

Modernising the arrangements for registration and transfer of British Government Stock

Consultation Document

November 2002



HM TREASURY

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Chapter 1 - Introduction

The Government is considering whether it is possible and practical to modernise and simplify the registration and settlement of government stock (gilts). Currently, transactions and records of legal title for uncertificated gilt holdings are managed electronically within the Operator System (OS)¹ and the Bank of England is required to keep a full record of these transactions. Transactions and records of legal title for certificated (retail) gilt holdings are wholly administered by the Bank of England. This is a cumbersome arrangement which necessitates some costly duplication in so far as the transaction records kept by the OS and the Bank of England are the same for uncertificated stock. The Government is seeking to identify the necessary changes to the OS and associated systems, together with changes to market practice and legislation, which would remove this duplication. In addition the Government is considering the changes required to facilitate the settlement and registration of all gilts through the OS, and the removal of costly paper processing from the registration and settlement functions.

2. Following extensive consideration of a variety of options, and some informal consultation by way of a discussion document placed on the Treasury website, the Government has settled on the model in this consultation document as most likely to succeed. If implemented it would replace the two current regimes with a single, modern, electronic regime for gilts registration and settlement, accompanied by the removal of paper from the trading and settlement of retail stock.

3. Furthermore, the Government is considering whether, how and when to place the registration and settlement of gilts into the private sector. It is the Government's current objective to settle the question of the shape of the registration regime early in 2003, with a view to putting elements of that regime out to public tender later in the year. Your answer to the questions set out in Chapter 10 will help the Government determine the shape and feasibility of the model which will be put out to tender. Responses should be returned no later than Friday 24 January 2003 to:

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¹ The transaction system run by CRESTCo which facilitates registration and settlement of dematerialised securities.

Chapter 2 - Government criteria for gilts registration

4. Before considering changes to the arrangements for gilts registration, it is important to be clear what those arrangements must deliver. It is vital that they ensure continued confidence in the gilts market and maintain the UK Government's exemplary record for servicing its debt - any failure in this regard might have implications for the future cost of issuing and servicing UK debt and might even affect the UK's credit rating, which would increase costs further. With that in mind, any future system for gilts registration must comply with the following essential criteria:

- Provision of a secure system with absolute assurance that payments and other registration functions will be provided to stockholders in an accurate and timely manner;
- Compliance with relevant legislation (as amended if necessary) including the ability to fulfil all relevant legal obligations and provide assurance that any changes to registration procedures would not be prone to legal challenge;
- Provision of a service at a cost to government that offers clear value for money;
- Provision of a service that operates to (or exceeds) industry standards, which is straightforward, easy to use, treats stockholders fairly and reasonably, and provides the Treasury (as issuer) with a reasonable level of management information; and
- Assurance of a reasonable degree of flexibility, such that service agreements or contracts do not excessively constrain strategic options for the future, and providers are able to respond flexibly to developments in issuance, the market, settlement and instruments. Sufficient flexibility must also be built in to meet the operational needs of the UK Debt Management Office (DMO).

Chapter 3 - Background to the proposed model

5. Until the inauguration of Electronic Transfer of Title (ETT) on 26 November 2001, the Registrar's Department of the Bank of England (the Bank) conducted the registration of legal title for the vast majority of UK gilts (although a small number of gilt holdings were registered on the Belfast or Dublin registers operated by the Bank of Ireland²). However, since 26 November 2001, effective registration of uncertificated holdings has taken place simultaneously with settlement, within the OS under the Uncertificated Securities Regulations (USRs). The registration of certificated gilts remains with the Bank, governed by a panoply of legislation, of which the most significant elements are the Finance Act 1942, the Stock Transfer Act (STA) 1963 and the Government Stock Regulations (GSRs).

6. The introduction of ETT eliminated the time gap between settlement and registration of uncertificated holdings (for market transfers), but it resulted in two differing registration regimes. This is because the USRs state that the *Operator register*, maintained within the OS, has to be mirrored by the issuer, or his agent, maintaining a *record* of all the uncertificated holdings. They also state that there needs to be regular reconciliation of the register and record balances. Maintaining these two separate systems includes unnecessary elements of duplication. As things stand for gilts, every settled transaction in the OS generates a Register Update Record (RUR) which is sent to the issuer to update the record. The balances on the register and the record are reconciled nightly to ensure the record has captured every transaction and that the correct balances exist, so that dividend payments can be made accurately. However, if the establishment of ownership of OS members' stock can be determined by the OS member account, and if the establishment of ownership of retail gilts is only required when an ownership transaction is made or when dividend/redemption monies are paid, it becomes unnecessary for the register and the record to be updated so frequently. Consequently it should be possible to eliminate some duplication and develop a more cost-effective system of registration.

7. Furthermore, the Treasury has been considering whether this presents a good opportunity for wider improvements to gilts registration. It seems, for example, to be desirable, on efficiency grounds, to find a way for all gilt holdings to be maintained within the OS in some way. This would of course necessitate changes to the arrangements for gilts currently held in certificated form. And it may also be possible for the registration services, currently supplied by the Bank of England, to be provided more cost-effectively in the future by one or more private sector bodies, on the basis of a competitive tender. The Treasury and the Bank of England have been looking at how these changes might be delivered in practice. The rest of this document considers one possible model, starting with what is required from a gilts registration service.

² The holdings on the Belfast and Dublin registers were integrated with the Bank of England register on 28 October 2002. The legislation which facilitated this also removed the prescriptive nature of the Finance Act 1942 which stated, in effect, that only the Banks of England or Ireland could hold the register of British Government Securities.

Chapter 4 - Objectives and assumptions for the proposed model

8. The Treasury's objective is to devise a model for gilts registration which continues to meet the criteria set out in chapter 2, but which removes any unnecessary duplication associated with the current arrangements, enables all holdings to be maintained in the OS in some way³, and facilitates open competition for registration services in the future. Working closely with the Bank and having consulted informally with legal advisers, the managers of the OS and others, the Treasury is currently considering the model outlined in detail below. It has been designed specifically to:

- centralise the settlement of all gilts transactions, so far as possible, into one electronic system;
- eliminate the need in normal circumstances for paper certificates of title and, so far as possible, paper Stock Transfer Forms, and thus the need to transport them from broker to registrar;
- provide each stockholder with a consolidated statement of their holding rather than individual, piecemeal certificates;
- enable retail gilts to be held within a new Issuer Pooled Retail Account (IPRA), which would pool all the retail accounts (that hadn't elected to be held either under the existing arrangements for OS private sponsored membership or within existing nominees) into a single account in the OS, backed by the Issuer's Retail Database (IRD);
- eliminate the need for the maintenance of the *record* and thus the need for full reconciliation with the *Operator register*, and so greatly reduce the need for transaction and balance data to be passed from the OS to the IRD;
- facilitate and simplify the transfer of dividends and redemption monies to OS members' accounts, and to persons holding stock in the IPRA, by giving consideration to the usage of Cash Memorandum Accounts (CMAs), in the OS, for all payments; and
- develop links from the brokers to the IRD, either via an OS-approved communication network or directly. Existing OS messaging would still be used as far as possible to minimize changes to systems and practices, although direct links from broker to IRD could perhaps be developed efficiently using the Internet.

³ The proposed model will not affect the small number of gilts held in *bearer* form, or the rights of stockholders to transfer to and from bearer form, where that right currently exists. The IRDM will manage a single bearer account, which will be used to facilitate transfers between electronic and bearer form.

