CHAPTER 4

INTERNATIONAL IMPLICATIONS OF EURO

Advantages of euro

The euro is acknowledged to have strong advantages and disadvantages. The biggest advantage is the exchange rate certainty that the euro will bring about for the 11 participating countries. Euro presents an opportunity for the investor to invest in a broader market without the currency risk and to achieve portfolio diversification at the same time. On the down side, the biggest drawback is that member countries will have to live with the same monetary policy and the same short term interest rates, whether or not they are appropriate to the specific economic conditions of a particular country.

4.2 Some of the benefits of the euro are listed below :

- The immediate implication of the introduction of the single currency will be the reduction in transaction costs. Costs associated with converting one currency into another and costs associated with foreign exchange management and cross-border transfers by companies will be reduced.
- By sharing the same currency, the euro zone will develop into a single, wider, deeper and more resilient capital market. This will enhance liquidity, and spur the development of new financial instruments in euro.
- New funding and investment possibilities will open up, which will bring down financing costs of firms, and complete the integration of the financial markets. The higher yield corporate debt market will in all likelihood become much larger in the euro zone with the elimination of foreign exchange risk (on intra-zonal corporate debt investments) enabling corporate credit risks to be priced more accurately.
- Markets in the eurozone are expected to become more efficient and competitive. As a result of increased price transparency, and consequent competition, prices will probably scale down.
- Elimination of exchange rate variation between legacy currencies is expected to lead to an increase in trade and investment within the euro area.

4.3 There are, however, some concerns which run deeper than the benefits listed above. These relate to the medium-term sustainability of the convergence criteria, particularly on budget deficits and public debt, critical to the success of euro. All countries in Europe would be required to make sustained efforts to meet the convergence criteria, especially getting the deficit to 3% or less. The issue that is now being debated particularly by the 'out' countries is whether the fiscal rigour that is necessary to sustain a single monetary policy for disparate economies can be sustained with prevailing high levels of structural unemployment. Moreover, the ECB will have to exercise some flexibility, especially in relation to constraints on fiscal deficits imposed by the Stability and Growth Pact. With fixed conversion rates under the EMU, single short term interest rate, limited cross-border labour mobility and no scope for fiscal redistribution across Europe, the only avenue available to governments for adjustments will be to maintain tight fiscal discipline.

4.4 Another issue being raised is whether the current central rates are a reflection of the relative economic situations within the EMU. The other issue is whether the fixed parity rate enhances the competitive position of certain countries within eurozone. Lastly if exchange rates were previously used as adjustment variables in the event of economic disequilibrium, it is debatable whether there will be recourse to different kinds of variables now that the exchange rates are fixed. Further, it would be difficult to define an appropriate consumer price index (CPI) because of problems in measuring price trends in 11 different countries. The fixed parities of the eurozone may not be able to prevent the emergence of economic disparities within the EMU.

Bank mergers

4.5 Competition in the financial sector in EMU will be much more fierce across whole range of products. With the disappearance of frontiers in Europe, cross-border mergers may become useful and appealing. A market freed by a common currency may be exploited better with a strong partner. In the past few months several US banks announced plans to merge with other financial institutions in a bid to get a strong footing in Europe to provide a challenge for Europe's universal banks, by setting up universal banks themselves with a transatlantic reach. It is likely that within the European Union also, some merger activities will gain ground to counter bank mergers in non EU countries out to get a share in the European market.

4.6 There will be significant restructuring with increasing market concentration around large commercial banks with an international presence on the one hand, and smaller specialised providers of financial services on the other hand.

Euro as a reserve currency

4.7 The launch of euro could provide an alternative to US dollar as the most important reserve currency. As a dominant currency in one of the world's largest trading blocs, the euro's role as an international investment, reserve and trading currency is likely to grow. The present shares of the EMU currencies in reserves are generally much lower than their share in GDP or international trade and therefore there is an under representation of European currencies in international portfolios. Whether in each of these markets that share will increase and the dominance of US$

as an international currency will be challenged, would depend on the interplay of several factors and is difficult to predict just yet. The dollar accounts for nearly two thirds of official foreign currency reserves world-wide. (See Table 6 and 7 appended to this report). However, central banks may increase the amount of euro investments they hold in their portfolio. Some countries, especially the small ones on the EU's periphery may even decide to tie their currencies to the euro so that they will have to keep the bulk of their reserves in the new currency. However, the view from the US is that the dollar can successfully co-exist with the euro, even if euro does increase in popularity.

4.8 The introduction of the euro will make it easier for central banks to invest in triple-A government treasury bills, of which there will be ample supply, and which are typically subscribed to by risk averse central banks. However, even this diversification of reserves portfolio in euro will depend on several factors, including the role of the euro as an anchor and vehicle currency.

4.9 Larger shifts may take place in private portfolios. Nearly identical interest rates in the private market for interest rate swaps in different EMU currencies suggest that with the introduction of euro in these markets will transform into a single liquid and deep private capital market in euros. There will also develop a liquid and deep market in government bonds denominated in euros.

4.10 A table on the international uses of major currencies before and after the euro is given at Annexure VIII.

Nostro accounts and euro

4.11 At present banks generally maintain at least one nostro account in each country in order to make payments in the country's currency via the local payment system. With the euro it will be possible to make euro payments to any participating member state from any account held in any other participating member state.

4.12 Banks will have to look into consolidation of their existing nostro accounts in each foreign currency of the 'in' countries to one or more euro accounts. Banks of 'in' countries will be changing standard settlement instructions which will enable them to move from a position in which payments in the various national currencies are made and received via one or more correspondents in each country across the national currency payments system, to a position in which all payments (euro and any national currency) are made and received by a participant itself or via a single correspondent which is a member of the national RTGS system connected to TARGET, or a member of other euro payments system such as the EBA clearing.

4.13 Transactions in ECU entered into before the onset of Stage III but maturing subsequently will automatically convert to euro, and must be settled in euro.

4.14 Outstanding transactions in any national currency will remain in that currency during the transition period, unless and until the parties agree bilaterally to convert to euro. Any such conversions should be irrevocable.

4.15 In cases of forward foreign exchange transactions involving two EMU currencies, the parties implementing the bilateral agreement to convert the underlying transactions should decide whether to leave the transaction in any national currency, convert it to euro or close it out immediately.

4.16 In case of payment netting, most market participants will not net amounts in underlying transactions that are in different national currencies, even if both parties use a euro nostro, because few have the systems capability to perform such netting. If market participants wish to net payments, they should convert their transactions in national currencies to euro with the bilateral agreement of the counterparty.

4.17 From the conversion weekend in January 1999 onwards, market participants will need to be able to look at their positions in participating national currencies as positions in euro at the conversion rates. Until all transactions are converted to euro, banks will need to have the capacity to create combined positions.

4.18 Consumers who opt for denominating all their transactions in euro during the transition period 1999-2002, can draw legacy currency notes and coins from just one euro account or a set of euro accounts in each country. Likewise cash – notes and coins – of legacy currency can be deposited into a euro account.

Financial Markets

4.19 At the end of 1997, the market value of bonds, equities and bank assets issued in EU countries was more than USD 27 trillion, roughly the same magnitude as World GDP. Euroland has the potential of becoming the largest financial market in the world.

4.20 EMU will create the second largest bond market in the world. With the total volume of outstanding bonds in EMU currencies, and the ECU of USD 7 trillion, the euro denominated bond market will be equivalent to 50 percent of the dollar bond market and 130 percent of the Yen bond market. The EMU bond market will be characterised by higher volumes of bond issues under broader range of instruments. This will also enhance the liquidity of the products. Yield differentials between euro denominated assets, e.g. government bonds will no longer entail exchange rate risk premia. Interest rate spreads will be determined only by the differences in the credit risk rating of the issuer and by market liquidity and will be much lower than have been so far.

