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CONSULTATION CCBM2

INTRODUCTION

The EBF and the EACB welcome the initial consultation on the next generation of collateral management made by the ECB.

We understand that the CCBM2 project (Collateral Central Bank Management 2) is mainly a project that relates to the central banks' internal systems for collateral management and appreciate to be consulted on some aspects of the project.

Due to the short timeframe given to respond to this consultation, the views expressed in this document are preliminary views only which may need to be refined when more information will be available about the planned scope and features of the system.

This response is sent on behalf of the European Banking Federation (EBF), the European Association of Cooperative Banks (EACB) with input from the TARGET Working Group ("the respondents").

We stand ready to discuss with the Eurosystem in more detail this response and questions raised.

GENERAL REMARKS

The Eurosystem's decision to launch the CCBM2 project is supported by the respondents. We agree with the project's objectives to improve the Eurosystem's internal management of domestic and cross-border collateral to the benefit of end-users (collateral providers).

Harmonised and consolidated collateral handling will improve greatly the efficiency of treasury and liquidity management in the euro-area.

Decoupling of CCBM2 from Target2 Securities (T2S)

CCBM2 has been announced alongside announcements relating to T2S and access to information about CCBM2 on the ECB web-site is through the T2S section.

Although CCBM2 and T2S might use the same interface, we strongly believe that the 2 projects must be decoupled and developed separately.

They must not be interdependent.

The CCBM2 project is of a different nature than the T2S project.

The decision to go ahead with CCBM2 must not depend on the decision to go ahead with T2S, which according to the ECB itself, will only be taken in the first half of 2008.

This means for instance that there is no reason to wait for the planned T2S launch in 2013, although it is clear that that the advent of both T2 cash and T2S will increase the benefits of CCBM2.

All three projects should be closely linked.

CCBM2 should go live as soon as possible. Both projects should have a different time line horizon.

It would be useful to receive a planning for the design, development and implementation of CCBM2.

Also the impact on end-users' IT applications and systems of different timings for different projects should be identified in conjunction with the industry and evaluated by the Eurosystem.

Costs

Costs to end-users (collateral providers) are not addressed in the consultation.

We expect that a solid business case will be submitted to users and that full transparency on the funding will be provided.

The use of CCBM2 should be cost effective.

Costs should be charged back to users on an equitable cost-recovery principle.

All users should pay the same price relevant to their use of the system based on transaction fees rather than on the collateral value or market value.

There should be a uniform and simplified pricing structure across multiple markets making the cost of collateral more transparent and quantifiable (based on the "user pays" principle).

Furthermore we expect the Eurosystem not to duplicate investment for users and to capitalise on synergies with existing or potential other systems like Target 2 cash and T2S.

Risk

The consultation does not mention risk management: users expect CCBM2 to be a highly risk-averse system, providing a.o. protection against the failure of a collateral provider through adequate default management processes.

Also CCBM2 needs to be a highly resilient system, with appropriate contingency and business continuity mechanisms in case of operational disruption.

Legal Certainty

This is a high priority for users: CCBM2 must provide legal effectiveness of the arrangements in all the markets, implying in the longer term a single legal framework to govern the creation, perfection and documentation of the collateral arrangements enabling both pledge and repo. It should allow the different collateral techniques, pledge and repo.

Legal harmonisation should be an integral part to an efficient CCBM2.

The Financial Collateral Directive has very much improved the situation in Europe for the creation of collateral and should be used as basis for this legal harmonization.

Shortcomings of the present CCBM

The main drawbacks of the current collateral management handling procedures is the lack of standardisation across countries, which materially impacts its usability due to the

administrative burden as well as the links between CSDs and their respective NCB and the difference in settlement models between CSDs which create delays and inefficiencies for collateral mobilization.

The present CCBM is of limited use on a cross-border basis.