9. In addition, the Treasury has been careful to base the development of the proposed model on a number of important prior assumptions. In particular the model has been designed so that:

- it should not incur significant ongoing net costs in excess of those pertaining to the current registration arrangements;
- it should not make changes to the current arrangements as regards the legal liability of the main participants;
- it should support existing functionality for the issuance, maintenance and redemption of stockholdings, plus any existing official operations carried out by the DMO; and
- it should be broadly consistent with the overall programme of securities market modernisation, including the proposal to dematerialise Money Market Instruments (MMIs), and with the government's desire to offer electronic access to its services across the board.

Chapter 5 – Key elements of the proposed model⁴

10. In essence the model has two principal features:

- All registered stockholders would in future hold gilts in uncertificated form in the OS, either as a system member or through a private sponsored member or within a Corporate Nominee (all available now) or within a new Issuer Pooled Retail Account (IPRA). All holders would thus have access to an electronic means of transfer through a broker of their choice. This change would be implemented universally and not offered as a further variant on existing arrangements. (Making the proposal optional would not simplify systems for the future, reduce system costs or give stockholders the benefit of a faster and more secure electronic transfer system.);
- An Issuer's Retail Database (IRD) would be established and maintained separately from the Operator register, in order to remove the need for an issuer register or record.

11. For the proposal to be successful, the potential anxieties which stockholders who currently hold gilts in certificated form might have need to be addressed. These include:

- (i) possible discomfort from the loss of a material certificate;
- (ii) the fear that holding stock within the IPRA would give rise to the loss of legal title as in a nominee account; and
- (iii) the fear of being tied to a specific broker.

12. To address these concerns the Treasury proposes that:

- individual gilt certificates would be replaced by a **statement**, together with a secure Stockholder's Reference Number (SRN)⁵ which would need to be quoted in order to identify the holding and the particular stockholder on the IRD – there would need to be separate SRNs for each holder in a joint account;
- the appropriate legislation would be drafted to ensure that all stockholders on an IRD retain **full legal title to their stock**, this being tantamount to an "on register" position, yet able to deal with the full benefits of the faster OS-based settlement cycle; and
- stockholders would be allowed to deal through the **stockbroker of their choice**, via the appropriate IPRA, using an appropriate electronic access and transfer system. The OS would hold a separate IPRA for each line of stock, but all the IPRAs for gilts would be managed collectively for the issuer (ie HM Government).

⁴ See Chapter 6 for detail on how the proposed model would handle current gilt operations.

⁵ See chapter 7 for detail on the proposed construction and usage of Stockholder Reference Numbers.

13. These basic changes (minimising paper, facilitating electronic transfer and access, and removing the need for a "record" to be kept for gilts) would simplify the system of registration and should reduce the overall costs to the taxpayer. This proposal would result in the settlement of all transactions within the OS, whilst enabling an "on register" solution that would still give legal title to the underlying stockholder.

14. The constituent elements of the overall system have been identified as follows:

- Operator System (OS);
- Issuer's Retail Database (IRD); and
- Issuer Pooled Retail Account (IPRA).

And the key players would be :

- OS operator (currently CRESTCo);
- Receiving, Issuing, and Paying Agent (RIPA) – a body comprising the existing OS functionality of receiving agent, as well as issuing and paying agent;
- IRD Maintainer (IRDM) – who, in the proposal, would additionally be responsible for operating the IPRA.

15. Under the current arrangements the Bank effectively fulfils the roles of both RIPA and IRDM. The Treasury concluded early on that it was possible to separate these roles in the future, and that doing so might facilitate wider interest in an open tender for gilt registration, particularly among non-registrars, and a more cost effective service to the taxpayer. However, the Treasury is open to the argument that these elements can be better carried out together by a single body/organisation, particularly to the extent that the two functions depend on the same data and where separation might add further unnecessary duplication. Appendix B charts these functions/roles and compares this proposal to the current arrangements. It was also considered whether the Receiving Agent role could reasonably be separated from the Issuing and Paying Agent role, and whether the IRDM needed to operate the IPRA. However, informal consultation suggested that these options would fragment the service too much, resulting in higher costs and suggesting greater operational risks. However, the Treasury is prepared to reconsider should it be demonstrated there is merit in doing so.

16. In summary, this proposal would see current uncertificated gilt holdings, with existing OS membership, remaining on the Operator register within the OS, but without a requirement to be duplicated on the issuer's record. There would be a requirement for the appropriate balance of these holdings to be made available to the RIPA on the Record Date, currently 7-10 business days before the payment date. This would also apply to the continuing private sponsored accounts and corporate nominees. Additionally, this proposal envisages that the balance on the IPRA should also be notified to the RIPA in the same way. Thus all gilt dividend payments would be made by the same RIPA. It should be possible to credit OS members' CMA's, and for nominees and the IPRA operator to distribute monies, according to the underlying stockholders' instructions.

Chapter 6 - How the proposed model would handle current gilt operations

(i) Primary Issuance⁶

Public Auctions

17. The prospectus and applications forms would be forwarded to OS members and the IRDM who would record the issue details on the IRD and arrange for the documentation to be printed and dispatched to prospective investors with existing holdings in the IPRA, who have expressed interest in participating at auctions. Investors would return completed application forms together with the appropriate payment to the IRDM. Investor details would be recorded on the IRD and payments would be banked.

18. The IRDM would inform the DMO of the total stock applied for by investors who wished to hold it in the IPRA. After the close of offer, the DMO would transmit the breakdown of successful bids received from the OS members, plus the total figure for the IPRA, via SWIFT, to the RIPA.

19. The total stock issued (OS members and IPRA) would then be credited to the RIPA's account in the OS, using existing OS messaging. The RIPA would then distribute the stock to the OS members using matched simple deliveries. There would also be a matched transaction with the IPRA in the OS representing the total retail applications but this would be "stock only" as the payment would have been made separately through the banking system. The final stage of the process would involve the RIPA transferring the cash received from OS members to the DMO's CMA, using a cash-only simple delivery.

Tap Issues/Standing Repos

20. A tap issue or standing repo issue⁷ would involve crediting the RIPA account in the OS with the total amount of additional stock for onward delivery by matched transfer.

Switch Auctions

21. The settlement process for members relinquishing a nominal amount of one stock (the source stock) at a given price and bidding for an amount of another stock (the target stock), to be purchased at a price determined by the DMO based on the bids received, should remain largely unchanged. The target stock would be injected to the RIPA's account. The two legs of the auction would still be linked using a "many to many" transaction type – the first leg debiting the member's account in the OS and crediting the RIPA account in the source stock; the second leg debiting the RIPA account and crediting the member's account in the target

⁶ See flowchart I in appendix D

⁷ A further injection of an existing stock, whether permanent or cancelled the following day.

stock. Normally these types of auction are only available to retail investors through a market maker, therefore the IPRA operator would not be involved.

Reverse Auctions

22. Reverse auctions are used by the DMO to buy stock back from the market at a price determined by a bidding process. Stock would be delivered by successful bidders to the RIPA account in return for cash using OS simple deliveries. The stock could then either be cancelled using a negative OS adjustment (by the RIPA) or delivered back to the DMO. Currently, the cash is refunded to the RIPA outside the OS; under the proposal this could also take place within the OS using a cash-only delivery.

(ii) Secondary Market Purchases⁸

23. When purchasing existing stock, the investor would approach the broker of his choice (who would normally, but not necessarily, be a member of the OS)⁹ with an instruction to purchase stock, and would agree the purchase price. If the investor is already known to the broker s/he may get faster settlement by already having funds on deposit, or the broker would insist on forward dated settlement whilst payment clears. Responsibility must still lie with the broker to establish the identity of the customer.

24. Brokers and Gilt-edged Market Makers (GEMMs) would use existing messaging to move stock from the GEMM to the broker in return for the cash. Stock and cash would settle in the OS via a simple delivery in the usual manner.

