manner for all relevant actions. In the opinion of the EMI, four important dates mark the process toward a complete changeover.

- 1) *About one year before the start of Stage Three* the Council, meeting in the composition of the Heads of State or of Government, is expected to decide which countries will participate in the European currency area.

- 2) *At the starting date of Stage Three* the exchange rates between the currencies of the participating Member States will be replaced by irrevocably locked conversion rates. The national currencies and the European currency will become different expressions of what is economically the same currency. National banknotes will remain the only banknotes with legal tender status until the introduction of European banknotes. The ESCB will start conducting its single monetary policy in the European currency.
- 3) *At the latest three years after the start of Stage Three* the ESCB will start issuing European banknotes and start exchanging the national banknotes and coins against European ones.
- 4) *Six months after the first day of introduction of the European banknotes and coins* the changeover to the single currency will have been completed for all operations and all agents. National banknotes and coins, which will gradually disappear from circulation, will lose their legal tender status and the European ones will become the only banknotes and coins to have the status of legal tender within the European currency area.

The intervening periods between these four dates delineate three distinct phases of the changeover process:

- a first period, prior to the entry into Stage Three, during which some important final decisions are taken with a view to completing the preparation of the start of Stage Three and the introduction of the European currency;
- a second period in which the ESCB is given responsibility for the single monetary policy and the European currency starts being used in scriptural, non-cash form; it is expected that financial markets will largely change over to the European monetary unit at an early stage; however, most private individuals and most enterprises are expected to continue to operate in the national monetary units;
- a third period in which the use of the European currency is extended to fiduciary money or cash form (i.e. banknotes and coins) and at the end of which all economic agents, including the public sector, will have completed the changeover to the single currency.

The following three chapters deal more extensively with each of these periods. They indicate what type of changeover actions can be expected to occur during each one and what underlies the particular preference for their varying lengths (about one year for the first period, up to three years for the second period and six months for the third period).

3. FROM THE DECISION ON THE MOVE TO STAGE THREE UNTIL ITS START

The Heads of State or of Government will have to decide which countries will participate in the European currency area. As indicated in the introductory chapter, the procedure for such a decision is clearly defined in the Treaty. The Treaty also specifies that, immediately after the decision to move to Stage Three is taken, the governments of the participating Member States will appoint the members of the Executive Board of the ECB. However, it will not start the full exercise of its powers until the first day of Stage Three.

A good deal of preparatory work will have been carried out in advance of the decision to proceed to Stage Three. Indeed, the EMI has been mandated by the Treaty (Article 109f (3)) to specify, at the latest by 31st December 1996, the regulatory, organisational and logistical framework necessary for the ESCB to perform its tasks in Stage Three. The Monetary Committee, in co-operation with the Commission, has already drawn up a Council Action Plan including a list of legislative measures for which formal and informal preparation will need to have reached an advanced stage by the time the decision on the move to Stage Three is taken. National authorities have started a thorough investigation of the changes which the introduction of the European currency will entail for their legal systems as well as for the proper operation of public administrations. Various parts of the private sector have started reflecting on their strategy for coping with the introduction of the European currency. The banking and finance industry is undoubtedly furthest advanced in this respect given that monetary transactions are at the heart of its business. This sector will also be the first to be exposed to the introduction of the European currency through its direct and indirect links with the national central banks which will become part of the ESCB as issuer of the European currency.

However, several actions at various levels can in practice only be carried out after the list of countries that will participate in the European currency area is known. In the official sphere, the following tasks will have to be carried out:

The Heads of State or of Government will have to appoint the members of the Executive Board of the ECB in accordance with Article 109l (1) of the Treaty. Article 50 of the ESCB/ECB Statute lays down the procedure for the initial appointment of the members of the Executive Board. All members, a minimum of four and a maximum of six including the President and Vice-President, will be appointed by common accord of the governments of the Member States participating in the European currency area, at the level of Heads of State or of Government, on a recommendation from the Council after consulting the European Parliament and the EMI. Only nationals of participating Member States may be members of the Executive Board and the procedure will thus only start after the list of participating countries has been laid down by the Heads of State or of Government. The legal establishment of the ECB and the ESCB will consequently take some time.

The Council, at the level of Ministers, will have to adopt various legal acts in view of Stage Three. Article 106 (6) of the Treaty refers to several articles of the ESCB/ECB Statute which need to be complemented by secondary Community legislation. Article 109l (1) provides for the "immediate" adoption of such legislation after the decision on the

starting date for Stage Three has been taken. The informal preparation of all the required secondary legislation will benefit from the preparatory work carried out by the EMI. This should avoid considerable delays in the formal adoption of the relevant Community acts following the establishment of the ECB. However, some of the secondary legislation proposals, in particular those relating to monetary policy instruments, can only be finalised after the ECB's Governing Council has taken a final decision on the operational framework of monetary policy in Stage Three. Legislative measures will also be needed to enable the European currency to be used from the start of Stage Three.

The Member States will have to ensure the compatibility of national legislation with all relevant Treaty requirements. In particular, they shall ensure, at the latest at the date of the establishment of the ESCB, that their national legislation including the statutes of their national central banks is compatible with the Treaty and with the Statute of the ESCB.

As soon as they are established, *the Governing Council and the Executive Board of the ECB* will have the task of:

- 1) turning the ECB into an operational organisation;
- 2) taking final decisions on the framework needed for the ESCB to perform its tasks in Stage Three and ensuring implementation of that framework;
- 3) undertaking final testing of the operational procedures set up in the context of the framework decided upon.

The ECB will announce, as soon as possible after its establishment and in any event prior to the start of Stage Three, the date for the launch of the European banknotes. In preparation for this event, a public awareness campaign will be conducted and consultations organised with those parts of industry which will professionally handle the European banknotes, in particular financial institutions and manufacturers of note-operated machines. Very close co-ordination with the national Mints will be needed to ensure a joint launch of European banknotes and coins (see Section 4.2.3 below). Consultation with professionals has already started in this area under the aegis of the EMI, the Commission and the ECOFIN Council.

Each of the above tasks will take time to execute, even though they will have been prepared by the EMI.

Sufficient time will also be needed for those parts of *the private sector* in the participating Member States to prepare the technical and organisational adaptation needed to start using the European currency in Stage Three. Notably the banking and finance industry will want to be prepared for the start of Stage Three when the ESCB starts conducting its single monetary policy in the European currency.

As a consequence, the required time interval between the decision date and the start of Stage Three has to be sufficiently long to allow for the completion of all these final preparations in order to avoid complications at the start of Stage Three and ensure the full credibility and sustainability of the single currency project. On the other hand, the interval should be short enough so as to underpin the credibility of the decision to move to Stage Three and keep up the momentum of ongoing preparatory work with the aim of

arriving at a satisfactory state of final preparation before the introduction of the European currency. After careful consideration of all the elements involved, the EMI is of the view that the tasks which have to be completed within the interim period prior to the start of Stage Three will take about one year.

4. INITIATING THE CHANGEOVER TO THE SINGLE CURRENCY FOR NON-CASH TRANSACTIONS

At the starting date of Stage Three of EMU, the exchange rates of the currencies of the Member States participating in the European currency area will be replaced by irrevocably fixed conversion rates decided by the Council. The European currency will become a currency in its own right. It will have a fixed conversion rate at which it shall be substituted for the currencies of the participating Member States. The national central banks, which were previously responsible for the definition and implementation of the monetary policy relating to their national currency, will together with the ECB constitute an integral part of the ESCB. The ESCB will start conducting a single monetary policy for the European currency area. All this has been provided for in the Treaty.