Priorities

In order to materially improve the attractiveness of the collateral management arrangements:

- the first priority is to standardise the key features that directly impact users: uniform handling and operational procedures irrespective of whether pledge or repo is used, cost-effective pricing and fee collection process, standard haircuts for collateral types and a single entry/interrogation point enabling monitoring of both intra-day and over-night liquidity: the same interface should be used - for instance the ICM of T2 cash - for interconnection with T2 cash, T2S and CCBM2.
- a second priority is arrangements that enable intra-day movement of collateral to obtain liquidity.
- a third priority is to support all collateral arrangements: repo, pooled or earmarked pledges, with recognised legal validity and according to uniform terms.
- a fourth priority is to have the capability to accept all types of collateral: the system needs to be technically flexible in order to handle all types of securities and credit claims to cope with any decision taken in the future by the Eurosystem regarding eligible collateral. In this context, CCBM2 should cater for the possibility to accept the use of non-euro securities to obtain liquidity with euro area central banks in crisis situations, implying the extension for crisis management of eligible collateral to include securities issued outside EEA and therefore the conclusion of two-way agreements with outside EEA central banks.
- a fifth priority is **non-regression**: Users would not expect any decrease in functionality or efficiency compared with existing services.

RESPONSE TO THE 6 CORE PRINCIPLES

Principle 1: The CCBM2 will provide central banks with an IT platform for the management of eligible collateral used for Eurosystem credit operations, while complying with the principle of decentralisation of access to credit.

The objective of the next generation of collateral management from a user's perspective should be to facilitate the mobilisation of collateral both cross-border and domestically. CCBM2 should provide a facility enabling banks to maintain a portfolio of eligible assets in one single location, if they so wish, with the ability to use this portfolio to obtain liquidity across all markets (both intraday and overnight) where a bank is eligible to obtain central bank liquidity.

In other words with CCBM2 all rules preventing the possibility for end-users to pool collateral in a single location should be abolished.

The end-result should be a virtual single pool of collateral, built upon the principles of simplicity and efficiency with the highest safety standards.

CCBM2 should be the central collateral service to handle tasks such as segregation of accounts and securities holdings, verification of eligible collateral, instruction receipt, validation, reporting and servicing of collateral held.

It is essential that all central banks will connect to this collateral IT platform in such a way that full harmonisation and level playing field is achieved. Centralised collateral management is more than just a central IT-platform. It also implies the harmonisation of all country specific practices regarding cut-off times, order execution, handling of corporate actions etc. Therefore we suggest the wording of this principle to be extended to express this intention.

CCBM2 will need to assume all collateral custodian and administration functions in relation to the securities held and the provision of related information, acting as a central collateral custodian service provider.

This would imply registration and mobilisation: CCBM2 should be able to manage and to integrate technically collateral registration especially for credit claims and mobilisation according to the best practices existing in the market. During the transition period, CCBM2 should be fully compliant with national registration systems (such as the French TRICP system used for credit claims).

Obviously we appreciate that changes can not be achieved overnight and would therefore suggest to define a migration period for NCBs to migrate to the new platform (as with TARGET2). During the migration period the central collateral platform should have access to all the local collateral accounts of central banks in order to limit the impact of non-participation of a NCB to its own counterparties.

Principle 2: The CCBM2 will be fully compatible with TARGET2 and T2S, in particular, with the communication interfaces and the settlement procedures used by T2S for the delivery of the securities.

We agree with principle 2.

Interfaces should be fully compatible resulting in one standard interface and a single entry point (for all 3 systems, including the T2 ICM), although this compatibility should not result in dependencies.

Principle 3: The scope of CCBM2 will cover both the domestic and cross-border use of collateral, as well as different collateralisation techniques (such as pool pledge and repo), depending on the practices of each central bank.

We agree that CCBM2 should have full coverage. The differences between cross-border and domestic as well as between pledge and repo should be completely transparent for the users. There should be no difference with regard to costs with regard to cross-border or domestic.