25. The broker would input investor details (or the SRN if adding to an existing account) via OS messaging using extra fields contained within the existing simple delivery transaction type. As well as containing the investor details the message would also contain matching instructions debiting the broker's OS account and – if the stock is to be held in the IPRA – crediting the IPRA. This transaction would require matching with the IPRA operator before settlement could take place.

26. The IPRA operator would be enquiring throughout the day to pick up any transactions made against any of the IPRAs (ie the IPRA for each line of stock). On receipt of an enquiry, matched instructions would be sent by the IPRA operator to allow settlement in the OS. If there was a problem with either the SRN or the investor details, the transaction would not be matched. When the broker viewed his unmatched transaction list he would need to be able to identify which transactions the IPRA operator had rejected in order that they could be

⁸ See flowchart II in appendix D.

⁹ It is possible that some brokers would be willing to handle retail transactions entirely off-market. They would need to match a purchaser with a seller, or be prepared to carry a float in the line of stock being transacted.

corrected and re-submitted [the details of this procedure still need to be discussed with the OS managers].

27. If the IPRA operator matched the transaction, settlement would take place and the stock would move from the broker's account to the appropriate IPRA. Another enquiry would then be sent to confirm the transaction status.

28. Once the transaction had settled, and the stock was in the IPRA, the IRD would be updated, ie the investor account would be created (or an existing account credited). A statement, including the SRN, would be sent to the investor, at his registered address, as proof of purchase. In the case of a joint holding, a statement and unique SRN would be sent to each named stockholder.

(iii) Secondary Market Sales¹⁰

29. The investor would approach the broker of his/her choice (who would normally, but not necessarily, be a member of the OS) with an instruction to sell stock, and would agree the sale price. Responsibility must lie with the broker to establish the identity and "bona fides" of the customer. The investor would produce the SRN previously sent to him/her when the stock was purchased. Joint holdings would require the production of each unique SRN as confirmation that the sale had been agreed with all parties.

30. The broker would input a new OS enquiry message using the investor's unique SRN. This message would be picked up by the IRDM who would return information relating to the investor's holding. The exact make-up of this response remains to be determined - it could either give a positive or negative response or return the name and address of the investor, plus confirmation that sufficient stock was available for sale. The IRDM would have to ensure that sufficient checks were carried out on the account, ie that there were no restrictions such as probates pending or court orders, before the response was sent. The checks should not incur any delay to the response, as they would be immediate and would not require any user intervention. Alternatively, direct access to the IRD could be made available to the broker via a secure website, in order to send the investor's SRN, rather than using OS messaging.

31. The broker would input the investor's SRN via the OS using extra fields contained within the existing simple delivery transaction type. The message would also contain matching instructions crediting the broker's OS account and debiting the IPRA. This transaction would require matching with the IPRA operator before settlement could take place. The IPRA operator would be enquiring throughout the day to pick up any transactions made against any of the IPRA's.

¹⁰ See flowchart III in appendix D.

32. On receipt of an enquiry, the IRD would be updated and the investor's account either closed or debited. If there was a problem preventing registration then the transaction would not be matched by the IRDM. When the broker viewed his unmatched transaction list s/he would need to be able to identify which transactions had been rejected in order that they could be corrected and resubmitted [the details of this need to be discussed with the OS managers].

33. Once the IRD had been updated, matched instructions would be sent by the IRDM to allow settlement in the OS. If the transaction matched, settlement would take place and the stock would be moved from the appropriate IPRA to the broker's account. The broker and the GEMM would use existing messaging to move stock from the broker to the GEMM in return for cash. Stock and cash would settle in the OS via a simple delivery in the usual manner, and a new statement, showing either the account closed or the new balance, would be sent to the investor as confirmation that the sale was complete. In the case of a joint holding, statements would be sent to each named stockholder.

(iv) Conversions¹¹

34. Once a decision to offer a conversion had been made by the DMO, the equivalent of the entire amount of source stock available for conversion would be credited to the RIPA account in the OS as "assented" stock. The total amount of stock in issue can be viewed on the OS. Stockholders would be invited to convert, and application forms in respect of holdings on the IRD would be returned to the IRDM for processing. Completed forms would transfer the holdings of source stock into "assented" stock.

35. On the close-of-offer day, the IPRA operator would input a message debiting the IPRA and crediting the RIPA account in the OS with the total amount of stock assented by retail investors. OS members who assent to the conversion offer would also carry out this step for the total amount of the stock that they wished to convert. The RIPA would then create accounts in the assented stock for each member assent as they are received, and for the total assented stock to be held in the IPRA.

36. At the close of business on the day before the conversion date, the RIPA would draw down the assented stock member balances and the total assented stock held in the IPRA, from the OS. The member and IPRA balances would be scaled by the RIPA in accordance with the conversion rate. The RIPA would distribute scaled credit adjustments to the OS member accounts and the IPRA in the target stock. The assenting IRD stockholders' accounts would be scaled by the conversion rate, and new holdings created in the target stock, by the IRDM. An extra credit to the IPRA may be necessary to bring the account into line, with respect to any "rounding fractions", with the retail account on the IRD, as they would have to be merged individually; notification of the adjustment amount would be sent from the IRDM to the

¹¹ See flowchart IV in appendix D.

RIPA. Finally, a balance enquiry would be required to reconcile the balance on the IPRA with the converted retail accounts on the IRD.

(v) Cancellations

37. Stock may be cancelled as a result of a special operation (eg a switch or reverse auction, or a standing repo operation). This involves removing the stock from the OS using a stock withdrawal transaction, thus reducing the amount of stock in issue. Although under the proposed model, stock would not be permitted to be re-materialised¹², functionality still needs to be in place to allow for stock cancellation. This could be achieved by using an OS negative adjustment (by the RIPA), which would effectively reduce the nominal amount outstanding in the OS.

(vi) Stock Dividend Payments/ Redemptions

38. These proposals assume that all payments would be made in the OS: dividend and redemption payments would be made by the RIPA using the existing transaction type "cash only" unmatched stock events. On the dividend/redemption record date, the RIPA would draw down the member balances from the OS, which would also include the balance for the IPRA, and make one payment to each account. The distribution to the underlying retail stockholders would be made by the IRDM (by BACS or warrant) based on their individual account balances as shown on the IRD and recorded payment instructions. The intention would be to preserve the option for individual stockholders to receive payments either gross or net of tax, with information and tax deducted being passed to the Inland Revenue accordingly – therefore the single payment made to the IPRA would be gross, but any balances after individual payments had been paid would be passed back to the Inland Revenue by the IRDM. The total of individual payments plus tax returned to the Revenue should agree with the payment made by the RIPA to the IPRA in the OS.

39. This proposal assumes that the OS members receive their payments into their CMA, and that their settlement banks are able to pass real money, received via the settlement cycle intra-day, on to the members' accounts for immediate use. This should be feasible, but is not necessarily achievable in the settlement banks' current systems. Alternatively, if settlement banks were unable to make the CMA cash available at the time of settlement, these proposals would require the individual member to hold and maintain BACS payment instructions within his OS account. The RIPA would pull down these instructions on the Record Date together with the OS account balances.

¹² Except where the right to convert to bearer form exists – see footnote 3.

Chapter 7 - The stockholder's reference number

40. The proposed model would entail the abolition, for normal market trades, of Stock Transfer Forms (STFs) and Certificates of Title. STFs, signed by transferors, and certificate controls, which have remained virtually unchanged since the late 19th Century, would be replaced. However, it is imperative that an alternative system be developed in order to identify an individual holding and the particular stockholder on the IRD, which provides a level of security that will be at least as sound as the present arrangements, but that is more appropriate for an electronic transfer system.

