

CCBM2

Initial Consultation

Position paper by Clearstream

1. Introduction

The Governing Council of the European Central Bank has decided on 8 March 2007 to review the current Eurosystem collateral management handling procedures, in particular, the Correspondent Central Banking Model (CCBM). It decided to develop a single platform, allowing the Eurosystem to manage collateral for both domestic and cross-border operations, based on existing systems such as that of the National Bank van België/Banque Nationale der Belgique and De Nederlandsche Bank.

The efficient use of collateral is one of the major challenges for the market participants. Increased risk awareness and new regulatory requirements like e.g. Basel II have prepared the ground for a continuously growing number of collateralised transactions. It is crucial to have the right tools in place to quickly mobilise and transfer the scarce resource of available collateral within an institution.

On one hand, this is a question of the organisation's internal processes, their effectiveness, robustness and quality. On the other hand, the bottleneck can often be found in the current market infrastructure with Central Banks being a very important piece of the puzzle. This is the place where market participants manage liquidity as a vital element of their business.

In particular from that angle, it has to be welcomed, that the ECB intends to review the current procedures of the Eurosystem and contribute to overcome shortcomings. Also, it makes a lot of sense to consider the dependency to the T2S project, as full compatibility will be important once the service is in operation (currently scheduled for 2013).

Going forward, the involvement of the market participant in the definition of the user requirements is mission critical, as the merits will come from the end-to-end process including not only the set-up of the Eurosystem but also the sound integration in the user environments as well as those of infrastructure providers, esp. the SSSs. We highly welcome the intention of the ECB to closely work with and listen to the input of those stakeholders and look forward to contributing to the project also beyond the current initial consultation phase.

In section 2 of this document, we elaborate on some aspects we consider relevant to the proposed CCBM2 in general.

Section 3 and section 4 focus on specific comments as they relate to the announced principles and the posted questions, respectively.

2. General remarks

Interoperability and openness

One central platform CCBM2 used by all NCBs can in principle increase the efficiency for the cross border use of collateral. In order to be successful, it will be essential that the system is open to existing collateral pools that have already been developed in close cooperation with the market and the NCBs. For participants, this will avoid the split of collateral liquidity and therefore most likely increased opportunity cost as well as additional cost to adjust their internal set-up.

Compatibility with TARGET2 and T2S is a necessary feature for CCBM2, but not the sole way to ensure the efficient use of collateral. Any attempt to create exclusivity will most likely destroy value, lead to inefficiencies and incur extra cost. Furthermore, support from the industry for the project may decrease substantially.

Another necessary feature is the adoption of industry standards, esp. the S.W.I.F.T. collateral management messages. It is self evident that STP is essential.

Cross border use, assessed and relayed links

The portion of cross border use within the collateral posted to the Eurosystem has been constantly growing to overtake the domestic use first time in 2006 (50.15%).

CCBM was introduced in 1999 as an interim solution for the cross border use of collateral. In parallel, a series of links between SSSs were deemed to be eligible for use in Eurosystem credit operations. We fully support the statement of the ECB, that those links represent a valid alternative and that this shall continue to be the case with CCBM2.

In that context it was an important step that in 2005 the ECB introduced the concept of relayed links. We are convinced those can address major shortcomings in the current environment, esp. in terms of the speed for the transfer of collateral to and from the Eurosystem. Unfortunately, no relayed link handed to the ECB for approval has been finally assessed to date. We see the need to improve the approval process for assessed and relayed links, esp. with respect to its duration.

Time-to-market

T2S is currently scheduled to be launched in 2013. Given the importance of the cross border collateralization, the initial launch of CCBM2 should be decoupled from T2S to make benefits available to the market participants and the NCBs in a much shorter timeframe ahead of T2S.

During this initial phase, the current business model of CCBM should remain largely unchanged (access to credit, means of delivery, each NCB acting as a depository for all other NCBs) in order to allow the quickest possible time-to-market for CCBM2.

CCBM2 should handle all eligible collateral, however a first phase should attempt to deliver a solution for securities rather quickly and not be delayed by additional requirements for other types of collateral (e.g. credit claims). Those can be integrated in subsequent phases.

Scope

In contrast to T2S, where value added services are clearly assigned to the participating CSDs, it is foreseen that CCBM2 will offer such services (corporate actions, tax, etc.). The question needs to be raised, if this part could be better served by the respective CSDs, which have constantly invested in those areas over the years and have accommodated sometimes complex changes for their respective markets. This will shorten the process chain and reduce cost.