It is worth underlining the fundamental change in nature which will take place at the start of Stage Three in the areas of money and foreign exchange rates for the participating Member States. Their bilateral exchange rates will no longer exist and will be replaced by irrevocably fixed conversion rates; their national currencies will cease to be foreign currencies in terms of one another. In economic terms, there will remain only one currency which can be expressed in different ways: either in terms of the European monetary unit or in terms of any of the national monetary units.

Taking into account the Treaty provision for a rapid introduction of the European currency as the single currency of the Member States participating in the European currency area, it will be necessary for the authorities of those Member States to take, at the start of Stage Three, a number of measures related to the final changeover. The aim of these measures is to facilitate the changeover for economic agents. The sections hereafter discuss in greater detail the following categories of measures:

- 1) action by the ESCB at the start of Stage Three;
- 2) suggested action by the public authorities at the start of Stage Three.

4.1 Action by the ESCB at the start of Stage Three

Article 109I (4) of the Treaty provides for the European currency to become a currency in its own right at the start of Stage Three. The Statute of the ESCB already denominates the capital of the ECB in the European currency and stipulates that the consolidated balance sheet of the ESCB shall be composed of the relevant assets and liabilities of the national central banks and of the ECB. The ECB and the national central banks will adopt the European currency for accounting their assets and liabilities and for the weekly publication of the consolidated financial accounts of the ESCB. Accounts held by counterparties of the ESCB will be denominated in the European currency.

The ESCB will announce and conduct its *monetary policy operations* in the European currency. In the operations of the national central banks with their counterparties, within the context of the single monetary policy, the European currency will be used for quoting, transacting and settling purposes subject to the use of conversion facilities as explained

below. Tenders organised by the national central banks will have the amounts expressed in the European currency. Funds paid to or received from the ESCB will be accounted for as European currency amounts.⁶ Annex 2 illustrates how the European currency will be used in the conduct of the single monetary policy right from the start of Stage Three.

The same holds true for the *foreign exchange operations* of the ESCB, whether it is with respect to currencies of EU Member States not participating in the European currency area or with regard to third currencies. Purchases and sales of foreign currencies for its own account or for the account of its customers will be effected against, and settled in, the European currency.

Conversion facilities will translate amounts from European into national monetary units and vice versa, at the irrevocably fixed conversion rates. In principle these facilities will be set up in financial institutions. However, for those financial institutions which have not been able to equip themselves with the necessary conversion facilities, the national central banks could provide such facilities. Conversion facilities will enable those counterparties to deal with the national central banks in the national monetary units for all payments, in particular for all monetary policy operations. The same would apply to national Treasuries and other public and private customers which have an account with the national central banks. These facilities will allow them to send payment orders or other information to national central banks expressed in national monetary units. Counterparties may also receive information on their operations with national central banks and their statements of account with the national central banks expressed in national monetary units. The national central banks, as part of the ESCB, will record all transactions as having taken place in the European monetary unit. The conversion facilities offered by the national central banks will expire at the latest when national banknotes cease to be legal tender.

Annex 3 of this document presents in more technical detail some examples of how conversion facilities could work.

Payment systems are of course of critical importance. A wide range of payment systems will exist at the start of Stage Three in the participating Member States. Some of them process mainly large amounts typically dealing with payments stemming from the interbank money and foreign exchange markets requiring urgent settlement. Others process mainly small amounts linked to retail transactions. Some are organised by the authorities, others are privately run. The infrastructure of all of them is quite different except for the fact that they all use one monetary unit (i.e. the respective national currency) in their system, and final settlements are at the national central bank in most cases.

At the start of Stage Three, the Trans-European Automated Real-time Gross settlement Express Transfer (TARGET) system⁷ will be operational. TARGET will be able to process domestic as well as cross-border payments and thus serve the needs of the single monetary policy in Stage Three. The interlinking system run by the ESCB will link national

⁶ For purposes of information, national central banks may indicate the equivalent amount in national monetary units to the holders of accounts with them.

⁷ See the EMI's publication on the TARGET system, dated May 1995, for further details.

real-time gross settlement (RTGS) systems. Right from the start the interlinking system will operate in the European currency and the national RTGS systems will be capable of operating in that monetary unit. A generalised changeover of all payment systems infrastructures depends also on the decisions of private market participants, given that a number of systems are privately run. The changeover of all those systems will have to be decided at the relevant national decision-making level.

Since the ESCB will conduct its monetary policy in the European currency, liquidity in the European currency will be provided to, and withdrawn from, the *interbank money market*. To facilitate its smooth functioning as much as possible, this market will benefit from switching over to the European currency.

The ESCB will support the co-ordination of market participants' actions so as to ensure the smooth functioning of an EMU-wide money market based on the European currency. It will contribute to defining the main elements of such a market, for instance standards for quotation, types of operations and collateral.

Since the national currencies will be linked by irrevocably fixed conversion rates from the first day of Stage Three, there will no longer be *foreign exchange markets* between them but only purely arithmetical conversions. Market participants are expected to reorganise their market practices and start quoting prices for third currencies against the European currency. This will broaden the scope of the market and enhance its liquidity, which is one of the principal benefits to be derived from the introduction of the European currency. The national central banks involved in the foreign exchange market will accordingly change their market practice and quote third countries' currencies against the European currency only. The ESCB intends to encourage and support efforts to bring about an EMU-wide foreign exchange market in the European currency.

The national central banks will exchange national banknotes at par value. This has already been provided for under the ESCB Statute (Article 52).

4.2 Suggested action by the public authorities at the start of Stage Three

4.2.1 Legislative action

As referred to in the previous chapter, it is crucially important for a clear legal framework to be in place from the very first day so as to provide economic agents with certainty as to the status of the European currency and its irrevocably fixed conversion rates at which it shall be substituted for the national currencies. This legal framework will also need to provide economic agents with the freedom to transact in either national or European monetary units.

In more specific terms, the EMI considers that this legal framework should be embodied in Community legislation which should take the form of a Council Regulation to be adopted on the basis of Article 109I (4) of the Treaty. It would enter into force on the first day of Stage Three. It would have direct effect in the European currency area and would contain in particular the following elements:

- the conversion rates at which the currencies of the participating Member States shall be irrevocably fixed and at which the European currency shall be substituted for the national currencies;
- the legal status of the European currency;
- provisions governing the timing of, and the method for, the replacement of the national currencies.

The Community legislation should be drawn up in accordance with the *following principles*:

Firstly, the legal framework should respond to the principles of *clarity* and public *acceptability*.

Secondly, the Community legislation should ensure a *legally enforceable equivalence* between the European and the national monetary units. Legally enforceable equivalence means that, after the start of Stage Three, each monetary debt, denominated in a national monetary unit, is assigned a fixed and unchangeable countervalue in terms of the European monetary unit at the official conversion rate and vice versa.

Thirdly, private economic agents should be free to use the European monetary unit without any restriction *in contractual relationships* and for non-cash payments.

Fourthly, with a view to avoiding a dual-currency standard, rules governing the denomination and re-denomination of *rights and obligations of a non-contractual nature* should respect two principles. Firstly, economic agents should not be compelled to use the European monetary unit before the completion of the changeover. Secondly, Member States should be free to prescribe the use of the respective national monetary unit for denominating rights and obligations of a non-contractual nature. At the same time, Member States may permit, at their discretion, the European monetary unit to be used to that effect without, however, imposing its use.