4.21 Growing competition will also intensify the trend of disintermediation of corporate borrowing. There will be a shift from bank financing to debt security financing. The new asset classes such as asset backed securities are gaining in importance for the same reasons.

4.22 The euro equity market will be second only to that of USA in terms of market capitalisation and turnover. However, the ratio of market capitalisation to GDP at 44 percent in the euro areas is still significantly lower than that of USA (139 percent) or even Japan (50 percent). What is more important is that the EMU equity markets are highly segmented along national lines today.

The elimination of the exchange risk in eurozone will increase transparency and competition. This will accelerate the integration of markets. There will be a shift in emphasis from currency to various sectors such as institutional investors and Pension Funds as currency matching rules between assets and liabilities will become irrelevant for euro denominations. A key factor in the potential for growth of the eurozone equity market is the expectation of stable and low yields on euro bonds which beyond a stage will inhibit private investor interest in eurozone bonds and turn it towards equity investment instead.

UK and EURO

4.23 UK has decided not to participate in the EMU for the present. It is therefore one of the 4 ‘out’ or ‘pre-in’ countries. For the present it may also not join ERM 2. It has however given its intention to join the EMU if the single currency works and is successful. Remaining out would not mean that UK will not be concerned with the development of the single currency and its market. It is being ensured that UK's infrastructure is developed to allow any one who uses euro in wholesale payments, and across financial markets to do so from the first day of EMU. The financial community is being prepared in particular for the introduction of euro by explaining as widely as possible the relevant issues, identifying areas of co-ordinated activity and identifying and filling gaps where required. The UK’s commitment to euro reflects London’s commitment to maintain its pre-eminence as a financial centre for Europe.

4.24 CHAPS Euro will be available to make euro wholesale payments within UK, and cross-border to and from UK from the start of 1999. CHAPS Euro will be priced competitively, as EMI had indicated that the prices of cross border and domestic transfers in euro should be broadly similar, even though pricing of payment transfers within national RTGS would be a national decision. The capacity of CHAPS Euro will be flexible so that it can adjust to any increase in demand. Furthermore, CHAPS Euro will remain open on every day that TARGET is open, i.e. every week day except Christmas day and New Year day, even when it is a public holiday in UK. The system will allow wider direct membership. Applications for direct memberships from overseas banks on a remote basis will also be allowed, although, given the number of banks already operating in London, this option is unlikely to be exercised by a significant number of banks.

4.25 The CHAPS Euro will be a robust and efficient Real Time Gross settlement System (RTGS), like the sterling RTGS. TARGET would also be made efficient and as attractive to users as possible. UK has also decided that commercial banks operating within UK will be able to make and receive TARGET payments, which may involve scheduling payments or obtaining their own credit where needed. In addition Bank of England is also exploring the possibility of providing its own credit if necessary. Irrespective of the rules governing payments systems there will be active euro markets in major international finance centres outside the euro area. Payments and settlements will take place in the most efficient, reliable, and competitive routes.

4.26 Finally, the emergence of euro will mean that London's status as a premier financial centre will be under strong challenge from Frankfurt (which enjoys the advantage of home base of ECB) and Paris (which is a strong base for derivatives trading).

Euro and SDR

4.27 SDR has a weight of 40% dollar, 43% for European currency and 17% for Yen. The European currency therefore has the largest weight in SDR. The IMF has decided that after launch of the EMU in Europe, on January 1, 1999, the euro will replace the current currency amounts of the DM and the FRF in SDR valuation basket, which includes the currencies of Japan, U.K. and the US. The specific amounts of euro and the valuation basket which will replace the DM and the FRF respectively will be announced by IMF promptly following the announcement of the conversion rates between the euro, DM and FRF of the European Council. The financial instruments in the SDR interest rate basket, the market yield of three month treasury bill for France, the U.K. and the US, the three month inter-bank deposit rate for Germany and the three month rate on Certificate of Deposits in Japan, will remain unchanged although the French and the German instruments will be expressed in euro. In line with the currently effective decision on the SDR valuation and interest rates basket, the next revision of the SDR will take place not later than the year 2000 with any changes to take effect on January 1, 2001.

Europe and Asia

4.28 Europe and Asia are important trading partners for each other. USD 146 billion worth of goods and services, i.e. 14 percent of Asian countries' aggregate exports were exported to the EU in 1996, more than three quarters of which went to the member states of the EMU. In the opposite direction, about the same quantum, namely, USD 146 billion was imported by the Asian economies from EU. This amounted to 16 percent of the region's total imports.

4.29 The weight of the Asian region in determining the future international currency structure is indicated by its important role in international banking and bond markets, its share of global currency reserves and rising presence in world trade.

4.30 A decisive factor in the eventual importance of the euro in the global markets is its acceptance as a reserve medium by other countries especially those with large currency reserves. Asia's financial weight is particularly apparent in this regard. With regard to the level of international reserves, the top five in the world are located in Asia viz. Japan, China, Taiwan, Hong Kong and Singapore. Japan alone holds 14% of the world's reserves. Asia's share will rise further, as part of the reserves held by central banks in Europe will become obsolete.

4.31 The current strong dollar orientation of the global trade has been particularly evident with respect to Asian trade. The invoicing in Asia has taken place mostly in US dollar for a variety of reasons. A large proportion of trade is in raw materials, which is typically denominated in US dollars. US is also the most important market. The dollar's sway in Asia at the expense of Europe has been enhanced by the fact that given the many different European currencies, capital markets were relatively illiquid in each individual currency and change in currency reserves and invoicing structures were saddled by high transaction costs. The move to euro, will in the long run lead to a levelling of international currency structures and reveal the economic significance of each underlying currency area. The dynamics of globalisation can also be expected to favour euro since EMU firms with production bases in Asia will tend to invoice in euro particularly if they source their components from Europe or export to Europe. The attractiveness of euro as a trading and payment currency for Asians will definitely increase.

4.32 The likely reorientation of Asian countries towards bond markets and away from bank credit could lead to a broader international use of euro.

4.33 It can be expected that EMU will attract new Asian business ventures into Europe. A number of reasons which upto now might have discouraged companies from European investment will disappear, such as comparatively small and highly fragmented product and financial markets, wide interest rate differentials or heavy currency fluctuations. The next few years will be required for Asian companies to reassess their European market presence and business structure.

4.34 While there will be benefits from the use of a single currency and a single internal market, competition between firms within eurozone will increase, making it harder to operate in the area. A side-effect of this competition will be that it will be easier to identify weaker companies whose survival in the market has been the result of protection or advantage offered by home currency. These companies run the risk of being taken over or being forced into liquidation. All corporates, including importers from Asia will have to make sure that their business strategies live up to the demands of this environment. There may be competition from European companies in the Asian market or in other markets in which Asian and European firms operate as rivals.

Euro and gold

4.35 The Monetary Union is going to have a significant impact of various aspects of international investment not least gold**.** Generally it has been assumed that the euro would put further downward pressure on gold prices. As the ECB will need less reserves than the combined total of EMU members the need for large holdings may be reduced. There has recently been gold selling by national central banks including those of Australia and Netherlands. Switzerland is considering reducing its gold stock. Although there was some fear that there could be EMU related gold sales the position is uncertain. Banque de France and Bundesbank have both indicated that they have no intention themselves of selling gold. The EMU-11 have gold holdings which are more than the USA and more than 10 times that of Japan. These countries may not want to reduce further gold's position. There could be better management of gold holdings through gold lending and options. The decision by ECB to hold 15% of the total reserves in gold is significant. However there is no clear view on the impact of EMU on gold price. However, the views of the European Central Bank on the use of gold in the world financial system will be the key to the future price of the metal.