41. There is currently an obvious risk that both certificates and STFs can be stolen, addresses changed and frauds committed – the stockholder being unaware that anything untoward has happened until he notices that the next dividend payment has not appeared. To a great extent brokers, who have to warrant transactions, and usually bear the cost of any fraud, have already developed more effective procedures, such as requiring clients to open accounts with the broker before trading commences, as well as the now familiar money laundering checks. This proposal goes further and suggests the use of an alphanumeric reference number probably consisting of two parts - the first to identify the stockholder's account on the IRD and the second, unique to the stockholder, identifying him/her specifically. The introduction and use of such Stockholder Reference Numbers (SRNs) will not in itself prevent fraud, but it will add further to the existing anti-fraud measures operated by brokers. It will still be necessary for the broker to “know his/her client” before instigating any trade. It is also proposed that the use of such a reference number should be supplemented by some new procedures addressing the following questions/points, on which the Treasury would welcome views:

- *Should statements, containing details of all a particular stockholder's holdings, be sent directly to the stockholder? Or, as the delivery of statement and reference number to the stockholder could conceivably happen before the broker has received payment from his client, should they be sent to the broker for onward transmission?*
- *Should the broker consider forward dating settlement to ensure he receives his money from the client before completion of the trade?*
- *Should stockholders be allowed to request a new SRN at any time? (They might wish to do this if they believed for any reason that the security of the original reference number had been compromised).*
- *Would it be prudent to change the SRN after each transaction? Or would there be added benefits of keeping the same reference number for the life of the account, and thus permitting the addition of new purchases to an existing account? How is the cost-benefit balance here perceived in the market?*

- *Should each joint stockholder have to give his SRN in order to fully authenticate a trade, or should it be possible for the first named stockholder to act alone?*

42. This proposal envisages that, prior to the new arrangements taking effect, stockholders would have the opportunity to obtain their SRNs, but they would not be useable until after the cutover. Stockholders would receive a separate SRN for each of their accounts, whether sole, joint or designated, and they would be printed on the statement, alongside the stock to which they were applicable.

- *Is the transmission of the entire two part SRN secure enough, if printed in full on the statement, or should only that element of the reference number identifying the holding, i.e the account number, be sent with/printed on the statement, and the second element, identifying the individual, be sent separately?*

There is obviously a cost/risk balance to be struck here, as there is with more advanced technologies that have been considered appropriate for other systems where personal identification is essential. Replacement reference numbers could be issued by post or over the telephone (once the IRDM had satisfied himself as to the identity of the caller – the method of doing this would be the responsibility of the IRDM). The old reference number would be cancelled irrevocably, on such replacement, as well as at the time of redemption or total sale.

Using SRNs

43. This proposal suggests that SRNs should be used for sales and purchases in the following ways, although, the Treasury is open to alternative suggestions for the use of SRNs.

44. For sales, investors would be able to deliver SRNs by hand to the broker, or if already a known customer, by telephone. The broker, having used whatever methods he thinks appropriate to validate the *'bona fides'* of his client, would use a new OS enquiry message comprising the International Security Identification Number (ISIN), quantity and SRN to access the IRD. On receipt of the enquiry the IRDM would check the account for quantity, legal restrictions etc. and return either a positive or negative response to the broker. If the response was negative, a reason would also be returned such as "insufficient stock" or "invalid SRN". If it was considered necessary to earmark the stock after a positive response to a broker's enquiry had been sent, and the subsequent sale did not happen, then the earmark would have to be removed, which would involve more OS messaging. If the IRDM received a second enquiry against the same account within a short period (yet to be determined), then the broker would receive a message stating that another enquiry had already been made of that particular account, and the IRDM would need to be contacted for guidance.

45. If the response to the enquiry was positive, the broker would continue with the sale, virtually guaranteed that registration would be successful. Having arranged the sale with a GEMM, the broker would input the OS message which would include the SRN. On receipt of the transaction, the IRDM would debit the relevant retail account and issue a new statement to the stockholder. For joint holdings each stockholder's SRN would be needed by the broker as confirmation that all stockholders were party to the sale and were content to proceed with it. In addition all SRNs would need to be input in the balance enquiry, otherwise a negative response would be received from the IRDM requesting the outstanding SRNs.

46. For purchases, if the investor did not have an existing account in the stock that he wished to purchase, and therefore did not have an SRN, the broker would input the appropriate OS message and include the full investor details for the sole, or each joint, holder. On receipt of the transaction, the IRDM would create a new account and generate an SRN for each stockholder, which would be sent to each investor at his/her registered address along with a statement. If the investor already had an SRN for the stock that he wished to purchase, and wanted to add to his existing account, the broker would quote the SRN instead of supplying the investor details. This would ensure that the existing account was credited when the OS message was received by the IRDM. A new SRN would not be generated for this transaction - only a new statement.

Off-Market Transactions

47. If a holding of stock is transferred off-market (ie by operation of law such as on the death of the holder, through an off-market broker or through a direct transaction with another retail stockholder) then the SRN would need to be surrendered to the IRDM, together with the new holder's details, possibly utilising an STF or something similar to communicate these details. A new SRN would be issued to the transferee, together with a statement, after the transfer had taken place. There would not be an OS movement, as the total stock on the IPRA would not have changed.

Chapter 8 - Amending the USRs and other legislation for the proposed model

48. The main features of the model which require legislation appear to be:
- (a) removal of the need to issue a certificate, which for gilts is enshrined within the **Government Stock Regulations (GSRs)**, and replacing it in the case of investors on the IRD with a requirement to issue a statement which would not be *prima facie* evidence of title;
 - (b) removal of the possibility to convert gilts from uncertificated to certificated form;
 - (c) definition of the nature of an IPRA and the requirements for it to be maintained;
 - (d) providing that evidence of legal title to gilts held in an IPRA is constituted by entry of the stockholder on the issuer retail database;
 - (e) removing from the **Uncertificated Securities Regulations (USRs)** the need for the issuer to maintain a ‘record’ and thus the need for reconciliation of the ‘Operator register’ with the ‘record’;
 - (f) facilitating the transfer of payment balances to the RIPA on the Record Date in order to make accurate and timely dividend or redemption payments; and
 - (g) permitting the setting up of IPRA in the OS and requiring the balances held on them to be reconciled with the details shown on the corresponding IRD.

These legislative changes, set out in more detail below, would be designed to establish a regime whereby the underlying holders on the IRD would have legal title to stock held on the OS register in an IPRA. It would be essential that the aggregated total of the individual retail accounts on the IRD was reconciled with the balance on the IPRA in the OS on a daily basis. Such a reconciliation could feasibly be carried out in a similar way to the reconciliation of a nominee’s client accounts to the nominee account in the OS. It would be substantially less costly than the current arrangements which require full duplication and regular reconciliation of the wholesale (uncertificated) records as well as the retail (certificated) element.

Detail

49. At present there are two ways of registering UK Government stock (gilts) under two different sets of legislation. Legal title to certificated gilts is established by their entry on a register maintained by the Bank of England and administered under the Government Stock Regulations 1965 made under the Finance Act 1942; and such gilts are transferred by written instrument in accordance with the Stock Transfer Act 1963. Legal title to uncertificated gilts is established by their entry on an “operator register of public sector securities” maintained in the OS under the USRs 2001 made under section 207 of the Companies Act 1989, and such gilts are transferred electronically through the OS under the USRs. The GSRs are largely disapplied in relation to uncertificated gilts – see regulation 52(1) of the USRs, paragraph 12(2) of Schedule 4 and paragraph 14 of Schedule 7 – but regulation 21(2) of the USRs and paragraph 13 of Schedule 4 require the Bank to keep a “record of uncertificated public sector securities” mirroring the details of uncertificated gilts shown on the Operator register.