CCBM2 should allow banks to technically manage the different collateralisation techniques according to common rules in every country. CCBM2 guidelines (like T2 cash guidelines) that define those common rules for collateralisation techniques would be useful.

Principle 4: The CCBM2 will handle all eligible collateral (both securities and non-marketable debt instruments).

Principle 4 is an obvious and a minimal requirement.

In addition the Eurosystem should consider making the CCBM2 Model by design suitable for collateral in other major currencies i.e. to use non-euro securities including those issued in non-EEA countries to obtain liquidity from euro area central banks, in order to ensure the system is sufficiently flexible to accommodate both any extension to the list of eligible securities and any future changes in policy related thereto which may occur.

The developments now should not rule out possible future connections to other countries / central banks / currencies for cross-border / cross-currency use of collateral. This could also be useful in order to facilitate contingency arrangements between major central banks in crisis situations.

Banks do not have an institutionalised way to handle cross-border use of collateral in a crisis situation at the moment. Currently banks depend on the help of central banks in these situations without any transparent system to support this. CCBM2 could be a first step to institutionalise the cross-border use of collateral between Central banks in different currency zones. In times of liquidity crisis it will be key to handle imbalances between several currencies to deal with the crisis. This will lower the chance of a knock-on effect as a result of a liquidity crisis in a specific system or with a specific participant.

The actual use of non-euro securities to obtain liquidity in euro area central banks should be subject to bilateral negotiations. The relevant non-euro central banks should hence also allow the use of euro securities as collateral to obtain liquidity in these relevant central banks.

Users would need more information on how valuation management will work and on how the handling of corporate actions on securities posted as collateral and supporting tax services would work.

Counterparty users would need access to corporate action information as it relates to their securities held in CCBM2.

Principle 5: The CCBM2 will process instructions in real time on a straight-through-processing (STP) basis, permitting the delivery of collateral to generate the release of related credit in TARGET2 on a real-time basis.

We agree to this principle.

The time gap between confirmation that collateral has been received and the release of funds by the relevant NCB to the collateral provider must be as short as possible, almost simultaneous.

There should be automatic credit of funds by the relevant NCB to the collateral provider in T2 upon confirmation by the CCBM that collateral has been received in a SSS.

Full automation and STP on a real-time basis should also include CSDs or related systems covering the whole chain and flows including contractual SLAs. It should include also the withdrawal of collateral.

Warehousing should be provided: instructions should be accepted the day before (D-1) for execution at the start of the next business day (D).

Principle 6: The CCBM2 will be able to take collateral through all eligible SSSs and eligible related linkages between them.

We agree and reiterate the need to achieve standardisation via ISO for the interfacing and messaging required as well as harmonisation of time-lines and cut-off times.

CCBM2 will need securities accounts in each CSD in the EU and in the ICSDs for Eurobonds.

CCBM2 should also streamline the NCB-CSD process in order to avoid the so-called “spaghetti” architecture and to improve the specific NCB-CSD links which are today non efficient particularly in terms of timing.

RESPONSE TO THE GENERAL QUESTIONS

1) *In general, with regard to the current collateral management handling procedures, what are the main imperfections that should be addressed and the main advantages that should be retained in the next generation of Eurosystem collateral management?*

In general we can say that the biggest imperfections in the current CCBM model are all related to the absence of harmonisation which in some cases results in a non-level playing field. Banks operating in several countries are confronted to different sets of procedures and business dialogues with their central banks.

Examples:

- Handling procedures used by NCBs and message formatting for collateral transfers and reporting
- Telecommunications (should be electronic only)
- Costs
- Time-lines and Cut-off times (e.g. for receipt of instructions)
- Margining policies and haircuts
- Interfaces and connectivity to NCB s

CCBM2 should address these differences and achieve full harmonisation across the areas mentioned above to achieve a level playing field for all users.