CHAPTER 5

INDIAN BANKS AND EURO

The introduction of euro will have a direct impact on the operations of banks in India and on the overseas branches of Indian banks. The areas of operations which will be affected by introduction of euro are discussed in this chapter.

General

5.2 With effect from 1 January 1999, all ECU components of transactions will be converted to euro at the rate of 1:1. This implies that ECU will cease to exist. Except for the currency code and possibly interest indices, all transaction variables will remain unaltered. There will be perfect continuity. The correspondent banks will send new confirmations of the outstanding transactions after ECU conversion. During the transition period from 1 January 1999 to 31 December 2001, the currencies of the eleven countries of EMU will only be expressions of euro and therefore more appropriately referred to as legacy currencies.

5.3 A number of interest indices in the EMU area will cease to exist and be replaced due to changed market conventions. There will be no more ECU indices as a result. The major indices relevant for banks in India and the successor interest index are given below :

Country	Current Indices	Successor Indices
France	**PIBOR (FRF & EU)**	**EURIBOR**
	TMP	**EONIA**
Germany	**FIBOR**	**EURIBOR**
United Kingdom	**LIBOR ECU**	**EURO LIBOR**
United Kingdom	**LIBOR legacy currencies**	**EURO LIBOR**

The successor interest index will apply from 1-1-99; FIBOR and PIBOR will cease to exist from January 1, 1999.

5.4 The conventions under which the market operates at present link the currency of payment to a particular country. By default the payment is made and settled using a payment system in the country concerned. With the introduction of euro this linkage is removed. A group of 31 major global clearing banks called Heathrow Group has recommended best practices for clearing banks when routing euro payments for same day value to other clearing banks with access to more than one euro payment system.

5.5 All the market associations have issued or are in the process of preparing suggested amendments or addition to their standard documentation to take account of the introduction of euro. Although the precise context varies, there is a broad similarity as to the areas, which may be covered by counterparties e.g.

- Confirmation on continuity of contracts
- Confirmation of applicable successor price sources
- Clarification of payment and netting transactions
- New and amended definitions for such terms as the euro, ECU settlement days and business days
- Clarification of calculation methodology or necessary adjustments taking into account the nature of the underlying asset and other factors such as redenomination.

5.6 The full conversion rates (quoted to six significant figures) must be used for conversions in either direction between euro and its national denominations or between legacy currencies. Inverse rates derived from conversion must not be used. When converting from the euro to a NCU it is necessary to multiply the euro amount by the conversion factor. When converting from a NCU to the euro it is necessary to divide the NCU amount by the conversion factor. Following a conversion, any monetary amount to be paid or accounted for should be rounded up or down generally to the nearest sub-unit with results that are exactly halfway rounded up. Conversion between one NCU and another must be done via euro (triangulation). When converting legacy (NCU) to legacy (NCU) via the euro, the euro equivalent calculated must not be rounded to less than 3 decimal places. "Synthetic cross rates" between legacy currencies are not acceptable.

5.7 Payments in NCU can be made till 31 December 2001. However, the wholesale markets will deal exclusively in euro from 1-1-99. Customers will retain the ability to make payments in NCUs for the duration of the transition period and during this period, payments can be made from a bank's euro account in any one of the NCUs as well as in euro. In practice banks will rely on the customer specific accurate payment information. A request from a customer to make a FRF payment will be converted to euro at the fixed conversion rate on delivery by the paying bank. The paying bank might however include "ERI" or Euro Related Information which the bank receiving the resulting SWIFT payment message should recognize as a NCU funds transfer. The receiving bank is obliged to credit the account in the currency of the account (EUR or FRF). These account transfers between banks will be in euro.

5.8 With the introduction of the single currency, a global euro bond market will develop. From 1 January 1999 the governments participating in EMU will issue new debt in euro and redenominate all or part of their outstanding tradable debt into euro. Private issues will follow this stance ahead of January 2002, when redenomination will automatically occur. ECU denominated bonds will automatically redenominate into euro at the start of stage 3 at a rate of 1:1. From a legal point, the decision of a borrower not to redenominate outstanding debt during the transition period does not have any implications. According to Article 8(3) of the regulation based on Article 1091 (4) of the Treaty any amount payable within the member state can be paid by the debtor either in euro or in NCU and the same amount must be credited to the account of the creditor in the denomination of his account. Only at the end of the transition period, where in legal instruments a reference is made to the NCUs, these references shall be read as references to the euro unit according to the respective conversion rates.

5.9 Simple redenomination does not affect the bondholder as it does not represent a change in the economic value of the bond. However renominalisation (which is a step beyond simple denomination changing the minimum tradable amount) can induce a change in the economic terms of the contract, in so far as it implies a rounding different from the nearest euro cent. As a general rule and independently of the redenomination method applied, investors are guaranteed from the loss of the economic value of the contract.

5.10 The Association of Banking & Financial Industry has proposed a list of conventions for the euro market. Both EMI and the European Commission have endorsed these conventions. These conventions are given in the Annexure VII.

5.11 From 1 January 1999, there will be only one currency euro for the eleven members of EMU and the NCUs will only be expressions of the euro. The euro and the NCUs are fungible between each other during the transition period in view of the fixed conversion rates. The principle of "no compulsion no prohibition" will allow account holders to continue to hold NCUs accounts upto the end of 2001.

5.12 Correspondent banking will remain an important payment channel in the eurozone for several reasons :

- The introduction of euro highlights the current segmentation of clearing houses. For the time being there are no Automated Clearing House (ACH) to ACH links.
- Book transfers will offer a cost-effective alternative.
- Not every bank has direct access to European cross border banking systems.
- In most cases cheques will still have to be presented for payment in the city in which they are drawn.
- Efforts are needed to promote truncation and the smooth transfer of cheques throughout Europe.
- Account relations in other currencies will remain

5.13 Currently each bank has at least one nostro account for each European currency and sometimes more than one. Although this will probably not change at the outset, the need for banks to hold a cash account in each member state will gradually diminish once their principal correspondents are able to offer a clearing service throughout the monetary union. Indian banks technically would need only one euro account anywhere in the European Monetary Union for payments in all EMU countries. Most correspondent banks are offering the possibility of converting existing accounts to euro while keeping the same account number. The bank will automatically convert every settlement from a NCU to euro using fixed conversion rates. The advantages of a single euro account are :

- Only one contract of EMU.
- Uniform price and service level for entire EMU
- Reduced need for cash management activities
- Streamlined back office and nostro related functions

5.14 However, the consolidation of all nostro accounts to one euro account cannot occur overnight. One important factor in this context is that no one bank can offer an unlimited intra day credit or other credits and hence there may be need for more than one euro account. Banks have to take a decision on the number of nostro accounts including accounts, which need to be continued in national currencies. During the dual currency period of EMU it will not be necessary to hold an euro account to make all euro payments. The fixed exchange rate between euro and the NCUs allows for consistent and easy translation into either currency. An euro account can be held in any EU country regardless of whether that country participates in EMU. Any decision regarding the location of the account should consider the varied regulations or restrictions regarding pooling arrangement across the European Union if more than one euro account remains. During the transition period correspondent banks would be prepared to offer dual reporting of balances and individual entries regardless of whether the account is in euro or remains in NCUs. Therefore banks may decide on the number of accounts required depending on the invoicing pattern of their clients, need for direct access to the local market their internal computer systems, the quantum and nature of credit facilities required and tax and other strategic considerations.

Payment system

5.15 At the moment payment system in the European union are extremely compartmentalised. Each country has its own domestic clearing system in its local currency, which only deals with its national central bank. Non residents do not participate directly in national clearing systems and in general do not hold accounts with the central bank of other countries. To make their payments abroad they call upon the services of local banks (their correspondent banks). After the introduction of euro, domestic payments will continue to be channelled through national clearing systems (either a net Automated Clearing House or the RTGS). Whether this will involve the domestic net settlement or gross settlement system will depend on the amount and the urgency of the transaction.