50. The principal legislative changes necessary to implement the model are expected to be:

- **Removal of the requirement for a “record” kept by the Bank** – The obligation on the Bank to maintain a “record” of uncertificated gilts (currently held by the Bank’s Registrar’s Department in Gloucester) would be removed by amending or deleting regulations 21(2) and (3) of the USRs and paragraph 13 of Schedule 4.
- **Provision for the creation of IPRA**s – The USRs would be amended to define the nature of an IPRA (broadly speaking, an account holding in dematerialised form so much of a given line of stock as is not held in the name of a “system-member” of the OS) and the requirements which would have to be met in order to set one up. It is thought that the function of maintaining an IPRA may not need to be a regulated activity under the Financial Services and Markets Act 2000, because the person maintaining it would be carrying out functions replacing some of those which would at present be carried out by the registrar acting on behalf of the issuer (in the same way that acting as a company registrar is not a regulated activity, because registrars act on behalf of the companies whose registers they maintain). However, the USRs will need to specify requirements to be met by a person maintaining an IPRA, to ensure that it remains compatible with the OS, operates correctly and efficiently and is reconciled with the details on the corresponding IRD. Further consideration will be needed about other such requirements, though some might correspond to requirements which have to be met for a person to be approved as an Operator under Schedule 1 to the USRs. So far as the role of a person maintaining an IPRA would correspond to that of a system-member or participating issuer, that person would also have to be required to comply with the rules of the OS applicable to system-members and participating issuers.
- **Giving legal effect to entries on IRDs** – The Issuer’s Retail Database would, in effect, be a direct replacement for the register of certificated gilts. New provisions would therefore be required, either in the GSRs or the USRs, requiring an IRD to be set up and maintained for each line of stock held in an IPRA and specifying, for example:
 - the details required or authorised to be kept on the IRD;
 - that the IRD would be prima facie evidence of the matters required or authorised to be kept on it;
 - how title to the units of stock to which the entries on the IRD relate may be transferred, so as to cover not only transactions which involve the movement of such units out of or into the relevant IPRA, but also off-market transactions between retail holders both of whom hold the stock through the IRD – for example, where there is a transfer by operation of law upon insolvency or the granting of probate; and
 - the requirements which would have to be met by an IRDM.

As to the last of these, the role of IRDM may not need to be a regulated activity under the FSMA 2000 because the IRDM would be acting on behalf of the issuer (and the same person will in practice be both IRDM and operator of the IPRA). But again, it will be necessary to specify requirements to be met by a person both before and while acting as an IRDM, to ensure that the IRD operates correctly, efficiently and coherently with the relevant IPRA; and once more, these requirements may to some extent mirror some of those which have to be met for a person to be approved as a system Operator under Schedule 1 to the USRs. The obligations on an IRDM would include duties to issue statements of holdings and SRNs, with appropriate security measures, and to reconcile the details on the IRD with the balance shown on the corresponding IPRA.

- **Ensuring continuity of legal title** – When stock moves between an IPRA and an ordinary OS member’s account, the basis for establishing legal title to that stock will change from an entry on the IRD to an entry on the Operator register. The legislation will need to ensure that there is no ‘gap’ in the process during which legal title cannot be ascertained, and no ‘overlap’ during which there could be inconsistent entries.
- **Certificated gilts as a residual category only** – For all gilts normally to be held in future in uncertificated form on the OS, including (in IPRAAs) those owned by persons who do not themselves use the OS (even by direct or sponsored membership or through a nominee), the provisions of the USRs enabling securities to be converted from uncertificated to certificated form - primarily regulation 32 and in part paragraphs 18 and 25(b) of Schedule 1 - would need to be disapplied in relation to gilts. Gilts would then normally be issued only in uncertificated form and there would be no means of changing that form¹³. However, the Treasury needs to retain the ability to issue gilts in certificated form, in case an issue was required in an emergency when the OS was out of operation. Therefore:
 - the provisions of the GSRs and other legislation enabling the issue and “paper” transfer of certificated gilts would need to remain in force, for use if necessary; and
 - the provisions of the USRs enabling the conversion of securities to uncertificated from certificated form - primarily regulation 33 - would still apply to gilts, so that any gilts issued in certificated form in an emergency could be dematerialised and brought into the OS once the emergency was over.

Transition

51. At least two kinds of transition have already been used to bring securities within the USRs:

¹³ Except for those with the bearer option - see footnote 3.

- For equities, a two-stage process was used. First each line of stock separately became capable in principle of transfer within the OS - ie became a "participating security" - by each issuer signing the necessary OS forms and the Operator admitting that line of stock. Then each holder had to take action to put his own holding of stock into the OS, if s/he so wished, by sending a special form and relinquishing his certificate to the registrar and having his holding moved onto what was then the uncertificated part of the register (now the "Operator register of members").
- For gilts, a "Big Bang" approach was taken, whereby all stock held by persons who wished in future to carry out gilts transactions through the OS, together with outstanding transactions concerning them, were moved from the Central Gilts Office (CGO) into the OS over one weekend in July 2000. Members had been required to tidy up their holdings in the CGO and open equivalent accounts in the OS. These actions were permitted by regulations 2(2) and (7)(c) of the USR (Amendment) Regulations 2000, and by provisions in the GSR (Amendment) Regulations 2000. This was done because there were thought to be market difficulties with a gradual approach.

52. For TAURUS, governed by the Uncertificated Securities Regulations 1992, once the issuing company and the Operator had agreed to admit the security, share certificates were no longer evidence of title (regulation 48 of the 1992 USRs); no action was needed by holders, but publicity was required to ensure that those holding certificates as collateral could take the necessary action to secure their charges.

53. It is expected that, in the case of certificated gilts, no action will be required by stockholders. At the point when certificates become invalid, stockholders on the IRD will be issued with a statement of their holding and an SRN, and the relevant IPRA will begin operating. The legislation will be drafted to effect this. However, the detail about transition has yet to be discussed, and the Treasury would welcome views, in particular:

- *Would there be any practical issues arising from adopting a big bang approach, ie dematerialising all certificated securities in one go, which might suggest it would be better to dematerialise certificated securities line-of-stock by line-of-stock?*

Other miscellaneous legislation

54. A host of other detailed amendments will be required beside the main changes outlined above, both to the USRs and to the other legislation currently governing gilts. For example, the definition of "stockholder" in section 3 of the National Debt Act 1870 (which determines to whom the dividends on gilts are payable, and which has already been amended by paragraph 1 of Schedule 7 to the 2001 USRs) will need to refer to a person entered as the holder of gilts on an IRD rather than on a register kept by the Bank.

Chapter 9 - Implications for other securities

55. The Treasury is also currently consulting on changes to the USRs in relation to modernising the settlement of money market instruments (MMIs) (www.hm-treasury.gov.uk/consultation_and_legislation/monmarket/consult_monmarket_index.cfm). In the light of responses to the consultation on MMIs and to this consultation, a decision will be taken whether to make the necessary amendments to the USRs separately or together.

56. Looking more widely, the Government is aware that this proposal, which will mean all gilts are held electronically whilst investors still have the choice of holding equities in certificated form, will reasonably lead to questions about the settlement procedures for equities. The issue has been raised in response to an earlier HM Treasury informal consultation paper on gilts registration.¹⁴ And the industry itself has put forward proposals on electronic shareholding for equities.

57. The Government has no current plans to change the current arrangements for the registration, transfer and settlement of equities. We believe that there are important differences between the requirements for registration of equities and gilts, and therefore that it is possible to deal with proposals for the modernisation of settlement procedures for equities and gilts separately. We would though be interested in hearing views on the links to equities. In particular on:

- *What, if any, are the implications of introducing these proposals for gilts and therefore having two different systems for the registration, transfer and settlement of gilts and equities?*
- *Whether the specifics of the proposed model for gilts would give rise to any difficulties if at some point in the future it were to be decided to transform all holdings of equities into electronic form?*

¹⁴ 'Proposed Model for the Re-engineering of Gilts Registration – A Discussion Document', HM Treasury, September 2002.