Fifthly, national banknotes and coins should remain *legal tender* within the boundaries of the respective national territory until the completion of the changeover to the single currency.

Sixthly, the ESCB is to be enabled to conduct its *monetary policy operations* in the European currency as from the start of Stage Three.

With these principles in mind, the EMI has been examining several options for the legal framework. It will make its recommendations when current studies have been finalised.

There is also a need to establish, by means of legislation, uniform rounding rules to be used when applying the conversion rates. The question of rounding is a technical matter. An amount expressed in a particular national monetary unit, when converted into the corresponding amount in European monetary units and rounded, and subsequently re-converted into the original national monetary unit and again rounded, may not always lead to exactly the same figure. Agreeing on a legal procedure for accounting for such minor differences in the process of rounding will bring clarity to the organisation of conversion facilities.

4.2.2 The changeover of public debt

The EMI expects that new public debt issues will be denominated in the European currency from the start of Stage Three, in particular as regards securities actively traded in financial markets. Such actions would promote the development of the financial market in the European currency and enhance its liquidity and depth. Private agents will have the possibility of acquiring securities denominated in the European monetary unit against settlement in national monetary units. The value of securities sold to small savers could be indicated also in national monetary units.

The timing of, and the method for, the re-denomination of existing public debt should be studied.

4.2.3 Other types of action by the public sector

It is recommended that the authorities step up their public awareness campaign to make it clear that the complete changeover to the single currency will occur reasonably soon and that this switchover will by itself have no effect on the purchasing power of incomes and savings of citizens. The production of European coins will need to be organised by the national Mints and relevant information made available to interested parties. The public authorities will also need to announce the specific organisation of their own changeover strategy (see Section 5.2).

5. COMPLETION OF THE CHANGEOVER TO THE SINGLE CURRENCY

5.1 The changeover for cash transactions

The precise point in time when European banknotes will be introduced will be decided by the ECB Governing Council as soon as possible after its establishment and in any event before the start of Stage Three. This decision will be announced immediately. Introduction will occur at the latest three years after the start of Stage Three. The launch date will take into account the lead times required to introduce a complete new series of banknotes and coins and for the banking industry to complete the changeover for all scriptural money (see Section 5.2 below).⁸

The European banknotes and coins will be legal tender from the first day they are put into circulation in parallel with the national banknotes and coins. From that day on, the national central banks will start withdrawing the national banknotes and coins from circulation. Six months later, the national banknotes and coins will lose their legal tender status throughout the European currency area. The national central banks will of course continue, as a service to the public, to exchange the old national banknotes for European banknotes at their counters, as is the current national practice throughout the EU for banknotes of a series which has been withdrawn from circulation.

Four motives have inspired the EMI to put forward a six-month interval for the replacement of the national banknotes and coins by the European ones. First, the phasing-in of the new banknotes and coins cannot be done overnight. As a major additional related task concerns the physical withdrawal, authentication and disposal of the old banknotes and coins, opting for a period shorter than six months might create bottlenecks in the banking system, including the national central banks. Moreover, keeping in mind the fact that a part of the banknotes are circulating in countries other than the participating Member States, a very fast withdrawal process might pose problems for those outside holders.

A second reason for opting for a six-month period has to do with the fact that manufacturers of banknote and coin-operated machines have indicated that they will need such a time span to physically change and/or reprogram all of their machines. At the moment, an estimated 3.15 million vending machines and 0.13 million Automated Teller Machines (ATMs) are in use in the EU.⁹ These figures, which do not include the Teller Assist Systems (TASs) used by bank employees, are likely to rise over the coming years.

Third, the banking and finance industry has expressed the wish to keep the period of co-circulation as short as possible. A six-month period is deemed to be long enough to accommodate the necessary changeover arrangements but short enough to minimise the disadvantages of a dual operating system.

⁸ The EMI has been specifically assigned the responsibility (in Article 109f (3) of the Treaty) for supervising the technical preparation of the European banknotes. In its 1994 Annual Report, the EMI reported on the technical preparatory work in this area. Annex 4 offers more detailed explanations on the production lead time of European banknotes.

⁹ In a large majority of Member States, about half of the banknote payment flow from commercial banks to their customers occurs via ATMs.

A final consideration relates to the learning process for the public at large. Although advance information campaigns will greatly assist in getting the public acquainted with the prospect of the new banknotes and coins, the challenge of the changeover in this area is not to be underestimated. It does not merely concern a new physical shape for a complete series of banknotes and coins; above all, it concerns a change in the unit of account. People will have to be given the opportunity to grow accustomed to using the new unit of account. A six-month period may be expected to offer a sufficiently long learning period. A very long period of co-circulation may have the opposite effect, in that it might lead people not to make an initial effort to get accustomed to the new unit of account.

5.2 The changeover for non-cash transactions

The introduction of European banknotes and coins will, together with the switchover of the public administrations' operations (e.g. payment of salaries of civil servants and social benefits, collection of taxes and procurement), lead the banking and finance industry to complete its own changeover for scriptural money. The non-bank sector may also come to see the first day of introduction of the European banknotes and coins and the changeover of the public sector as intermediate deadlines and as an objective to undertake its own final changeover at that same point in time or very soon thereafter.

The use of the European monetary unit for public sector operations should occur in all participating Member States around the time at which European banknotes and coins are introduced. The time frame should be laid down in Community legislation and might leave some freedom to individual Member States. Public authorities would, however, continue to accept payments expressed in national monetary units as long as national banknotes and coins remain legal tender. Public institutions and bodies could declare themselves prepared to accept payments in the European monetary unit already some time in advance of the introduction of European banknotes and coins.

The changeover would be completed six months after the first day of introduction of the European banknotes and coins, i.e. at the date when national banknotes and coins cease to be legal tender. At that time, all monetary liabilities will de jure be redeemable only in the European currency. The banking and finance industry would only handle European currency transactions.

6. JOINING FORCES FOR A SUCCESSFUL CHANGEOVER: THE CHALLENGES AHEAD

Any given plan will only lead to a successful outcome if the planning stage is followed up by detailed design and appropriate implementation of all the elements involved. This is most evidently the case for a matter as complex as having a group of countries with sophisticated financial systems jointly changing over to a single currency. The Treaty's insistence on the irreversibility of the move to Stage Three and the European currency area further underscores the importance of carrying through in an integrated manner all the elements required to bring the ambitious project to fruition. Obviously, this will require an active involvement of all economic agents since all are users of money. From an economic point of view, the issue can be approached from both the supply side - making available the European currency to all users - and the demand side - having the European currency accepted by all users. The particular nature of the challenges to be addressed differs according to the viewpoint taken.

Supplying the new currency is primarily a function of technical preparatory work. The ESCB will need to set up its entire operating framework to be ready on day one of Stage Three to undertake the complete changeover, except for the banknotes, for which it will have to set and announce, before the start of Stage Three, a separate deadline. The public sector, which in a number of Member States represents almost half of gross national product, for that very reason exerts considerable influence through the way it prepares itself for the changeover. The private sector will have a key role to play in setting up the appropriate infrastructure to accommodate transactions in the new currency. The providers of monetary and financial services in particular have a special responsibility in this connection as they will need to facilitate the usability of the new money as a means of transaction and a store of value. It will be necessary to ensure that all of the individual actions undertaken by each of these categories of economic agents are complementary and mutually reinforcing toward achievement of the final goal. The authorities have a natural mandate to play an oversight role in this respect, both at the national and at the European level. They will have to do so in close co-operation with the private sector. The EMI and the national central banks have a firm intention to monitor closely, at the European and national level respectively, the adaptation of those parts of the financial system for which they are competent. They stand ready to co-operate with other public authorities in the exchange of information and the co-ordination of actions related to the financial system in order to smooth the changeover to the single currency.