5.16 Intra European Union payment will be able use of one of the following four channels :

- Correspondent banking i.e. cross border payment arrangement through direct account relationship between banks.
- Domestic clearing systems via direct or remote access e.g. French TBF or German EAF system.
- The Euro Banking Association (former ECU Banking Association) clearing system which is being adapted to operate euro in future.
- The payment transaction system of the ESCB, “TARGET”.

5.17 The choice of channel for the transmission of a payment order from one bank to another will be within the clearing bank. Thereby, these clearing banks will make the decision about which payment channel has to be used on factors such as costs involved, cut off time, speed of processing etc. However, they have to route a payment order through RTGS, whenever instructed. It will be mandatory for credit institutions to use TARGET for payments directly connected with monetary policy operations. As far as banks in India are concerned correspondent banking will be the major channel for payments.

5.18 Overseas bank branches operating in euro area need to familiarise themselves with several key features of TARGET relevant to banking operations. These include timing of operations, provision of intra day liquidity and pricing of services.

Cash management

5.19 The ability to sweep surplus cash balances or fund short balances in euro across borders is a feature of the single currency that has received much attention as corporates and banks seek to evaluate the real value of the euro in terms of cash management.

5.20 Indian banks could avail of the pooling and sweeping services, which will be subject to legal, tax, and regulatory constraints, which still exist, in individual countries. Pooling enables the account holder's credit and debit balances in euro and NCU to be notionally offset for the purposes of calculating interest to maximize liquidity without transferring funds. Sweeping involves transferring funds between different accounts denominated in euro and NCU into a single euro account so as to give the account holder more flexibility in handling cash flows. Sweeps can be carried out domestically or cross border. If they are carried out cross border and for same day value, sweep time may have to be aligned with the cut off time in the markets concerned. While deciding number of accounts to be maintained and the number of correspondents, banks should keep in view the potential for more efficient cash management with the single currency.

Money and foreign exchange

5.21 Treasury services in the euro money and foreign exchange markets are expected to continue to take much the same form in euro as they do in participating currencies at present. The difference will be the depth and liquidity of the euro cash markets and associated derivatives with foreign exchange trading focussed, in particular, on euro against the dollar and to some extent against sterling and yen. There will be a liquid inter bank market with bank loans, FRNs, swap and other derivatives priced on the basis of EURO LIBOR or EURIBOR.

5.22 Regarding quotation of euro in the Indian foreign exchange market, it will be based on 'Certain for uncertain' that is 1 euro = Rs….. The symbol for euro is…

5.23 FEDAI may have to formally adopt the method of quotation of merchant and interbank rates for euro in line with the conventions given in Article 235 Regulation and advise its members accordingly.

Documentary credits and euro

5.24 The International Chamber of Commerce has issued a Decision Paper unanimously adopted by the ICC Commission on Banking Technique and Practice on 6 April 1998 which ensures the future smooth running of the instruments issued under ICC Rules. The Decision Paper does not amend any articles of ICC Rules in any way but merely indicates the correct interpretation of these rules after the introduction of euro. With effect from 1 January 1999, as per ICC decision, the documents can be denominated in euro, in the original currency of the documentary credit or in the NCU of the beneficiary. Payment can be made in euro or in the original currency of the documentary credit. Documents will give the appearance of conformity (no divergence) if they are expressed in different currencies in accordance with what is stated above. These guidelines apply to transferable credits also during the transaction period. The principles set forth in the Decision Paper also apply to guarantees and bonds. The Decision Paper is given in Annexure IX.

5.25 All letters of credit (L/Cs) issued by banks which are in legacy currencies could as a matter of abundant caution and transparency contain the following clause "subject to UCPDC (1993 Revision) ICC Form No.500 read alongwith ICC Publication No.470822 Rev of 6 April 1998".

5.26 Although Letters of Credit can be issued in euro from 1 January 1999, it is possible to draw up the offers or contracts in euro and provide for a clause for the substitution on 31 December 98 of the euro for the NCU at the fixed conversion rate if the dispatching of documents or payments are to be made after 1 January 1999. From 1 January 2002 LCs/guarantees/bonds can be issued only in euro.

FCNR/RFC deposits

5.27 FCNR deposits can be accepted in four currencies currently i.e. USD,GBP, Yen and DM. DM deposits can continue to be accepted till 31 December 2001. Euro provides opportunity for raising larger FCNR deposits as there will be no currency risk between EMU currencies.

5.28 In this context the following may be taken note of :

- From 1 January 1999, DM will continue only as a legacy currency.
- Price sources for DM will be replaced by that of euro and the interest rate on euro and DM will be identical.
- During the transition period the “no compulsion no prohibition” principle applies which gives a choice to the investors to use euro or DM.

5.29 In view of the foregoing RBI may allow existing DM deposits to run to maturity till 31 December 2001 after which they get automatically converted to euro. Banks may accept new / renewed deposits in DM and euro. The DM depositors may be advised that the deposits will get automatically converted to euro on 1 January 2002. Deposits already accepted in DM may be allowed to be converted into euro at the option of the investor. This will be consistent with the “no compulsion no prohibition” principle.

Interest rates on euro deposits

5.30 From 1 January 1999, the money market reference rate could be EURO LIBOR or EURIBOR. Both EURO LIBOR and EURIBOR are daily average rates at which banks lend to each other but the make up of the two rates is different. Some bankers criticize EURIBOR for basing its calculation on a wide pool of 50 + banks compared to 16 for LIBOR which may result in EURIBOR being quoted at a higher rate as some of the member banks of EURIBOR may have lower credit ratings and liquidity. However Banque de France and Bundesbank are understood to be strong proponents of EURIBOR which they hope would lure money market business away from London after EMU. ISDA has confirmed that the replacement of all existing national price sources with EURIBOR is certain. (Italy is expected to make an announcement shortly).

5.31 At present even though there are several price sources as per RBI regulations the ceiling interest rate on FCNR deposits is linked to LIBOR. We may therefore advise banks to fix interest rates based on LIBOR as hitherto. The British Bankers Association proposals for EURO LIBOR are as follows :

- From 1 January 1999, BBA will cease to fix LIBOR for ECU and replace it immediately on the same screen page with a LIBOR fixing for euro.

- EURO LIBOR will be fixed spot. A cash euro fixing will also be provided if there is sufficient demand.
- The fixings on the last two London business days of 1998 (i.e. on 30 and 31 December) will be euro fixings for value of 4 and 5 January 1999 respectively. They will be fixed by the new panel of 16 banks.
- The days count basis for calculating interest accrual for EURO LIBOR will be the actual number of days elapsed, divided by 360.
- Settlement rates for NCUs for which LIBOR is currently calculated and which participate in the euro will continue to be published during the transition period. The rates for NCUs will be identical to those for euro units from 30 December 1998. There will not be separate panels for rates in NCUs.

5.32 The RBI may therefore issue instructions to banks on the following lines.

- In the case of existing fixed rate FCNR deposits, banks will continue to pay the rate contracted till maturity.
- In the case of existing floating rate FCNR deposits, banks may at the next interest fixing date calculate the spread over the relevant EURO LIBOR rate.
- For new deposits/renewed deposits, interest rates both fixed and floating should be linked to EURO LIBOR.

EEFC/RFC deposit accounts

5.33 Banks are currently allowed to accept these deposits in any currency. The deposits are mostly in US dollars. However, the instructions applicable to FCNR deposits in regard to currency in which these deposits may be accepted i.e. euro or DM may be made applicable mutatis mutandis to these deposits also. As regards interest rates, there are no regulations from RBI in this regard and RBI may leave it to each bank to determine the interest rate as hitherto.