Chapter 10 - Matters for discussion

58. The Treasury believes that this model offers a realistic and practical way to modernise the arrangements for registration and transfer of gilts. In particular it largely gets rid of paper from the system and avoids the costly duplication of effort inherent in the current arrangements. However, it may not be the only way to achieve these goals, and it is conceivable that variants on the model might improve the outcome. It is important to have the views of industry participants and others to ascertain whether there are any improvements which could be incorporated, or indeed whether there are any hurdles to delivery which have so far not been apparent.

59. With that in mind, in addition to the questions set out in chapters 7, 8 and 9, it would be helpful to have answers to the following questions:

- How would the proposed model work in practice? Will it achieve its objectives?
.....
.....
- What advantages and/or costs does the model offer, compared with current arrangements?
.....
.....
- What issues are not covered, or are insufficiently/inappropriately covered, by the model?
.....
.....
- What are the principal commercial considerations? What costs/savings might you incur?
.....
.....
- Which of the constituent elements of the system, set out on page 8, could/should be provided by the same body/organisation?
.....
.....
- Would your organisation be interested in tendering for any of the constituent elements, should the Government decide to put them out to the market? Which one(s)?
.....
.....

**HM Treasury
November 2002**

APPENDIX A

Glossary of terms

Operator System (OS)	The electronic transaction system, run under the Uncertificated Securities Regulations 2001 (currently by CRESTCo) which facilitates the registration and settlement of dematerialised securities, including gilts.
Electronic Transfer of Title (ETT)	The changes that brought about the simultaneous settlement and registration of stock transfers, thus eliminating the gap between settlement and registration.
Issuer's Pooled Retail Account (IPRA)	A single OS account having a balance equal to the aggregate total of all the retail accounts on the IRD for a particular line of stock.
Issuer's Retail Database (IRD)	A database containing all the investor details for all the retail stockholders who hold their stock under the pooled arrangements in an IPRA.
Issuer's Retail Database Maintainer (IRDM)	The operator of the IRD and the IPRA.
Receiving, Issuing and Paying Agent (RIPA)	A single body covering the functions of receiving agent and issuing and paying agent, using existing OS functionality. Has powers to make central dematerialised issues and the ability to create and administer issues in the OS. The RIPA would adopt the Registrar's membership. RIPA receives stock from the issuer and distributes it to OS members' accounts and the IPRA, in accordance with the successful bids at issuance, in return for cash, which is passed to the issuer. Also responsible for the distribution of the funds obtained from the issuer to each individual OS account and the IPRA, for each dividend/redemption payment, according to the stock balances on each OS account.

APPENDIX B

Draft Regulatory Impact Assessment

1. Purpose and intended effect of proposed measures

The objective of the proposed model, and the associated legislation, is to modernise and simplify the registration and transfer of certificated holdings of British government stock, by removing paper from the system. This will be facilitated primarily by new or amended Uncertificated Securities Regulations and Government Stock Regulations. The effect will be a more cost effective and efficient service for the taxpayer and the retail investor.

2. Risk assessment

In the context of the required legislation, there is no perceived situation which would lead to any harm or detriment to any individual or organisation. It is intended that the model would be at least as secure against fraud as the current arrangements.

3. Identification of options

There are two options:

- Option (i) – to do nothing;
- Option (ii) – to re-engineer the service along the lines of the proposed model.

4. Issues of equity and fairness

It is perceived that the proposed measures should impact equally across the entire retail market, and that they are consistent with the desire of the market to move towards the registration and transfer of all securities through electronic means. There is intended to be no significant additional burden on market participants to implement (or operate) the measures.

5. Identifying the benefits

- Option (i) – none.
- Option (ii) – modernises and simplifies the registration and transfer of government stock, removing paper from the system and potentially reducing settlement risk by having all settled stock in one system. It should deliver the most cost-effective service to the taxpayer in the medium term and is a good fit with the industry's desire to register and transfer all securities through electronic means.

6. Identifying the costs

- Option (i) – none.
- Option (ii) – will attract start-up costs and material changes to the operator system, and could be potentially unpopular with investors who wish to retain certificates.

7. Securing compliance

Neither of the options is likely to entail compliance costs.

8. *Implementation costs*

- Option (i) – none.
- Option (ii) – will entail some one-off investment costs for the operator system and some systems costs for participating brokers. The setup costs for the database maintainer and paying agent will be met by the Treasury, using existing budgets. There should be no significant ongoing costs for any participant, and there should be savings for most.

9. *Consultation with small businesses*

This public consultation is aimed at small brokers as well as other market participants.

10. *Results of consultation*

Informal consultation with the Bank and CRESTCo and other market participants suggested strong support for modernisation of this type.

11. *Effect on competition*

There are currently a limited number of brokers dealing in gilts. All brokers, current participants and new entrants, would incur the same set-up costs, and benefit from the same savings from the reduction in costly paper-processing. Some brokers may discontinue gilts business, but others may enter the market. The net effect on competition should be insignificant.

12. *Summary and Recommendation*

Option (ii) is recommended, as it offers the best opportunity to secure cost-effective modernisation of the registration and transfer of government stock, at a low cost of implementation, removing paper from the system and potentially reducing settlement risk by having all settled stock in one system. It should improve the chances of delivering the most cost-effective service to the taxpayer, and is a good fit with the industry's desire to transfer all securities through electronic means.

13. *Enforcement, sanctions, monitoring and review*

None.

APPENDIX C

Roles and responsibilities now and under the proposed model

FUNCTION	ACTIVITIES
The Issuer	<ul style="list-style-type: none"> • Current <p>The Issuer's function (in relation to gilts registration) can be defined as:</p> <ul style="list-style-type: none"> - Production of forms for all special operations and liaison with the Registrar to arrange distribution; - Sending details of special operations to the Registrar; - Receiving total new issue retail applications from the Registrar; - Sending breakdown of all new issue market bids to the Registrar; and - Receiving daily update and final total of retail and market conversion assents from the Registrar.
	<ul style="list-style-type: none"> • Future <p>The issuer's role would remain largely unchanged. However, if the functions currently undertaken by the Bank of England Registrar were performed by different bodies, the issuer would need to interface/communicate with all of them:</p> <ul style="list-style-type: none"> - Production of forms for all special operations and liaison with the IRDM to arrange distribution; - Sending details of special operations to the IRDM & RIPA; - Receiving total new issue retail applications from the IRDM; - Sending breakdown of all new issue market bids to the RIPA; - Sending total of all new issue bids (market & retail) to the RIPA; - Receiving daily update and final total of retail conversion assents from the IRDM; and - Receiving daily update and final total of market conversion assents from the RIPA.
Broker	<ul style="list-style-type: none"> • Current <p>The broker currently has to complete a stock transfer form over the signatures of the stockholders and obtain the stock certificate before sending the transfer to the OS counter services. Without access to the retail database the broker has no assurance that the transaction will not be rejected by the registrar.</p>
	<ul style="list-style-type: none"> • Future <p>Instead of accepting stock certificates as proof of ownership, brokers would use the new stockholder's reference number (SRN) to enquire of the issuer's retail database via the OS. The response from this enquiry would determine whether or not the transaction would be accepted by the IRDM.</p>