CCBM2 will optimise communication and processes between the various NCBs and facilitate process for users thanks to harmonisation. However the main issue for users remains the links between CSDs and their respective NCBs as well as the differences in settlement processes between the CSDs which creates delays to mobilise collateral and even the need to pre-deposit collateral the day before.

Other imperfections are:

- The need to pre-deposit collateral the day before
- Repatriation: i.e. in order to pledge Finnish or Portuguese securities via an ICSD account, Belgian banks for example have to transfer first these securities out of their ICSD account to the account of the NBB in the Finnish / Portuguese CSD. From there, the securities will be pledged to NBB using the CCBM. This procedure is cumbersome, time consuming and error -prone. It should be replaced. The Eurosystem should take the securities in collateral as much as possible where they are. This means that the NCBs have to open a custody account with all CSDs/ ICSDs as needed to collect the collateral for all the countries. This is also cost efficient because these are internal transactions for the banks.
- The present system is relatively slow. At times it is possible to see that collateral has been delivered successfully to the recipient NCB but that NCB has not confirmed receipt to the home NCB, who therefore will not release the liquidity. Cutting out that confirmation stage between NCBs should solve this problem. Presently, securities movements using CSD links are not completely synchronised. It is not rare that the securities of one party are debited in one CSD while its counterparty has not yet received them in another CSD. In a secured CCBM2 environment, those movements should happen as simultaneously as possible. CSDs should respect same cut-off

times and harmonisation rules which should be contained in the Service Level Agreement of CCBM2.

The main advantages of some current national collateral management handling procedures are:

- the use of the same collateral pool for both monetary policy operations and intraday credit;
- the fact that all collateral pledged with the central bank is always used for different purposes, at the discretion of the treasurer. The balance not used to cover monetary policy transactions or other external collateral needs is either used to increase the intraday credit capacity in Target or to create liquidity in other systems.
- the use of the collateral pledged with their central bank to provide a central bank guarantee to external systems like Clearnet: banks do not have to take care of their collateral management towards Clearnet or other external systems.

2) Do the CCBM2 principles as formulated above address your needs for improving the current Eurosystem collateral handling procedures (in particular, for the cross-border use of collateral through the CCBM)?

The principles formulated in the consultation document are a good starting point to address user needs for improving collateral handling procedures. We should stress however that there must be continued consultation over specific design features to ensure that this remains true. For example, will collateral givers be able to see that individual collateral securities have been pledged/repoed to different NCBs or will the collateral of each provider be credited to a single Eurosystem level pool?

Also how will the mechanism of recall/return of pledged collateral operate? Will the pledgor request a collateral return directly via CCBM2 or, request the recall of the collateral via the pledgee (NCB)?

In the future, when all central banks have joined the new platform, principle 6 would probably need to be amended in order to allow for more flexibility in the way central banks may receive cross-border collateral;

The respondents' main objective is to optimise the use of collateral, having a pool of collateral for both monetary policy operations and intraday credit in a secure environment using central bank money only.

3) What enhancements should the CCBM2 be able to achieve in comparison with the current CCBM beyond the principles expressed above?

Apart from the components internal to the Eurosystem, what types of feature should be covered by the CCBM2 user requirements, from your perspective?

Do you have specific technical requirements that should be considered in the user requirements of CCBM2 (such as type of technical access; monitoring functions; opening hours/days; customer support requirements)?

In addition to the points mentioned within the remarks to the core principles:

- The same procedures, speed and efficiency should be possible when using all eligible collateral, be it safe-kept domestically or abroad. Real time straight through processing (STP) should speed up collateral substitution.