Overnight and Money market investments

5.34 Banks in India are allowed to invest 15 per cent of their Tier I capital in specified money market instruments. Since these are short-term investments, they will run till maturity without the need for redenomination. New deals will most likely be denominated in euro. Banks are also permitted to invest surplus funds on overnight basis. The Wholesale Market Bankers Association (WMBA) is creating a new index called Euro Overnight Index Average (EONIA) in conjunction with BBA to support the Euro Overnight Index swap market. It will be a weighted average rate of all unsecured overnight euro deposit trades arranged by bankers in London only. The ESCB will compute the EONIA as a weighted average of all overnight unsecured lending transactions undertaken in the euro area inter bank market by banks on the reporting panel. However, banks may be advised to make investments after 1 January 1999 only in instruments denominated in euro. As all money market transactions are expected to mature in the original currency, all day count conventions and conditions will remain the same.

Other investments

5.35 Banks in India do not have long-term investments and the need for redenomination of securities may not arise. Even otherwise the redenomination will be decided by the issuer of the bond.

Foreign currency loans

5.36 Foreign currency loans in DM can continue in that currency till 31 December 2001. After 1 January 2002 it will get automatically converted to euro. While there will not be any change in interest on fixed rate loans till maturity unless the agreement provides otherwise, in respect of floating rate loans, it will have to be linked to EURO LIBOR if it is LIBOR based loan. In this context banks may advise their borrowers of this implication well in advance after consulting their legal department. Documentation may also be reexamined for impact and terms should be renegotiated where necessary. New documents should incorporate a clause ensuring continuity of contracts. Banks could also refer to the international practice in this regard. In the case of new loans, the reference rate could be either EURO LIBOR or EURIBOR. (See para 5.45)

Indian banks' overseas branches

5.37 The overseas branches of Indian banks will be subject to local regulatory requirements in regard to the introduction of euro. The Indian banks presence in euro zone is as follows :

Germany	:	State Bank of India – one branch in Frankfurt
France	:	State Bank of India and Bank of India - one branch each in Paris.
Belgium	:	State Bank of India – one branch in Antwerp
	:	Bank of Baroda – one branch in Brussels

5.38 The regulatory authorities in the countries where our banks operate in the euro zone as well as other countries would have issued instructions or may be in the process of doing so. The Chief Executive Officers at each centre would have to take a decision on the opening of euro accounts in consultation with the Head Office. The quantum of business and credits and the opportunity for efficient cash management would be some of the considerations. In respect of investments held by the branches, in NCUs, they will have to be redenominated. The national stock exchanges and Central Securities Depositories of the 11 participating countries have chosen to quote trade and settle securities exclusively in euro from 4 January 1999. Broker dealer will therefore be prepared to quote trade and settle securities in euro from 4 January 1999 following their migration to euro over the conversion weekend. Institutional investors, however, do not face such an aggressive timetable as the accounts and reports will continue to be available in national currency denominations. The principle of "no compulsion no prohibition" means that these will continue to be provided by custodian banks until NCU denominations are phased out on 31 December 2001.

5.39 Over the conversion weekend, bonds issued by all 11 of the governments whose currencies are participating in the EMU will be redenominated in euro. All new bonds issued by governments will be denominated solely in euro. Banks investments in bonds will also get redenominated.

5.40 The most significant impact for the branches operating abroad is the elimination of exchange rate risk across the euro zone, which will encourage branches to buy and sell securities across national borders on a larger scale. Indian banks will also face more competitive pressures as banks previously protected by currency barriers will face increased competition for domestic business.

5.41 Indian banks abroad will have greater opportunities for asset allocation as exchange risk is eliminated. The structure of the bond market will gradually change within eurozone. As a consequence the eurozone will gradually move towards a credit culture as the emphasis shifts from inflation and currency risk to credit risks.

5.42 Indian banks will also have opportunities for diversifying their borrowing sources by tapping the vast liquid and diversified financial market.

Information Technology

5.43 Major European banks have invested substantial sums for setting up technology appropriate for the euro. As far as Indian banks are concerned certain modifications would be required to the existing systems to take care of the advent of euro. Some of the areas are listed below :

- Account books will be required to be maintained in dual currencies
- A new currency 'euro' will have to be put into the Master Table of the computers.
- Arrangements will have to be made to take care of conversion rates set between the legacy currencies and the triangulation approach used to calculate from legacy to legacy currency.
- Systems would have to be modified to provide for linkage between the legacy currency and the euro as all the legacy currencies will be connected through the euro.
- In order to avoid confusion all outputs should show both euro and the legacy currency till 2002 and the system should be capable of dual reporting.

5.44 Each bank may set up a small group of 2 or 3 members to examine each and every form/book, which is required to be modified following introduction of euro.

Continuity of Contracts

5.45 The basic principles underpinning continuity of contracts are :

- Any country is entitled to define its currency – 'the sovereign right' or the ***lex monetae principle***. Any change in a country's monetary law is therefore binding on any third party. So continuity of contracts should be ensured.
- Within the member states of the EU, the concept of continuity of contract under EMU means that the introduction of the euro will not affect or alter any terms of a legal instrument

unless the parties to it agree to the contrary. Regulations regarding continuity – which will apply to all EU members whether they are EMU members or not state that the introduction of the euro will not justify contract amendments, adjustments, termination, changes in reference rate and other currency or interest rate related parameters of the contract. However, the regulation allows parties to agree otherwise.

- An EU regulation does not have any force outside the EU. Recognition of the contract in jurisdictions outside the EU depends on the local legal position.
- The 'problem contracts', which need to be identified are those where the following criteria apply

i. The term of the contract extends beyond 31 December 2001.
ii. There is a payment obligation in one of the NCUs which will cease to exist.
iii. The law of non-EU country is applicable.
iv. The contract is in ECU which will cease to exist.

5.46 If the law of the non-EU country is applicable, problems with respect of continuity of contracts will arise. Two aspects of continuity will be as under :

i. Will the single currency be recognised by a third country law as replacing the existing national currency of the relevant member state?
ii. Will there be any grounds on which it might be claimed under that law that the contract is to be cancelled, rescinded or terminated or varied in whole or part, consequent to the introduction of euro?

5.47 As regards **i.** above, with a few exceptions, in most countries, the 'nominalistic' principle applies. This principle connotes that a debt denominated in a national currency should be satisfied in the currency which is a valid currency according to the laws of that country. As regards (ii), " no Indian law would appear to prohibit an Indian debtor from discharging his obligations" merely because of the introduction of euro. It has been the view held by the courts in India that commercial impossibility or hardship caused by larger financial liability does not entitle the debtor to claim discharge from his contractual obligations. Impossibility must be physical or legal impossibility and not impossibility in reference to ability or circumstances. Whether the Indian party is entitled as creditor to receive payment in the currency of the member state or in euro when substituted, there appears no legal provision governing the situation, except perhaps Foreign Exchange Regulation Act. While no amendment to the Act appears necessary, RBI (Exchange Control Department) may consider if the prescription of permitted currencies and permitted methods of receipts/payments requires amendment.

5.48 It is, however, advisable for individual contracting parties to incorporate a standard continuity clause in various agreements/documents on the lines of ISDA EMU continuity provision, with suitable modifications. However, prior to inserting the clause, the documentation should be checked with regard to provisions conflicting with the continuity clause.[1]

[1] The State of Illinois in USA has enacted a new legislation in this regard, known as the "Euro Conversion Act". Section 10 of the Act deals with continuity of contracts. Section 10, Clause (a) provides that if the subject or medium of payment of contracts, security or instrument is a currency that has been substituted or replaced by the euro, the euro shall be a commercially reasonably substitute, and calculated in accordance with the regulations

5.49 Principle of hardship is expressly recognised by some European countries. However, replacement of national currencies by euro is not an unforeseeable event, whose application would add to or detract from the wealth of any one party to a contract. As such, there should not be any ground for applying hardships. Similarly, adjustment clauses concerning events that substantially alter the balance of provision of services should not apply to the transition to euro.