APPENDIX C

Roles and responsibilities now and under the proposed model

FUNCTION	ACTIVITIES
Investor	<ul style="list-style-type: none"> • Current The investor buys and sells stock either direct from the issuer (for new issues), through a broker or the Bank of England's brokerage service. He can take part in a number of special operations including outright auctions, conversions, reverse auctions and redemptions. The Registrar sends a certificate for every purchase but nothing for a sale. A sale requires a stock transfer form to be signed and backed by a stock certificate. <hr/> <ul style="list-style-type: none"> • Future The investor's role would change in a number of ways but all should be marketed as improvements and be seen as beneficial: <ul style="list-style-type: none"> • Retail stock would be held in a pooled account in the OS but the equivalent of “name on register” status would be achieved through on the IRD; • The stock certificates would be replaced with a single statement showing all holdings. A new statement would be issued against every sale and purchase giving advance notification of transfer fraud; and • A stockholder’s reference number (SRN) would be issued on the statement which would be accepted by all brokers (wishing to trade in gilts) for sales and purchases.
Receiving, Issuing & Paying Agent (RIPA)	<ul style="list-style-type: none"> • Current Performed electronically in the OS under a Registrar's membership. Receives stock from the Registrar and delivers it to the members in return for cash. The cash is paid back to the issuer through the OS. Also has responsibility for corporate actions - ie conversions where members receive target stock in return for a like amount of source stock. On the evening before the conversion date OS members receive scaled amounts of the target stock from the Registrar. Stock is credited to a an account in the OS and reconciled daily against the overall stock balance held on the Bank of England Register. Cash to meet dividend and redemption payments is drawn down from HMT and reconciled annually. All redemption/dividend payments are made by warrant or BACS. On an annual basis the paying agent is responsible for reporting to the Inland Revenue all payments made to individuals including any amounts of tax, under section 17/18 Taxes Management Act 1970.