Creating genuine demand for the European currency is ultimately a function of generating public acceptability. Instilling confidence in the new currency presupposes sufficient prior knowledge about the coming into being of the European currency. Here again, a co-ordinated effort is called for by the EMI and the national central banks, and, after its establishment, by the ESCB, which will issue the European currency, by the public authorities, both at the European and the national level, and by the private sector, in particular the banking and finance industry. Building the confidence of the users of the European currency, including those residing outside the European currency area, will require determined action by the authorities aimed at keeping the currency's purchasing

power stable as well as convincing markets that the authorities will be able and willing to maintain such a policy stance. Such confidence-building is in fact already underway to the extent that Member States are making the necessary efforts to adhere to the Treaty's convergence criteria requirements. Once the participating countries in the European currency area have been designated, the authorities of those countries may have to step up their confidence-building efforts, prior to the final stage of the changeover, so as to ensure that the two sides of the changeover, the supply and the demand side, together deliver a successful outcome.

ANNEXES

DIALOGUE WITH THE BANKING COMMUNITY ON THE ISSUE OF THE CHANGEOVER TO THE SINGLE CURRENCY

In the spring of 1995, the EMI organised a large-scale enquiry of the EU banking community by contacting nearly 400 commercial banks in all Member States through the intermediary and assistance of the national central banks. This turned out to be the most extensive EU-wide survey conducted thus far on the subject of the changeover to the single currency. Not only large banks were approached but a deliberate effort was made to arrive at representative samples of medium-sized and small banks as well.

In general, the enquiry was not meant to deliver precise quantitative indications on lead times needed by the banks to be ready for the changeover. Rather, it was seen as a stepping-stone for a more technical discussion with the banks, whereby the answers received from respondents were expected to indicate the focal points for such an extended dialogue. The enquiry triggered an intensification of the exchange of views between the EMI and the national central banks on the one hand, and commercial banks on the other.

Only a relatively small percentage of the EU respondents indicated, in spring 1995, that their business decisions were significantly influenced by the prospect of a single currency. The publication of the present document - as well as the decision on the scenario which the European Council in Madrid is expected to take in December of this year - may enhance the readiness of the banking industry to start its own preparation for the changeover.

Indeed, a substantial part of the banking sector indicated that it will start preparatory work after the scenario is made public by the authorities, even before knowing which countries will participate in the European currency area from the outset. This is not to deny that the question of participation of their country is an important consideration for banks when they come to undertake investments to implement the adaptations to their operational framework which have been planned beforehand to cope with the changeover.

The dialogue with the banking community offered the possibility of drawing some preliminary conclusions on the degree of perceived complexity of the measures needed to adapt to the introduction of the European currency.

Some of the questions put to the banks related to a scenario whereby the ESCB was assumed to start conducting its monetary policy in the European currency right from the start of Stage Three.

Asked about the impact of changing over their operational account with the central bank to the European currency, banks in most cases claimed to need between six and twelve months to switch their internal operation of that account from the national to the European monetary unit. Considering individual types of operation with the central bank, banks were of the opinion that a changeover for open market operations conducted between

themselves and the ESCB and for foreign exchange operations would be the fastest to achieve and would take less than twelve months. About half as much more time would be needed in their view to prepare the changeover to the European currency of the real-time gross settlement (RTGS) payment system.

Banks were also asked to assess the impact of a scenario whereby the ESCB was assumed to start conducting its monetary policy in the European currency from the start of Stage Three on the money and financial markets. In most Member States a large majority of banks were of the opinion that the interbank money market would, following the changeover in the operations of the ESCB and in the area-wide TARGET system, change over to the European currency, either very rapidly or in discrete stages. They would therefore have to equip themselves accordingly. Banks' assessment of the expected changeover in the foreign exchange market, once the ESCB starts operating in the European currency, very closely mirrored their view of the expected developments in the interbank money market. Banks' assessment of the assumed reactions of large non-bank operators (such as multinational companies) invariably pointed to a rapid changeover to the European currency. Private issuers of securities were expected by banks to change over to the European currency gradually once the ESCB had done so and the interbank money and foreign exchange markets had followed.

During the summer months and into the autumn of 1995 the dialogue between the banking sector, both at the European and the national level, and the EMI and the national central banks respectively, intensified. It led to new insights on both sides which prompted many banks to adjust their opinion of and planning strategies for the changeover process. At the same time, it allowed the EMI Council to deepen its understanding of the impact the changeover process may have on different categories of financial institutions.

Following the announcement by the European Council in December 1995 of the main characteristics of a reference scenario for the changeover, the dialogue of the EMI and the national central banks with the banking community in Europe is expected to evolve further and lead to a detailed planning of the changeover. Such detailed planning will allow for a timely implementation of the changeover as soon as the countries participating in the European currency area right from the start have been designated.

EXAMPLES OF THE CONDUCT OF THE SINGLE MONETARY POLICY IN THE EUROPEAN CURRENCY

From the start of Stage Three of EMU, the European currency will be the currency in which the ECB defines the single monetary policy and in which all monetary policy operations are conducted by the ESCB.

The ESCB, comprising the ECB and the national central banks, will be governed by the decision-making bodies of the ECB, which will be responsible for the definition and implementation of the single monetary policy. Operations in the context of the single monetary policy will be carried out by the ECB and the national central banks on the basis of instructions given by the decision-making bodies of the ECB. To conduct such operations, both the ECB and national central banks may open accounts for banks and other market participants.

When defining and implementing its *monetary policy*, the ESCB will need to monitor a variety of indicators for the European currency area as a whole, including various monetary and financial aggregates. These area-wide data will be based on data in the different monetary units in use in the participating Member States and expressed in the European monetary unit. More generally, the ESCB will report on its operations and publish all relevant statistical information in the European currency.

Conducting all ESCB *monetary policy operations* in the European currency involves its use as the unit of account in which all the relevant conditions are announced and in which operations with counterparties are concluded and then recorded by the ESCB. The European currency will also be the currency of settlement of these operations, i.e. the one in which central bank money is denominated. To clarify how ESCB operations would be carried out in the European currency after the start of Stage Three, two examples are provided below: an open market operation, and a lending operation in the context of a standing facility.

As an example of an *open market operation*, a securities repurchase (*repo*) transaction, currently the type of open market operation most frequently used by national central banks in Europe is considered below. Repo operations will be conducted mainly through tenders on the terms announced each time by the ESCB. Tenders may take the form of an interest rate tender or a volume tender, at the discretion of the ECB.

Under an *interest rate tender*, the ESCB will ask for bids in volume and price in terms of the European currency. A commercial bank will participate in the auction through a bid addressed to a national central bank, consisting of a proposed interest rate and an indication of the amount desired. Next, the national central bank will check the amount and quality of the underlying security; if the security is expressed in national monetary units, the national central bank will have to convert its amount into European monetary units. After having evaluated all bids received in all Member States on the basis of the information collected from the respective national central banks, the ECB will allocate

funds, at the chosen interest rates, to each of the banks whose bids are accepted. These banks' accounts with the national central banks will be correspondingly credited in the European currency. Each bank will receive a communication of the amount allocated.