Financial supervision

5.50 The Maastricht treaty envisaged a separation of responsibility between the ECB which would handle monetary policy, and the national authorities which would continue to conduct financial supervision.

CHAPTER 6

EURO AND INDIA – IMPLICATIONS FOR TRADE AND INVESTMENTS

The European Union (EU) has been an important and growing partner for India. Indo-EU trade had received a major boost with the introduction of Generalised System of Preferences (GSP) in 1971 and signing of Commercial Co-operation Programme in 1974. These two developments had a major impact on the composition of trade that underwent a shift in favour of manufactured items. There has been a rapid growth of Indo-EU trade since then, and EU has emerged as India's largest trading partner, with 27 percent share in India's exports and over 30 percent share in imports. However, despite India's large share of trade with EU, invoicing in EU currencies accounts for only 7.2 per cent of the trade. (See Table 10 for world invoicing in major currencies) To the extent trade is with the euro countries or countries whose currencies move closely in alignment with euro, invoicing in euro is likely to minimise risk, given the expectations of a strong euro. From the European perspective, India still remains a marginal player in EU trade as India's share in EU's imports from the world ranged from 0.32 percent in 1980 to about 0.41 in 1995. On the export side, EU's share of exports to India in EU exports to the world was around 0.46 percent in 1995.

---

adopted by the Council of European Union. Clause (c) of the same section provides that performance of the obligation described therein may be made in the currency of the contract or in the euro, but not in any other currency. Section 15 of the Act provides that the substituted currency does not change the contract requirement, in the event of introduction of euro, so as to affect the performance of obligations in foreign currency. Section 20 makes the Act subject to anything that parties to the contract agree.

As of now the only overseas jurisdiction where specific legislation has been passed to deal with continuity are certain states in the United States. In New York and Illinois, legislation was adopted in July 1997 while corresponding legislation in California came into force in June 1998. The financial law panel has published a report on continuity of contracts under the law of Singapore. Even though the regulation under article 235 of the Treaty does not apply as part of the domestic law in Singapore, the report concludes that this seem to be of little consequence in respect of monetary obligations, given the natural inclination of Singapore law towards continuity. Hongkong Monetary Authority is aiming to introduce specific legislation to remove any doubt about continuity of contracts denominating in NCUs or ECU subject to anything that parties may have otherwise agreed. Other countries known to have considered their position, but which have no current plans to introduce specific legislation to deal with euro include Canada, Malaysia, South Africa and Switzerland.

6.2 The major exports of India to EU consist of textiles, leather and leather products, pearls, chemicals, machinery, animal and vegetable products and miscellaneous manufactured goods. The price elasticities of major exports to EU have been relatively large implying that any cost reduction and quality improvement in the products that are exported to EU, could lead to significant increase in quantum of exports. However, income elasticities for most of the commodities are quite low. The key to boost our exports to EU destinations will crucially depend on the movement on income elasticities of major exports to EU. The commercial policy constraints from the EU side in the form of tariffs, quantitative restrictions, technical barriers including product standards and anti-dumping investigations will have a bearing on India's exports.

6.3 A study conducted by the Research Department, Confederation of Indian Industry, published in March 1998 has listed certain specific action plans to enable India to benefit from the developments within EU and particularly the single market and EMU. As far as India EU trade is concerned, the study recommends need for a fresh approach to EU as India's trade structure does not reflect the changes taking place in the EU market. The other comments made in the study are :

- India's export basket consists largely of low value items catering to lower segments of the EU market.
- There is an urgent need for restructuring of India's Textiles and Clothing industry with a view to increase competitiveness for which textile mills have to be modernised and large scale units need to be encouraged to be export oriented.
- India needs a different textile policy for survival in a non-MFA regime.
- Large trading houses of the country could think of the possibility of forming joint ventures with large trading companies in the EU having EU wise business network.
- Meeting the EU standards would be a major challenge for Indian exporters. Following implementation of a single market, rules and EU policies relating to product standards have been raised substantially. Health and safety standards have been made stringent. Indian products have to meet not only system standards (ISO 9000 etc.) but also standards relating to product processes (such as CE Mark Certification). EU has notified bodies for giving CE Mark Certification. Certain Indian bodies may be trained and authorised to give such certification in India.

6.4 Economic reforms in India with liberalisation in trade and investment policies have now paved the way for broader industrial and technological co-operation between India and the EU. There has also been a remarkable improvement in bilateral initiatives for investment in India. Liberalisation of foreign investments through India's capital market has opened a new vista of opportunities for the EU investors. Also, significant investment opportunities have emerged for foreign direct investment (FDI) in a vast number of areas including manufacturing and infrastructure. The momentum of private investment inflows from the EU countries is set to be sustained.

6.5 Of the total foreign direct investment in India (as at the end of March 1993), EU countries accounted for around 65 percent. Share of EU countries in the total portfolio investment in India as at the end of March 1995 was around 50 percent. On the Indian side, many enterprises have been found to be establishing strategic business linkages within the EU. Many Indian corporates have raised substantial capital by way of listing their stocks in the European capital market, creating in the process a linkage between the EU investors and the Indian companies.

6.6 In the past, India received almost half of what South Asia received by way of official capital inflows from the EU countries. The 1990s, saw a significant improvement in the flow of official loans and grants from the EU countries. However, it is likely that official loans from the EU countries may suffer a reversal in view of their own long-term adjustment needs like moving over to zero-budget deficits, reducing labour-market rigidities and increasing demand for public spending in social sectors within the EU. In 1994-1995, EU countries accounted for 35 percent of bilateral assistance to India under external assistance programme.

6.7 **T**he effect of euro on the external debt hinges on the possibility of a strong/weak euro vis-à-vis the US dollar. Around 13 per cent of our external debt is denominated in the EU currencies.

6.8 Thus, EU has a much more important role to play in India's economy; a role that should facilitate effective and gainful participation of India in the global economy. Similarly, India too is significant for EU as a high potential and growing market outside the EU. The future relationship should be built on this principle of equal and mutually beneficial partnership along with growing inter-dependence and sustainable linkages. Such a relationship has to be built on the dynamics of co-operation in trade and investment. Focus has to be on marketing of investment opportunities in India to EU countries. Areas such as agriculture, infrastructure, energy etc. could be the prime focus of Indo-EU co-operation.

6.9 It must however be recognised that introduction of euro cannot be a sufficiently strong stimulus to alter the fundamental forces driving European – India trade. Factors such as the development of exchange rates, the cyclical performance in the two regions as well as the remaining barriers to trade and trade relations with the rest of the world certainly play a more significant role overall than EMU could conceivably do. In the long run, however, the euro will leave its mark on European Indian economic relations by paving the way for more stable relations and facilitating financing of trade and investment activities. But this will also require a response from Indian traders and investors to reconsider their business strategies in Europe in order to compete in a more dynamic environment.

Practical implications for Indian firms having trade relationship with EU

6.10 Indian trade and industry should note that when measured by most key economic parameters the 11-eurozone countries create in aggregate the second largest currency after the United States. The euro is also anticipated to become the second largest currency block after the US dollar and a global reserve currency. The market will be highly competitive. It is predicted that the creation of a single market will result in the rationalisation of a number of European industries with larger companies being able to grow through mergers and take-overs. Exporters, where competitors are euro land companies may face increased competition from a more streamlined and cost efficient group of competitors. At the same time a market of this size is expected to open up many new commercial opportunities for businesses which can be proactive and competitive. It is, therefore, important for Indian trade and industry to know and understand euro and its implications.