- It should be possible to maintain sub-collateral accounts. This in order to facilitate the possibility to manage several collateral providers within one group, for example for different business units but also possibly for indirect participants who in this way can provide collateral to support their business.
- Ability to substitute collateral across multiple markets: because participants will use their portfolios for both central bank collateral and for the commercial (repo) markets, it should be made easy and within pre-defined timelines to transfer collateral between the systems and parties involved. In both the system requirements as well as the procedures around CCBM2, this aspect should be given the proper attention.
- If full harmonisation of messaging between the Banks and CSD's proves not to be achievable in the short term, the system should on an optional basis facilitate 'one message only', whereby the CCBM2 is authorized to send the instruction to the CSD on behalf of the credit institution as well. By doing this, the level of harmonisation to the users of CCBM2 can be achieved in an easier way, as the differences between CSDs can be made transparent to the users (with regard to message formats at least).
- There should be an Application to Application interface available.
- Documentation on CCBM2 should be improved compared to the available documentation on the current CCBM model.
- Realisation of a cross-currency module.
- The recourse to triparty services or collateral management agents should be possible even for the credit claims but in a segregated environment from CCBM2 to avoid risks.
- To make it really attractive, the CCBM2 must be mandatory for all NCB's so that users have one system for their collateral. We recognise nevertheless that some NCBS may need to amortise recent investments and a migration plan should be defined taking that element into account.
- Liquidity management and Liquidity tools: it is key that banks have tools in order to manage directly their collateral (both when submitting instructions and for reporting purposes).
- It should be possible to monitor on-line collateral positions as well as the status of instructions preferably via a web-browser or trough the ICM module of Target2. This is valid both for normal situations (T2 cash credit lines) and in contingency situations (contingency module).
- Opening hours/days should be in-line with those of Target 2, for movement of securities. However CCBM2 should be open for position monitoring outside T2 opening hours.
- Banks who do not wish to develop automated systems based on SWIFT messages, should be able to introduce instructions manually in the CCBM2 system in a secure and user friendly way.
- Banking groups should be able to visualise the collateral positions of their branches & subsidiaries. CCBM2 should provide consolidated reporting of collateral in multiple markets.
- ISO standards should be used.
- Ability to transfer collateral in bulk, i.e. not by individual issue in order to support a single amount of funds for monetary policy or liquidity purposes
- Central valuation of collateral held by different CSDs, i.e. a multi-market, multi-instrument collateral valuation capability.
- Customer support and help desk, periodical service review, user profile control and accreditation.

Respondents wish to point out however that a careful analysis of the features mentioned above must be made in order to avoid that some of these features take priority over our critical needs, cause delays in implementation or make CCBM2 overly complex and costly.

4) Are you aware of planned market initiatives that might have an impact on the design and the business case for the CCBM2 as outlined in the principles mentioned above?

CCBM2 should follow the common European recommendations as far as communication is concerned: XML, ISO 15022 and 20022 standards. The migration timetable for T2 cash messages MT103 and MT202 to be converted to XML has of course not yet been announced by SWIFT.

CCBM2 should be compliant with the communication protocol defined to remove Giovannini Barrier 1.

Furthermore increased use of triparty services should be taken into account.

5) How do you wish to conduct dialogue with the Eurosystem on the project in the future? For instance, the Eurosystem intends to continue consulting the market on an elaborated version of the user requirements. Would this level of interaction be appropriate? Do you think it could take place through the relevant market consultation groups at national and Eurosystem levels, or would you like to suggest another level of interaction (e.g. a contact group at Eurosystem level)?

Yes, users expect to be consulted on an elaborated version of the user requirements. This consultation gives little detail on these requirements. Respondents encourage the ECB to provide a feedback statement on all the responses to this consultation.

With regards to the consultation process, we believe it would be useful to have interaction both at the relevant European working group level directly with the Eurosystem and in parallel interaction with the existing country working groups at national level. The members of such groups should be the end users of the CCBM system and should represent both securities settlement experts as well as experts on the liquidity/treasury side.

Interaction with CSDs should be done directly between the Eurosystem and the CSDs.

We would also strongly advise user involvement going forward in the design and realisation phases and particularly for the development of the common interfaces for T2, CCBM2 and T2S.