Under a *volume tender*, the ESCB will announce that it is ready to provide funds at a given short-term maturity and a specified interest rate. Commercial banks will be invited to apply with an indication of the amounts they wish to receive at that rate. A commercial bank will submit a bid for a given volume to the national central bank. As in the case of an interest rate tender, the national central bank will need to check the security, if necessary convert its value into the European currency and then send the information to the ECB. After having collected all information from national central banks, the ECB will decide whether or not to satisfy, completely or partially, the requests of the various counterparties. The banks will have their accounts with the respective national central banks credited by an amount in the European currency.

In the context of a *standing facility* (e.g. a lending facility), a bank's request for a lending operation according to the conditions pre-announced by the ECB will normally be expressed in the European currency. Collateral for lending operations may be represented by instruments denominated either in European or in national monetary units; regardless of the denomination of the collateral, its value will be converted into the European currency in order to allow the ESCB to check its adequacy. Both individual operations and a bank's outstanding position will be recorded in the ESCB's books in the European currency.

In all cases, financial institutions which are themselves unable to translate amounts expressed in national monetary units into amounts expressed in the European monetary unit, and vice versa, may communicate with national central banks in the national monetary unit and receive information from them expressed in the national monetary unit alongside the information expressed in the European monetary unit (see Annex 3).

CONVERSION FACILITIES

1. INTRODUCTION

Following the start of Stage Three and until the completion of the changeover to the single currency, two monetary units will circulate in each of the participating Member States: the national and the European one.

One method to ensure the parallel circulation of two monetary units within a country consists of duplicating the domestic payment systems infrastructure and accounting procedures so that each monetary unit has its own processing environment. Although dual systems may in specific cases be a cost-effective way to handle the co-existence of two monetary units, this method would, if generalised to all payments systems, entail substantial costs which would make it unattractive, in particular against the background of the temporary co-existence of the two monetary units.¹

The preferred alternative method would consist of establishing conversion facilities which will enable payments expressed in either of the two monetary units in use in a Member State participating in the European currency area to be processed by financial intermediaries and the interbank funds transfer systems (IFTS), whatever the monetary unit in which they operate. They will consist of sets of rules, or algorithms, setting out how amounts in European monetary units can be converted into national monetary units, and vice versa. Based on a simple multiplication (or division) using the fixed conversion rate, such algorithms ought in principle to be very easy to set up in any particular computer system. The only practical difficulty could be the need to introduce such algorithms in a large number of programs and procedures. Care must be taken that the accounting unit used in individual transactions is always recognisable.

Depending on the use made of the conversion facilities, the latter may lead to a *payment conversion* or an *accounting conversion*. A payment conversion is needed when the monetary unit in which a payment is expressed is not consistent with the monetary unit used by the payment system in which it is processed (internal processing systems within banks, or interbank funds transfer systems). An accounting conversion is necessary when the monetary unit in which a payment is expressed differs from that of the accounting system of the intermediary in the payment chain.

Although most of the conversion facilities will probably be set up independently by individual institutions, some rules will have to be defined either at the EU level or at the interbank level in each country.

¹ Setting up a payment systems infrastructure able to process all national monetary units of the Member States participating in the European currency area has to be ruled out on the basis of the same argument.

At the EU level, public authorities will have to ensure the unity of the conversion rates throughout the European currency area. This relates in particular to the number of decimal places to be used, not only for conversion rates between the European monetary unit and each national monetary unit, but also for “cross-conversion rates” between each pair of national monetary units. It can be expected that the number of these EU rules will be limited.

In contrast, most rules will have to be defined at the national level, in co-operation between the central bank and the country's banking system. This is a consequence of existing payment processing mechanisms which always involve several credit institutions and are mostly organised according to specific rules, procedures and infrastructures which are very different across countries. These domestic arrangements will concern in particular the location of the conversion facilities and the possible adaptation of data formats.

2. LOCATION OF CONVERSION FACILITIES

The interlinking system of TARGET will operate in the European monetary unit and the national RTGS systems will be capable of operating in that monetary unit right from the start of Stage Three. However, this will not necessarily be the case for other systems. In particular, net settlement systems processing retail payments may operate in the national monetary unit during the day and only settle in central bank money (in the European monetary unit).

Conversion facilities will have to be organised to allow for the processing of payments expressed in the monetary unit which is not the one in which the funds transfer system operates.² Ideally, these facilities should be incorporated within the bank's software. However, it may also be envisaged - for some countries or for some systems - that the conversions are effected at the payment system level. As far as RTGS systems which involve immediate settlement in central bank money are concerned, central banks may accept payments denominated in the national monetary unit, and convert them into the European monetary unit, in order to help those credit institutions which experience difficulties in organising conversion facilities themselves.

As a result, conversion facilities will probably be organised differently across countries and across institutions. These differences should not matter too much provided that a continuous circuit for financial market transactions between banks, large-value payment systems and central banks exists, which is able to process the European and the national monetary units smoothly.

Three cases are proposed below to provide examples of how conversion facilities could be organised. In all cases, accounting conversions would be needed if the bank agrees to process payments denominated in a monetary unit which is not the one in which its accounting system operates.

² When net settlement systems operate in the national monetary unit, a conversion facility will also be needed to provide for settlement in central bank money.

Example 1

Assume that: i) a customer sends a payment order in the national monetary unit to his bank; and ii) the payment needs to be processed through an RTGS system (which settles through banks' accounts at the national central bank in the European monetary unit).

In principle, a payment conversion from the national to the European monetary unit would be effected by the bank using its own software. The payment is then processed in the European monetary unit through the RTGS system.

However, for those counterparties which were not able to set up such facilities themselves, some national central banks may agree to provide conversion facilities which would allow banks to submit their payments in the national monetary unit. In this case, the central bank would convert the payment received before settling it.

Example 2

Assume that: i) a customer sends a payment order in the national monetary unit to his bank; and ii) the payment needs to be processed through a net settlement system.

If the system operates in the national monetary unit, conversion facilities would only have to be organised when netted balances are settled in central bank money. In principle, this facility could easily be incorporated within the net settlement system's software.

If the system operates in the European monetary unit, a conversion would have to be made either by the bank itself, or within the system's software, before the payment is netted.

Example 3

Assume that: i) a customer sends a payment order in the European monetary unit to his bank; and ii) the payment is processed through a net settlement system operating in the national monetary unit.

As in the previous case, a conversion would have to be made either by the bank itself, or within the system's software, before the payment is netted.

3. MODIFICATIONS OF DATA FORMATS

Possible modifications to data formats also need to be discussed at the interbank level in each country. Data formats are conventions with which all participants in a given IFTS have to comply in order to process payments in a fully automated way.

Today, data formats almost always assume that the amounts of the payments are expressed in one monetary unit. If customer payments may be issued in two monetary units after the start of Stage Three, then data formats should incorporate at least an indication which allows payments to be sorted and possibly converted. In most countries,

this method appears the least costly one to implement; however, it raises rounding problems which are difficult to solve in the event of several successive payment conversions. For example, assuming the conversion rate is 3, a 1,000,000 payment in the national monetary unit becomes 333,333.33 once converted, and 999,999.99 if re-converted into the national monetary unit.

This inconvenience could be reduced if amounts in both monetary units were inserted in the data format. Conversion would only need to occur once, and the result would fill an additional field in the data format. Subsequently, the various components of the payment systems would "read" the appropriate field, depending on whether they operate in the European or in the national monetary unit. This solution would create fewer rounding problems but might involve substantially higher costs.