6.11 The important impulse for closer trade links between Europe and India will result from positive economic forces set free by the euro. Indian firms will be able to enter one unified market free from impediments to internal trade with an impressive growth potential. The firms will be able to effect all their financial transactions in the entire EMU area in only one currency. This will offer scope for streamlining treasury activities.

6.12 With effect from 1 January 1999 euro will become the book currency of 11 countries in the eurozone, comprising Germany, France, Austria, Netherlands, Belgium, Luxembourg, Spain, Finland, Italy, Portugal and Ireland. The currencies of these eleven countries will exist for three more years. Euro notes and coins will appear in the market on 1 January 2002 and will replace the legacy notes and coins by 30 June 2002.

6.13 Eurozone will resemble USA in certain respects. Its GDP will be 80 per cent that of USA and 50 per cent larger than that of Japan. A significant part of the external trade of the 11 countries will become internal trade in euroland, which will contribute to about 20 per cent of GNP. Former national financial markets in the 11 countries will be replaced by an unified financial market which will be the second biggest in the world after USA.

6.14 There will be significant capital market efficiencies resulting from the elimination of currency transaction costs. The establishment of monetary union is expected to result in tremendous efficiency gains in the real and financial sectors.

6.15 The share of US $ in international transactions decreased from about 50 per cent in 1980 to about 47 per cent in 1992. The combined share of DM, FRF, NLG, ITL and GBP has risen from 31 per cent to 33 per cent during this period and the trend is likely to continue. Trends in trade invoicing are given in Table 8.

6.16 From 1 January 1999 the euro will be introduced in cashless form via payments travellers cheques, credit cards and trading systems throughout the eurozone. From this date, conversion factors/rates between the national currency and the euro will be irrevocably fixed. The ECU will be replaced by euro on a one-for-one basis. From 1 January 2002, euro notes and coins will be introduced and national currency notes and coins will be withdrawn from circulation within a maximum period of six months i.e. by 30 June 2002. From this date, euro will be the only legal currency in eurozone.

6.17 From January 1999 to 31 December 2001, companies can use either national currency or the euro for all international transactions credit facilities or deals. Under the EMU principle of "no compulsion no prohibition" a company is under no obligation or pressure to use either national currency or euro for any business transaction during the transition period. Invoicing and payment can be done either in euro or in national currency.

6.18 As the conversion rate between the euro and the national currency will be irrevocably fixed, there will be no exchange gain or loss and the currencies will be fungible. Conversion between one national currency and the other will also be via euro.

6.19 Although there is no compulsion to use euro during the transition period, Indian companies must be prepared to invoice or pay in euro because they may encounter customers and suppliers in Europe who deal only in euro. Euro will increasingly be recognised as a preferred currency for trade and related financial transactions. Countries which are not part of EMU but within EU and other countries which have shown interest in joining EU may also start adopting the euro as an invoicing and payment currency. However, some end customers in EMU may continue using national currencies throughout the transition period particularly retail businesses and other companies dealing mostly in cash. As per indications, the largest corporations in the chemical, electrical and automotive industry will change their accounting over to euro in 1999. As a result, initially all will request invoicing sales and purchases in the euro. The same is true for price quotations, new contracts etc. Other chemical companies, large retailers and service companies will follow in 2000. In 2001, most other companies will make the changeover, probably with the exception of those, which conduct most of their business with private households or in cash. Payroll systems will probably be the last area to change from their national currency.

6.20 The greatest advantage of euro will be price transparency as the euro will enable consumers and importers of European goods to benefit from being able to compare more easily between eurozone countries and select on price. Indian companies, which have economic relationship with countries in EU, should make arrangements to switch to the euro without waiting for the end of the transition period.

6.21 The progressive use of euro by Indian businesses will require assessment of the strategic, operational and information technology issues. Switching to the euro represents an investment in time and resources but it will provide a simple and convenient way of conducting business in Europe. Companies will have to review promotions, new business and sales strategies and contracts and decide what changes will be needed in the market communications plan.

6.22 There are currently a wide range of differing sales and value-added taxes, duties and imports across eurozone countries and there are no agreed plans to harmonise these. These tax disparities will be highlighted with increased product price transparency. Therefore importers from EU could seek the best value in EMU countries.

6.23 During the transition period, companies may have to maintain dual currency systems. The systems must be capable of processing euro transactions and adopting the new conversion process between euro and NCU or between legacy currencies (the triangulation method).

6.24 The International Chamber of Commerce has issued guidelines to cover handling of documents claims and payments. Briefly, during the transition period creditors can present documents in national currency or the euro. Debtors can settle in national currency or euro. From 1 January 2002 all payment and claims will be in euro. As already pointed out, as the national currency and euro are fungible, banks will be in a position to make and receive payments in euro or the national currency.

6.25 In the case of contracts where the payments are indexed to a basket containing national currencies, the composition of the basket will undergo a change. The weights of the national currencies will have to be substituted by their euro equivalents. Information relating to contracts indexed to SDR is given in paragraph 4.27. In view of what is stated therein, the specific amounts of euro and the valuation basket will be announced by IMF after the conversion rates are announced. In terms of the Indo Soviet Protocols dated 25 November 1978 and 30 April 1981, payments to certain Russian organisations who had supplied machinery etc. on deferred payment terms are indexed to the value of the rupee determined in terms of a basket of 16 currencies. Of the sixteen currencies named in the Protocols, seven currencies viz. Austrian Schilling, Belgium franc, French franc, Deutsche mark, Italian lira, Dutch guilder and Spanish peseta will be only denominations of euro. As in the case of SDR, the specific amounts of euro in the basket will have to be factored in.

6.26 There will be no change in the manner of calculating import duty on goods invoiced in euro or in national currencies from January 1, 1999 except that there will be only one exchange rate viz. The euro rupee rate. In the case of imports invoiced in national currencies during the transition periods, the currencies will be converted to euro at the fixed conversion rate and euro rupee rate will be applied.

6.27 On continuity of contracts, specific legislation has been established inside the EU and some other jurisdictions to ensure the introduction of the euro does not impair the continuity of ECU and national currency loan contracts. A reference may be made in this connection to paragraph 5.45 of the Report. In view of what is stated therein and in para 5.47, Indian companies are unlikely to face problems on continuity of contracts. However, in specific cases companies may take legal advice in the matter.

6.28 Travellers to eurozone will save exchange on costs associated with conversion and reconversion of the national currencies.

6.39 Banks in India will be able to offer spot and forward exchange contracts in euro as in the case of the national currencies**.**

6.30 There will be no serious impact on issues of debt paper denominated in EMU currencies maturing prior to 31 December 2001. However, Government bond markets will quote on actual/actual next year and most new paper is likely to be in euro. After that date the payment will have to be made in euro. Companies, which have foreign currency liabilities in EMU currencies, can pay either in euro or the national currencies till 31 December 2001. After that date the payment will have to be made in euro. In the case of fixed interest rate liabilities denominated in EMU currencies, the interest rate will continue till maturity. For floating rate loans, as some price indices would no longer exist, the appropriate benchmark will have to be used. For example the benchmark for DM LIBOR will be the new EURO LIBOR; for FIBOR it will be EURIBOR. Borrowers may seek advice of their banks/legal department to take appropriate action. The new indices are given in Annexure V.

6.31 As per current exchange control regulation the interest rate on short-term trade finance cannot exceed the Prime Lending Rate. FEDAI may continue to provide this information as hitherto by obtaining rates from banks in eurozone. RBI may also consider if changes are required in this regulation.