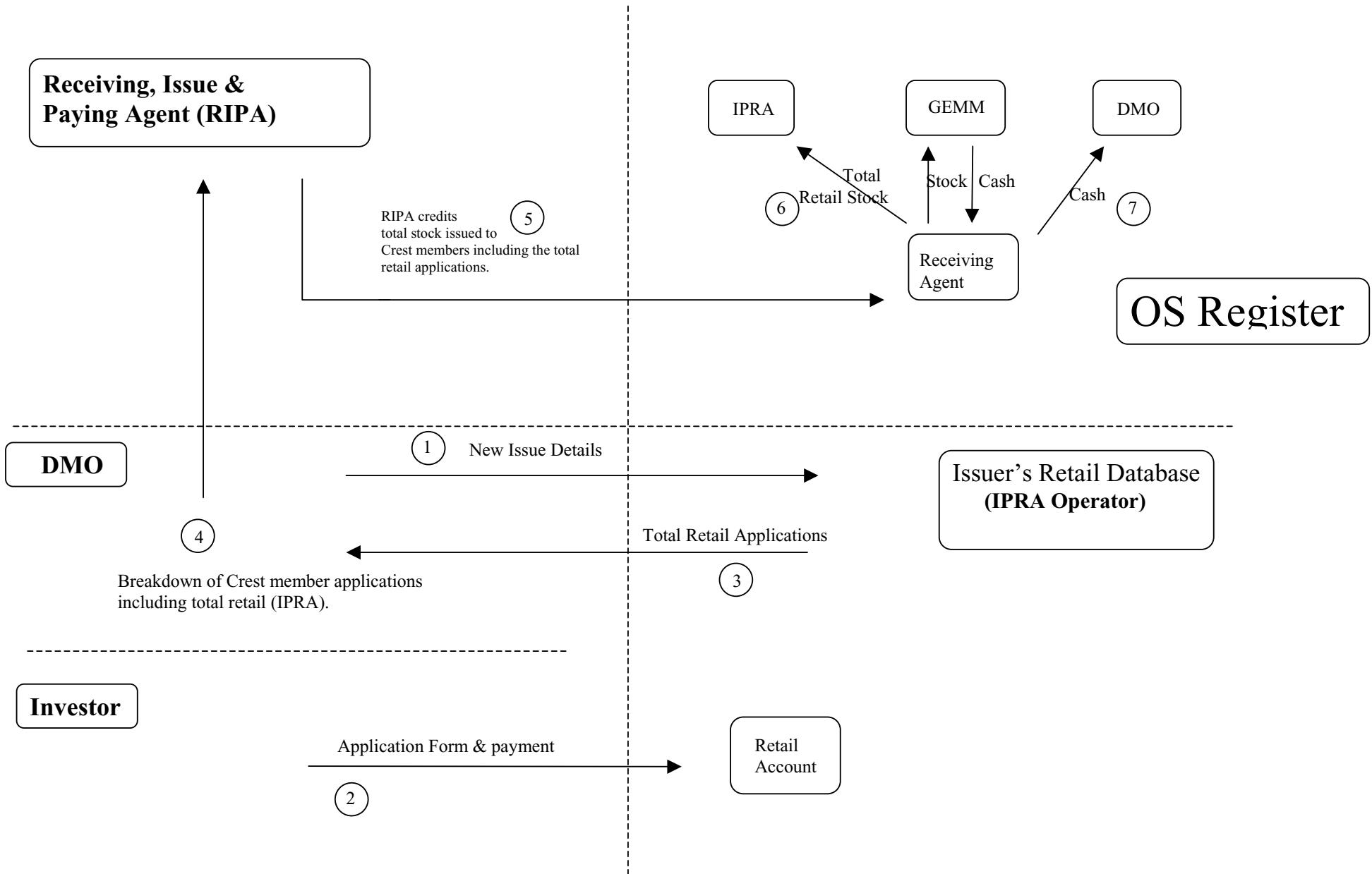
APPENDIX C

Roles and responsibilities now and under the proposed model

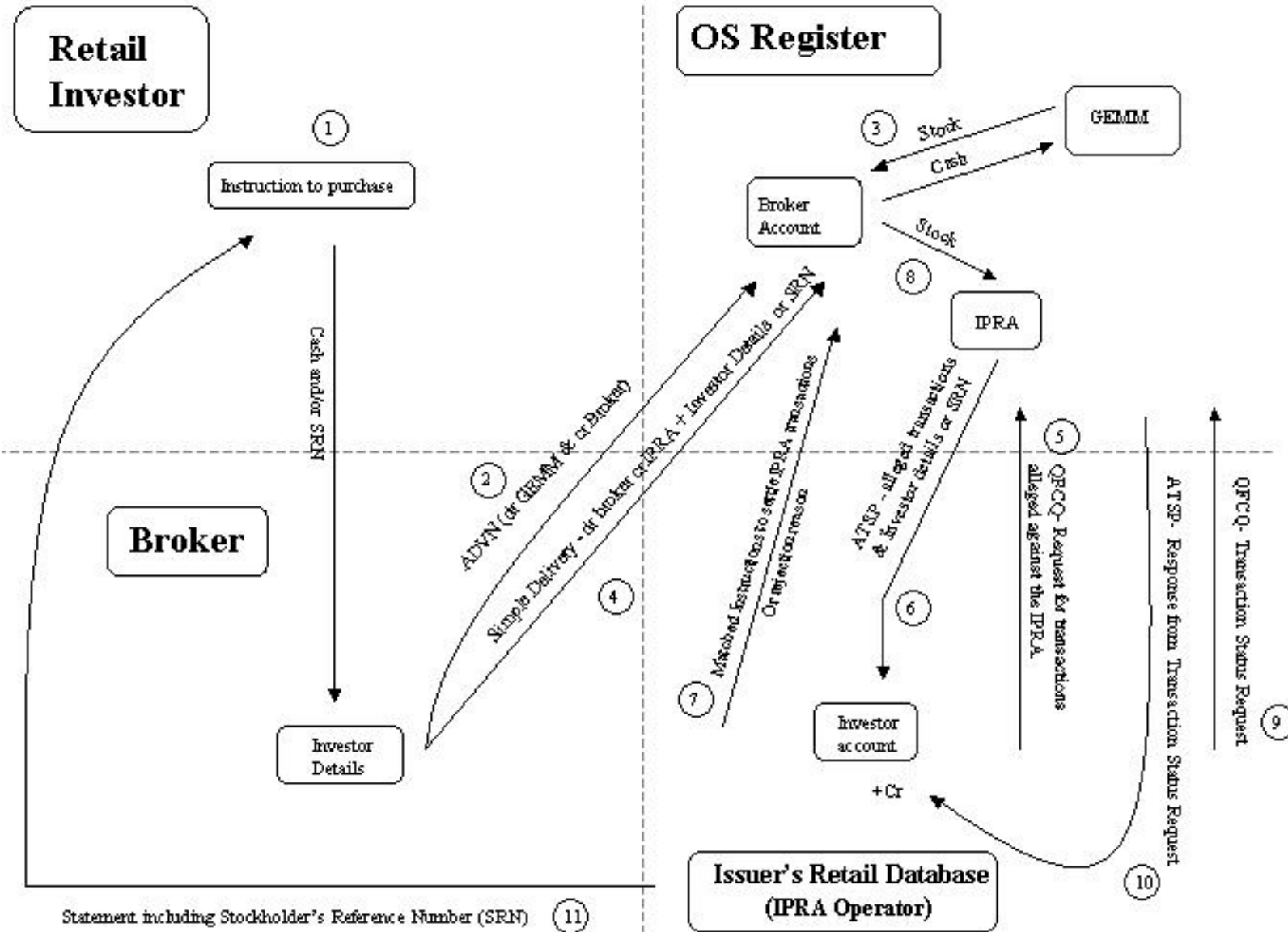
FUNCTION	ACTIVITIES
	<ul style="list-style-type: none"> • Future <p>Under the re-engineering proposal the RIPA would still retain all of the above responsibilities, but the role would be simplified if all payments were made in the OS including one payment to the Issuer's Pooled Retail Account - as a result there would not be any returned payments to deal with. In order to make the payments the RIPA would need to pull down the IPRA and member balances from the OS on the record date.</p>
Issuer's Retail Database Manager (IRDM)	<ul style="list-style-type: none"> • Current <p>Holds the database of all retail stockholders and is responsible for the creation, maintenance and closure of all retail accounts. The maintenance includes registration of death, court orders, powers of attorney and the registration of transactions (electronic and off-market). In addition to keeping the retail register, the registrar is legally obliged to keep a record of all OS member accounts and to update all account movements intra-day by picking up OS transactions across a secure network.</p>
	<ul style="list-style-type: none"> • Future <p>Under the re-engineering proposal this role would be greatly reduced in that there would no longer be a legal requirement to keep a duplicate record of the full OS Register. The IRDM would only retain responsibility for maintaining the retail database (IRD) and reconciling it with the IPRA. The distribution of all retail dividend and redemption payments would have to be made by the IRDM, if all payments were made in the OS by the IPA. Stock certificates would no longer be issued, instead the IRDM would issue statements and SRNs.</p>
Settlement System	<ul style="list-style-type: none"> • Current <p>To provide a real-time settlement system for UK and International shares, UK government bonds and other corporate securities. It enables participants to hold securities in uncertificated form and transfer them electronically with full delivery versus payment.</p>
	<ul style="list-style-type: none"> • Future <p>The role of the OS under the re-engineering proposal would not change although all British Government Stock would be held in the settlement/registration system with the consequence that stock would not be available for deposit or withdrawal - this would mean the introduction of a new broker enquiry message.</p>

ANNEX D – Operational Flowcharts

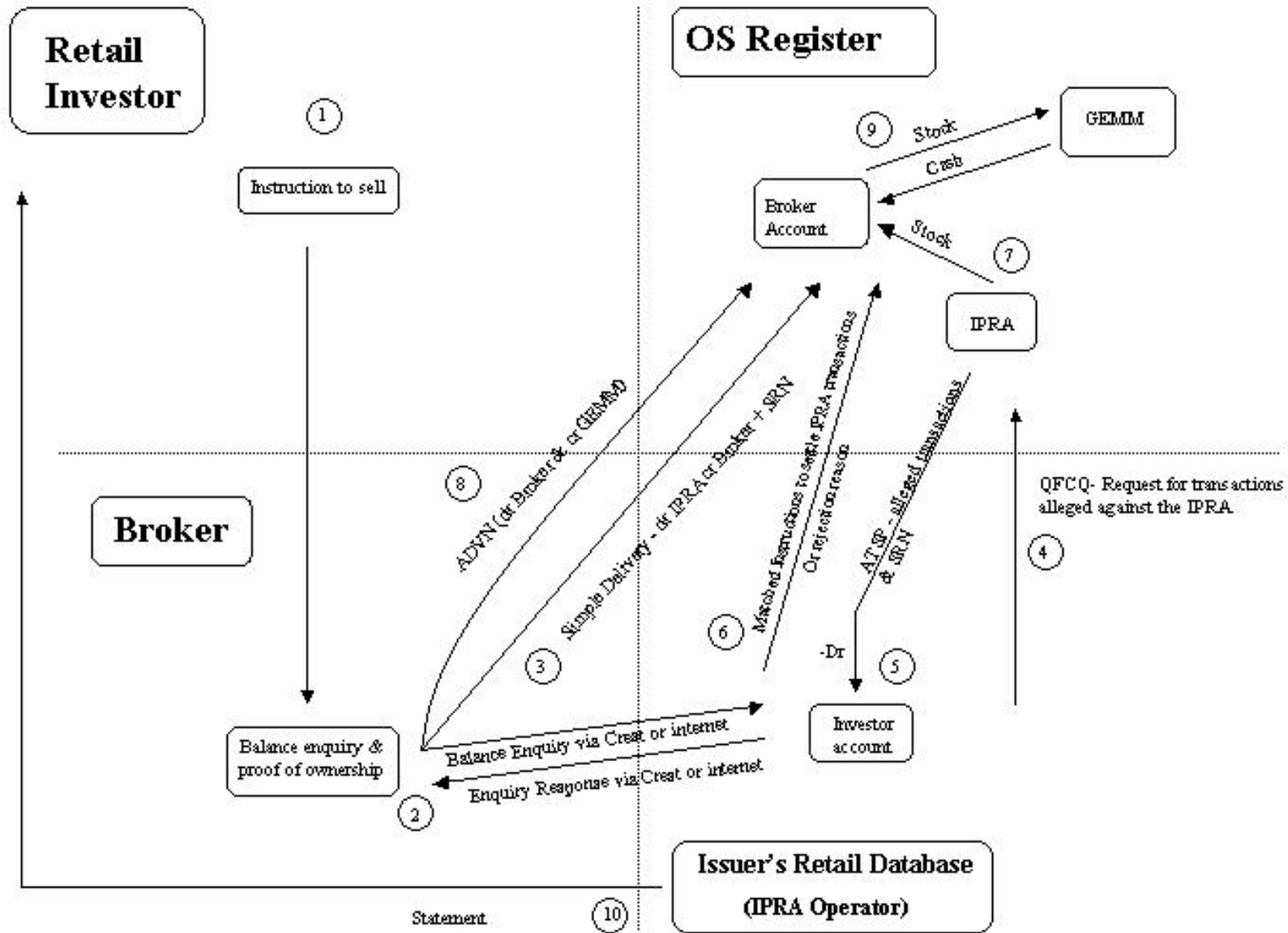
I - Issuers Pooled Retail Account (IPRA) - Stock Issuance



II - Issuer Pooled Retail Account (IPRA) - Purchases



III - Issuer Pooled Retail Account (IPRA) - Sales



IV - Issuer's Pooled Retail Account - Conversions