PREPARATION OF THE EUROPEAN BANKNOTES

1. The EMI preparatory work in the banknote area

Prior to the decision on the actual production of the European banknotes, numerous issues have to be considered. Some of the necessary decisions will be prepared by the EMI.¹ A consensus has already been reached in the EMI Council that the highest value for a European coin will be 2 and that 5 would be the smallest denomination for a European banknote. The agreed working assumption on the sequence, number and value of denomination of banknotes is the sequence 1:2:5 and seven notes from 5 to 500 units of the European currency.

Two options regarding the appearance of European banknotes are still being considered: a completely identical banknote, and banknotes which are identical on one side but which have a limited national feature on the other.

The selection of the themes and the features that are to be depicted on each of the seven banknotes is currently being considered. In this task, the EMI is being assisted by an advisory committee consisting of experts in history, psychology, art and graphic design. Simultaneously, the technical specification of the banknotes is under consideration, but a decision will need to take account of the most recent technical developments in the field of reproduction techniques and security features for banknotes.

Once the design features are selected it will take several months for the designer to develop a draft design that meets all requirements in terms of features and technical specifications, and which yields a satisfactory overall design. The EMI will be advised by experts in printing and design in this task.

Finally, the EMI Council will need to select the designs to become the models for the European banknotes, which will subsequently have to be transposed onto printing plates. It will be the responsibility of the ECB to take the final decision and to give the green light to the production phase.

2. The production phase

The production phase itself is defined as the length of time between the receipt of printing plates in the printing works and the delivery of sufficient stocks of European banknotes to introduce the new notes to the public.

Once proofs have been accepted and printing supplies (ink, paper, security threads and foils) received, the printing presses and other ancillary equipment must be prepared. After

¹ There is also co-ordination between the EMI and the Mint Directors in the preparation for the introduction of European coins.

final approval of one printed sheet, the preparatory phase is complete and production may begin.

Most printing works in the EU employ sheet machines with pre-cut paper sheets being printed in several successive processes (offset, intaglio and numbering). Some Member States use web printing, whereby within a single machine reels of uncut paper pass through offset, intaglio and numbering units, though not necessarily in that particular order. In addition to sheet or web printing, some Member States use foil application and silk screen printing.

After a quality control inspection, the finished notes are cut, sorted, counted and packed by fully automated note-processing machinery and delivered to the Cash Departments of the national central banks.

3. Exchange of the national for the European banknotes and coins

At the end of 1994 more than 12 billion banknotes and 70 billion coins, with a weight of more than 300,000 tons, were in circulation in the EU Member States. Not all of these banknotes and coins will have to be exchanged because not all Member States may participate in the European currency area right from the start. Furthermore, certain amounts, especially of coins, are lost or damaged and will thus not be presented for exchange against the European banknotes and coins.

Up to 50% of the banknote payment flow from commercial banks to their customers occurs via Automated Teller Machines (ATMs) and Teller Assist Systems (TASs). To enable producers of these machines to adjust the hardware and software of their ATMs and TASs to the European banknotes as fast as possible, they will need prior technical information as well as samples of the banknotes some months beforehand. Notwithstanding such advance preparation, limited manpower capacity in comparison with the large number of machines involved will result in a number of ATMs and TASs having to continue running on national banknotes for some time after the introduction of the European banknotes. The same applies to the coin-operated vending machines. Withdrawal of national banknotes and coins by the ESCB will therefore have to take into account the continued though declining demand for such banknotes and coins.

The physical acceptance, checking, storage and disposal of the national banknotes and coins will be a major task for the central banks of the Member States participating in the European currency area as well as for the commercial banks in those countries in their function as financial intermediaries. It is possible that national banknotes and coins will flow back via the commercial banks to the central banks at a high speed as the result of a pent-up demand for the European banknotes and coins. Handling reflows of banknotes and coins may be a considerable challenge for existing capacities, which are currently geared to a lower turnover speed in the reflow of banknotes and coins. This could also happen if the banknotes and coins flow back rapidly towards the end of the six-month period after an initially slow take-up. It is therefore likely that special procedures will need to be applied to speed up the processes of counting the reflowing national banknotes and coins and of checking their authenticity. It may also be necessary to expand storage

capacities if the destruction process of the national banknotes and coins fails to keep up with the reflow process.

OVERVIEW OF CHANGEOVER ACTIONS UNDERTAKEN BY THE AUTHORITIES

1. Action by the ESCB

Time frame	Nature of action by the ESCB
Between the date of the decision on the move to Stage Three and its actual start	<ul style="list-style-type: none"> - prepare for the changeover to the European currency in the execution of monetary and exchange rate policy as from the start of Stage Three, at the level of both the ECB and national central banks - make the ECB operational and prepare it to employ all necessary instruments - decide on, and undertake final testing of, the framework for the ESCB to operate entirely in the European currency from day one of Stage Three - start production of the European banknotes and announce their date of introduction as well as the date at which national banknotes will cease to be legal tender - assist in the preparation of the necessary legislation to be adopted with respect to the introduction of the European currency
From the start of the European currency area onwards	<ul style="list-style-type: none"> - conduct the single monetary and foreign exchange rate policy in the European currency - start the operation of the TARGET payment system in the European currency - provide conversion facilities to counterparties who are unable to translate between the national and the European monetary units - support the co-ordination of market participants' actions so as to ensure the smooth functioning of an EMU-wide money market in the European currency

Time frame	Nature of action by the ESCB
From the start of the European currency area onwards (continued)	<ul style="list-style-type: none"> - encourage and support efforts to bring about the rapid development of a foreign exchange market in the European currency and, where appropriate, quote third countries' currencies against the European currency only - exchange national banknotes at par value - monitor changeover developments in the banking and finance industry - co-operate with the public authorities as well as with the financial institutions in order to assist in an orderly changeover of both the public and the private sector
The six-month period for changing over all cash and non-cash transactions	<ul style="list-style-type: none"> - put into circulation the European banknotes (and coins) - withdraw from circulation the national banknotes (and coins) - monitor changeover developments in the public and private sector insofar as they have a bearing on the financial system
The completion date of the changeover	<ul style="list-style-type: none"> - continue, as a service to the public, to exchange the old national banknotes and coins for European ones

2. Suggested action by the public authorities

Time frame	Nature of suggested action by the public authorities
Between the date of the decision on the move to Stage Three and its actual start	<ul style="list-style-type: none"> - appoint the ECB's Executive Board - adopt various acts of complementary Community legislation for the establishment of the ESCB and the application of all instruments of monetary policy - adopt European and national legislation to provide for the introduction of the European currency - start the production of European coins and announce their date of introduction as well as the date at which national coins will cease to be legal tender - launch a wide-ranging public information campaign on the introduction of the European currency
From the start of the European currency area onwards	<ul style="list-style-type: none"> - new public debt expected to be issued in the European currency - announce the specific organisation of the changeover of public administrations - install oversight mechanisms at the European and national levels to monitor the progress in the private sector's changeover and give guidance where appropriate

Time frame	Nature of suggested action by the public authorities
The six-month period for changing over all cash and non-cash transactions	<ul style="list-style-type: none">- implement the complete changeover of the entire public administration, while continuing to accept payments expressed in national monetary units as long as national banknotes and coins remain legal tender- put into circulation the European coins- monitor the changeover in the private sector
The completion date of the changeover	<ul style="list-style-type: none">- establish the European banknotes and coins as the only legal tender by cancelling the legal tender status of national banknotes and coins- continue for some time to assist the public in the new single currency environment

GLOSSARY OF TECHNICAL TERMS

Collateral: asset pledged as a guarantee for repayment of the short-term liquidity loans which banks receive from the central banks in the framework of open market operations.