6.32 The euro will pose some challenging questions to Indian companies possibly requiring fundamental amendments to corporate strategies. Regardless of whether an Indian firm has established a presence in the EU or whether it is planning to enter, the euro will greatly enhance sales and procurement possibilities as currency related obstacles to the mobility of goods services and factors within EMU will vanish. The EMU countries will also be attractive investment locations as they may serve as access points to the entire EU and the newly emerging markets of Central and Eastern Europe.

6.33 Indian companies already established in the EU with already established sales and production networks in Europe will face more strategic challenges. They will come under pressure from newly emerging competition within the EMU area. Innovation and cost cutting will be crucial for competitiveness and the future market position in Europe. Management must see the timetable for the changeover for a number of business activities including offers and price lists, new contracts, invoices, accounting and controlling, pay rolls, balance sheet and profit and loss accounts. However there is no need to change everything at one stroke due to the transition period. A number of factors will determine the right timing, the EDP software configuration, the structure of customers and suppliers as well as the legal and public administrative framework of the respective country. Once the decision on timing is made, it must be communicated both internally and to customers, suppliers and shareholders. For companies having strong economic relationship with EMU, the euro project requires the attention and full support of top management.

6.34 Selecting a business location in Europe will be easier for Indian companies as exchange rate considerations no longer matter for the choice of the right business location. Enterprises can concentrate on other critical parameters directly related to the demands of the company such as production costs, proximity to market centres and infrastructure. It will also not be necessary to maintain more than one business location only for protecting the company against exchange rate movements and high currency related transaction costs.

6.35 One effect on investment into India could be that the absence of exchange rate uncertainty may provide a stimulus for intra EMU investment. This could happen when the investment destination in India is competing with an investment destination in EMU. The effects are, however, ambiguous. In general, balance of investment capital flows depends more on market volume and trade flows and is less influenced by the development of exchange rates. A strong domestic demand and a conducive FDI policy would continue to make investments attractive rather than the monetary innovation of EMU. Conversely since the investment guidelines of some Pension Funds in certain European countries have specified allocations for "foreign currency" investments and these allocations were in part being used for intra-European investment, there could be a higher appetite for Indian/Asian portfolio investment from such funds post January 1999 or euro.

CHAPTER 7

MEDIA, PUBLICITY AND HRD INITIATIVES FOR EURO

General Media and Publicity initiatives

In order to help create awareness and understanding on the euro, media and publicity initiatives need to be necessarily taken at all levels.

7.2 At the national level, important information relating to the introduction of euro should be released to the press and television in the form of advertisements, by the Indian Bankers Association (IBA) or Foreign Exchange Dealers Association of India (FEDAI).

7.3 Seminars may also be conducted by IBA and FEDAI on specific issues relating to banks and banking products for member banks. For example, seminars on Uniform Customs and Practices (UCP) conventions affecting trade finance may be held by FEDAI, and Frequently Asked Questions (FAQs) may be addressed by IBA and individual banks. Banks will also need to hold customer service seminars with major chambers of commerce and major export bodies.

7.4 The FEDAI may also conduct a flagship workshop in association with Federation of Indian Exporters Organisation (FIEO) for the Chief Executive officers of all Export Promotion Councils (EPCs) and other apex trade bodies, to familiarise them with the euro and its impact on the exports/imports from/to India. Subsequently, more workshops may be conducted by these EPCs and other apex trade bodies in various centres in the country to give a wider publicity to euro related issues affecting the public.

7.5 At the regional level, initiatives may be taken by banks to organise and lead forums on euro, bringing together for discussions key economic agents like the traders, customers, governments agencies like EPCs and the like.

Specific initiatives – customer education

7.6 One of the most important areas that banks will have to look into is preparing their customers for the changes that will come about in their banking transactions as a result of the introduction of euro. Banks will have to undertake customer education programmes in order make their customers conversant with the switch-over to euro, the transition phase, the final coming of euro and the phasing out of national currency units of EMU participating countries. Customers will have to be made aware of the choices available to them during the transition phase, of making or receiving payments in euro or a national currency, as well as the costs involved in the conversions from euro to national currencies, and vice versa.

7.7 Customer education will involve clarifications on conversions, rounding and triangulation procedures under the euro and that small rounding differences could arise during the transition period when euro or national currencies are both being used simultaneously for transactions. Such customer education should be provided not only at the individual bank level, but also at the levels of industry and government.

7.8 Three major groups need to be addressed separately for customer education programmes. These are, i. wholesale markets ii. the trade finance customers and iii. retail customers.

7.9 Wholesale Markets would involve the Indian banks, institutions and a few very large corporates who need to understand specific issues like the impact of euro on payment systems, nostro arrangements, TARGET, EURIBOR vs EURO LIBOR, market conventions, redenomination of bonds/instruments etc. in the capital and securities markets. In addition, impact of IT issues will need to be discussed with a few select large corporates (top corporates in the public and private sector), Indian banks and financial institutions, who may be involved in euro capital and money markets directly as borrowers and investors. Short duration seminars may be arranged at the National Institute of Bank Management (NIBM)/Bankers Training College (BTC) for the benefit of bankers and financial institutions.

7.10 Trade Finance customers involve exporters, importers and large/medium/small scale operators. This is the most vulnerable segment, and needs urgent and widespread education to benefit from opportunities thrown up by euro as well as understand the new rules governing this market, both in the pre-conversion and post conversion period. Contents of the communication to these economic agents should be based on the following :

- brief economic background, benefits and time table to the euro.
- list of FAQs on euro which have been prepared by many international banks, and modified specially to suit Indian companies.
- specific issues impacting exporters/importers, including, legal position on continuity of contracts, payments, SWIFT, reimbursement/settlement issues, redenomination, insurance cover, accounting, need to modify IT software and the impact of double taxation treaties on withholding tax.

7.11 In the case of retail customers using foreign currency demand drafts, telegraphic transfers and traveller’s cheques, it is a low value but high volume issue for the banks. For this reason, bank counter staff training would be very necessary. A communication kit for bank counter staff via IBA/RBI/IIB could be produced. It is essential that such training is imparted to the branch level officials.

7.12 As mentioned earlier, press advertisements placed in major dailies/magazines would greatly increase public awareness to the euro. Banks may also issue booklets to their customers on the practical issues that may arise and hold area-wise seminars and conferences, to enlighten them on the effects of euro on their businesses.

HRD and Training initiatives in banks

7.13 Banks would need to undertake speedy action to strengthen the expertise of their manpower in all fields, viz. Information Technology (IT), treasury operations, economics, finance and marketing in relation to euro. Banks must work out their strategies for the switch-over to euro, and their personnel must be kept informed of the same. For instance, the finance personnel need to be fully conversant with, and trained on loan accounting and bond valuation market practices which will come into effect with the launch of Stage III of the EMU.

7.14 A comprehensive module for training for banks may be worked out by FEDAI. Euro workshops and seminars may be conducted by FEDAI with a focus on the micro operational aspects of the banks. Seminars conducted by RBI and NIBM could focus on the macro aspects useful to banks and other participants.

7.15 The training programmes of the banks will have to pay specific attention to the following :

- in the key areas where the introduction of the euro is of critical significance e.g. finance, accounting and IT, the staff could benefit from familiarisation programs for statistical systems being developed under the EMU, including monetary and balance of payment accounting with special treatment therein of cross-border flows;
- Officials and other staff members who have frequent contact with customers, should be given a priority with respect to the training programmes. Training should prepare the employees sufficiently to handle queries as well as be familiar with any calculations relating to currency conversions, pricing of currency contracts and other operational eventualities. The training should also have a multiplier effect as the trained staff could serve as euro agents in their own banks.

7.16 The Group feels that an early conversion to and usage of euro will reduce conversion problems for banks. It will be in the interest of the Indian exporters/importers to also switch early, and start thinking in euro terms immediately. This needs to be emphasised in all customer communications.