Council (of the European Union): the supreme legislative body of the Community. It is made up of representatives of the Governments of the Member States, normally the Ministers responsible for the matters under consideration (therefore often referred to as *Council of Ministers*). The Council meeting in the composition of the Ministers of Finance and Economy is usually referred to as the *ECOFIN Council*. In special circumstances, in particular in the case of Article 109j of the Treaty, the Council meets in the composition of the Heads of State or of Government. The *European Council* brings together the Heads of State or of Government of the Member States and the President of the Commission.

ECB: the European Central Bank will have legal personality. It will ensure that the tasks conferred upon the ESCB (FESCB) are implemented either by its own activities pursuant to its Statute or through the national central banks. The ECB will have the exclusive right to authorise the issue of banknotes within the Community in Stage Three of EMU (FStages of Economic and Monetary Union).

ECB Executive Board: the decision-making body of the European Central Bank which will implement monetary policy in accordance with the guidelines and decisions laid down by the ECB Governing Council (FECB Governing Council). It will be composed of the President, the Vice-President and two to four other members, appointed from among persons of recognised standing and professional experience in monetary and banking matters by common accord of the governments of the Member States at the level of the Heads of State or Government, on a recommendation from the Council after it has consulted the European Parliament and the Governing Council.

ECB Governing Council: composed of the members of the ECB Executive Board and the governors of the national central banks of the countries participating in the European currency area; it will be the decision-making body of the European System of Central Banks which will adopt the guidelines and take the decisions necessary to ensure the performance of the tasks entrusted to the ESCB under the Treaty and the ESCB Statutes.

ECU: the term used in the Treaty for the European currency. In its present definition (defined by the Council Regulation No. 3320/94 of 20th December 1994), the ECU is a basket currency made up of the sum of fixed amounts of twelve out of the fifteen

currencies of the Member States. Article 109g of the Treaty states that this composition shall not be changed until the start of Stage Three, when the ECU will become a currency in its own right with an irrevocably fixed value in terms of the currencies participating in the European currency area. At this point in time, the ECU or the European currency will have the same external value as the ECU basket in its official uses.

ESCB: the ESCB is composed of the ECB and of the national central banks. It will be governed by two decision-making bodies, the Governing Council and the Executive Board. Its primary objective will be to maintain price stability. Its basic tasks are to define and implement the monetary policy of the European currency area, to hold and manage the official reserves of the participating Member States and conduct foreign exchange operations, to promote the smooth operation of payment systems in the European currency area and to contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system.

European currency area: area encompassing those Member States where the European currency will be substituted for the national currency and where a single monetary policy will be conducted under the responsibility of the decision-making bodies of the ECB (FECB Executive Board; ECB Governing Council).

Fiduciary money: refers to banknotes and coins. These means of payment are termed “fiduciary” because their value is based on the confidence and trust of the holder in the issuer of the currency; their intrinsic value is not guaranteed by a clause providing for an exchange at a fixed conversion factor against some other asset such as, for instance, gold.

Green Paper: the “Green Paper on the Practical Arrangements for the Introduction of the Single Currency” is a document published by the European Commission in Brussels in May 1995. The paper is called “green” because in the administrative language of the Commission this colour designates documents whose aim is to open a discussion and not to present the final position of the institution. The May 1995 Green Paper presents the Commission’s preference for a particular scenario on the changeover to the single European currency.

IFTS: Interbank Funds Transfer Systems are systems to transfer funds in which most of the participants are credit institutions.

Interbank money market: a market for very short and short-term deposits between banks. It represents the bulk of the money market; the latter also includes non-bank operators.

Interlinking: the Interlinking mechanism is one of the components of the architecture of the TARGET system (FTARGET). The term Interlinking is used to designate the infrastructures and the procedures which are used to process cross-border payments within TARGET.

Monetary Committee: the Monetary Committee is a consultative Community body, composed of two representatives from each Member State in a personal capacity (normally, one from the government and one from the central bank) and two representatives of the European Commission. It was created in 1958 on the basis of Article 105 of the EC Treaty, with the aim of keeping under review the monetary and financial conditions of the Member States and of the Community and the general payments system of the Member States and to report regularly thereon to the Council and to the Commission. Article 109c of the Treaty lists a set of areas where the Monetary Committee contributes to the preparation of EMU. At the start of the third stage of EMU (FStages of Economic and Monetary Union), the Monetary Committee will be dissolved and an *Economic and Financial Committee* will be created instead.

Official quotation or fixing: a procedure whereby for each working day an official exchange rate for the domestic currency in terms of an established list of foreign currencies is fixed. Official fixings of foreign exchange rates do not take place in all Member States. The role of the central bank in the organisation of official fixings varies from country to country. In some the central bank has sole responsibility for conducting the fixings, in others it shares this responsibility with the competent public or private body responsible for the operation of the foreign exchange markets, while in still others it is the latter body, rather than the central bank, which is responsible. In no country do official rates apply to interbank transactions, while their role in foreign exchange transactions by non-banks varies between Member States.

Re-denomination of securities: strictly speaking, the *denomination* of a security is the currency in which the par value of the security is expressed (in most cases, the face value of a certificate). In this document re-denomination refers to a procedure through which the original denomination of a security, issued in national currency, is changed into the European currency at the irrevocably fixed conversion rates. A broader set of alternative measures and procedures exists through which outstanding financial instruments may be traded in the market on the basis of the European currency, without necessarily involving a formal re-denomination of the par value of those securities.

Real-Time Gross Settlement (RTGS) system: a funds transfer system in which payment orders are processed one by one as they arise and which provides for the immediate settlement of all payments, provided that there are enough funds or overdraft facilities on the issuers' account with the settlement agent.

Scriptural money: all money in book-entry form and therefore not circulating in the form of banknotes and coins.

Stages of Economic and Monetary Union: the Treaty describes the process of monetary unification in the EU (very often called *EMU* as an abbreviation for Economic and Monetary Union) in three stages. *Stage One* of EMU started in July 1990 and ended on 31st December 1993: it was mainly characterised by the dismantling of all internal barriers to the free movement of capital within the EU. *Stage Two* of EMU began on 1st January 1994. It provided inter alia for the establishment of the European Monetary Institute. *Stage Three* will start at the latest on 1st January 1999, with the transfer of monetary competence to the *European System of Central Banks* and the coming into being of the European currency. The European currency will become the single currency when every reference to the lawful currency of the participating Member States, both in scriptural or fiduciary form (fiduciary money; scriptural money), will relate exclusively to the European currency.

Trans-European Automated Real-time Gross settlement Express Transfer (TARGET) system: the TARGET system is defined as a payment system which will be composed of one RTGS system in each of the Member States participating in the European currency area at the start of Stage Three (Stages of Economic and Monetary Union). Under certain conditions, RTGS systems of non-participating countries may also be connected to TARGET. The national RTGS systems are interconnected through the Interlinking mechanism (Interlinking) so as to allow same-day cross-border transfers throughout the European Union.

Treaty: the term refers to the Treaty establishing the European Community. The Treaty was signed in Rome on 25th March 1957 and entered into force on 1st January 1958. It established the *European Economic Community (EEC)* and was often referred to as the "Treaty of Rome". The Treaty on European Union was signed in Maastricht on 7th February 1992 and entered into force on 1st November 1993. It is often referred to as the "Maastricht Treaty". It amended the EEC Treaty with a view to establishing the *European Community*.

TREATY PROVISIONS RELATING TO THE CHANGEOVER

Article 105a: "(1) The ECB shall have the exclusive right to authorise the issue of banknotes within the Community. The ECB and the national central banks may issue such notes. The banknotes issued by the ECB and the national central banks shall be the only such notes to have the status of legal tender within the Community.

(2) Member States may issue coins subject to approval by the ECB of the volume of the issue. The Council may, acting in accordance with the procedure referred to in Article 189c and after consulting the ECB, adopt measures to harmonise the denominations and technical specifications of all coins intended for circulation to the extent necessary to permit their smooth circulation within the Community".

Article 109f (3): "(3) For the preparation of the third stage, the EMI shall:

- prepare the instruments and the procedures necessary for carrying out a single monetary policy in the third stage;
- promote the harmonisation, where necessary, of the rules and practices governing the collection, compilation and distribution of statistics in the areas within its field of competence;
- prepare the rules for operations to be undertaken by the national central banks within the framework of the ESCB;
- promote the efficiency of cross-border payments;
- supervise the technical preparation of ECU banknotes.

At the latest by 31st December 1996, the EMI shall specify the regulatory, organisational and logistical framework necessary for the ESCB to perform its tasks in the third stage. This framework shall be submitted for decision to the ECB at the date of its establishment".

Article 109j: "(1) The Commission and the EMI shall report to the Council on the progress made in the fulfilment by the Member States of their obligations regarding the achievement of Economic and Monetary Union. These reports shall include an examination of the compatibility between each Member State's national legislation, including the statutes of its national central bank, and Articles 107 and 108 of this Treaty and the Statute of the ESCB. The reports shall also examine the achievement of a high degree of sustainable convergence by reference to the fulfilment by each Member State of the following criteria:

- the achievement of a high degree of price stability; this will be apparent from a rate of inflation which is close to that of, at most, the three best-performing Member States in terms of price stability;
- the sustainability of the government financial position; this will be apparent from having achieved a government budgetary position without a deficit that is excessive as determined in accordance with Article 104c (6);
- the observance of the normal fluctuation margins provided for by the exchange rate mechanism of the European Monetary System, for at least two years, without devaluing against the currency of any other Member State;
- the durability of convergence achieved by the Member State and of its participation in the exchange rate mechanism of the European Monetary System being reflected in the long-term interest rate levels.

The four criteria mentioned in this paragraph and the relevant periods over which they are to be respected are developed further in a Protocol annexed to this Treaty. The reports of the Commission and the EMI shall also take account of the development of the ECU, the results of the integration of markets, the situation and development of the balances of payments on current account and an examination of the development of unit labour costs and other price indices.

(2) On the basis of these reports, the Council, acting by a qualified majority on a recommendation from the Commission, shall assess:

- for each Member State, whether it fulfils the necessary conditions for the adoption of a single currency;
- whether a majority of the Member States fulfil the necessary conditions for the adoption of a single currency,

and recommend its findings to the Council, meeting in the composition of the Heads of State or Government. The European Parliament shall be consulted and forward its opinion to the Council, meeting in the composition of the Heads of State or Government.

(3) Taking due account of the reports referred to in paragraph 1 and the opinion of the European Parliament referred to in paragraph 2, the Council, meeting in the composition of the Heads of State or Government, shall, acting by a qualified majority, not later than 31st December 1996:

- decide, on the basis of the recommendations of the Council referred to in paragraph 2, whether a majority of the Member States fulfil the necessary conditions for the adoption of a single currency;
- decide whether it is appropriate for the Community to enter the third stage,

and if so:

- set the date for the beginning of the third stage.

(4) If by the end of 1997 the date for the beginning of the third stage has not been set, the third stage shall start on 1st January 1999. Before 1st July 1998, the Council, meeting in

the composition of the Heads of State or Government, after a repetition of the procedure provided for in paragraphs 1 and 2, with the exception of the second indent of paragraph 2, taking into account the reports referred to in paragraph 1 and the opinion of the European Parliament, shall, acting by a qualified majority and on the basis of the recommendations of the Council referred to in paragraph 2, confirm which Member States fulfil the necessary conditions for the adoption of a single currency”.

Article 109k (1) and (2): “(1) If the decision has been taken to set the date in accordance with Article 109j (3), the Council shall, on the basis of its recommendations referred to in Article 109j (2), acting by a qualified majority on a recommendation from the Commission, decide whether any, and if so which, Member States shall have a derogation as defined in paragraph 3 of this Article. Such Member States shall in this Treaty be referred to as ‘Member States with a derogation’.

If the Council has confirmed which Member States fulfil the necessary conditions for the adoption of a single currency, in accordance with Article 109j (4), those Member States which do not fulfil the conditions shall have a derogation as defined in paragraph 3 of this Article. Such Member States shall in this Treaty be referred to as ‘Member States with a derogation’.

(2) At least once every two years, or at the request of a Member State with a derogation, the Commission and the ECB shall report to the Council in accordance with the procedure laid down in Article 109j (1). After consulting the European Parliament and after discussion in the Council, meeting in the composition of the Heads of State or Government, the Council shall, acting by a qualified majority on a proposal from the Commission, decide which Member States with a derogation fulfil the necessary conditions on the basis of the criteria set out in Article 109j (1), and abrogate the derogation of the Member States concerned”.

Article 109l: “(1) Immediately after the decision on the date for the beginning of the third stage has been taken in accordance with Article 109j (3), or, as the case may be, immediately after 1st July 1998:

- the Council shall adopt the provisions referred to in Article 106 (6);
- the governments of the Member States without a derogation shall appoint, in accordance with the procedure set out in Article 50 of the Statute of the ESCB, the President, the Vice-President and the other members of the Executive Board of the ECB. If there are Member States with a derogation, the number of members of the Executive Board may be smaller than provided for in Article 11.1 of the Statute of the ESCB, but in no circumstances shall it be less than four.

As soon as the Executive Board is appointed, the ESCB and the ECB shall be established and shall prepare for their full operation as described in this Treaty and the Statute of the ESCB. The full exercise of their powers shall start from the first day of the third stage.

(2) As soon as the ECB is established, it shall, if necessary, take over tasks of the EMI. The EMI shall go into liquidation upon the establishment of the ECB; the modalities of liquidation are laid down in the Statute of the EMI.

(3) If and as long as there are Member States with a derogation, and without prejudice to Article 106 (3) of this Treaty, the General Council of the ECB referred to in Article 45 of the Statute of the ESCB shall be constituted as a third decision-making body of the ECB.

(4) At the starting date of the third stage, the Council shall, acting with the unanimity of the Member States without a derogation, on a proposal from the Commission and after consulting the ECB, adopt the conversion rates at which their currencies shall be irrevocably fixed and at which irrevocably fixed rate the ECU shall be substituted for these currencies, and the ECU will become a currency in its own right. This measure shall by itself not modify the external value of the ECU. The Council shall, acting according to the same procedure, also take the other measures necessary for the rapid introduction of the ECU as the single currency of those Member States.

(5) If it is decided, according to the procedure set out in Article 109k (2), to abrogate a derogation, the Council shall, acting with the unanimity of the Member States without a derogation and the Member State concerned, on a proposal from the Commission and after consulting the ECB, adopt the rate at which the ECU shall be substituted for the currency of the Member State concerned, and take the other measures necessary for the introduction of the ECU as the single currency in the Member State concerned”.

Art. 52 of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank: “Following the irrevocable fixing of exchange rates, the Governing Council shall take the necessary measures to ensure that banknotes denominated in currencies with irrevocably fixed exchange rates are exchanged by the national central banks at their respective par values”.