Legal

Very similar to the discussions in T2S, clarification is required regarding the legal ownership and the governing law for the system as well as for the reflected collateral.

Indeed, it is deemed to be important, that CCBM2 should be open to all collateral techniques to include all relevant legal, functional and IT concepts in this area as for example pledge, transfer of title, appropriation, repo, pooling, delivery and earmarking.

Economics

It is understood, that participation in CCBM2 is voluntary for all NCBs. Should a larger number of NCBs decide not to join the platform then the value of CCBM2 would become questionable.

3. The principles

3.1. Principle 1

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

A central platform used by all NCBs is the right direction to increase the efficiency for the cross border use of collateral. It will be essential however, to ensure existing market solutions are seamlessly integrated without imposing additional cost for the participants.

In order to allow the quickest possible time-to-market for an initial launch of CCBM2, the current business model of CCBM should remain unchanged during that period (access to credit, means of delivery, each NCB acting as a depository for all other NCBs).

It is understood, that participation in CCBM2 is voluntary for all NCBs. Should a larger number of NCBs decides not to join the platform then the value of CCBM2 becomes questionable.

Clarification is required regarding the legal ownership and the governing law for the system as well as for the reflected collateral.

3.2. 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.

Compatibility with TARGET2 and T2S is a necessary feature for CCBM2, but at the same time already existing solutions also need to be seamlessly integrated in order to avoid splitting collateral pools.

Given the importance of cross border collateralization, the launch of CCBM2 should be decoupled from T2S, which is scheduled for 2013 earliest. This way benefits will be available to the market participants and the NCBs in a much shorter timeframe early ahead of T2S. Additionally the project risk for both initiatives will be reduced by decoupling.

3.3. 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.

Indeed, it is deemed to be important, that CCBM2 should be open to all collateral techniques to include all relevant legal, functional and IT concepts in this area as for example pledge, transfer of title, appropriation, repo, pooling, delivery and earmarking.

3.4. Principle 4

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

This principle is supported, however a first phase of CCBM2 should attempt to deliver a solution for securities rather quickly and not be delayed by additional requirements for other types of collateral (e.g. credit claims). Those should be integrated in subsequent phases.

In contrast to T2S, where value added services are clearly assigned to the participating CSDs, it is foreseen that CCBM2 will offer such services (corporate actions, tax, etc.). The question needs to be raised, if this part could be better served by the respective CSDs, which have constantly invested in those areas over the years and have accommodated sometimes complex changes for their respective markets. This will shorten the process chain and reduce cost.

3.5. 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.

STP is deemed to be essential. Moreover, established industry standards, esp. the S.W.I.F.T. collateral management messages should be used. In addition to real-time and STP, pooling and automatic allocation should be allowed through interface/intermediation of existing collateral services used by markets participants.

3.6. Principle 6

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

This principle is fully supported. CCBM2 should be able to take collateral through all eligible SSS and eligible related linkages on a level playing field for example in terms of pricing, available operating hours and functional aspects.

In that context we see the need to improve the approval process for assessed and relayed links, esp. with respect to its duration.

4. The questions

4.1. Question 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?

The most important goal is to enable market participant to allocate collateral to and withdraw collateral from the Eurosystem in an efficient and quick manner, minimizing the number of movements as far as possible.

In terms of imperfections this means to further streamline the internal processing of the Eurosystem. The introduction of one platform (CCBM2) to replace proprietary solutions within individual NCBs is therefore a step in the right direction.

Equally important is the smooth integration of existing infrastructures that already provide efficient and real-time products for the delivery of collateral to and from the Eurosystem. Market participants and infrastructure providers have invested in those solutions and integrated them in their system processing as well as their operational procedures. Should such an integration not be part of the overall project, there is a risk of lacking support from market participants.

4.2. Question 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 do support the right direction for the future development of the collateral handling for the Eurosystem. In order to overcome the current shortcomings in the cross-border use of collateral it will not only be important to accept assessed and relayed links as a viable alternative to CCBM, but to ensure the necessary approval processes for their establishment are reasonable and acceptable from a duration point of view. In that sense principle 6 should be extended.

4.3. Question 3

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

In a first phase CCBM2 should stick to the current CCBM model in order to deliver benefits to the market short term. In subsequent phases, the features created on the new CCBM2 platform should be used to further increase efficiency. NCBs could then for example directly include collateral solutions in cross-border locations for their counterparties, without the need to use other NCBs as intermediaries.

4.4. Question 4

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

The most important aspect is the definition of the interfaces of CCBM2 into the existing infrastructures. Automated real-time communication following industry standards (S.W.I.F.T. collateral management messages) should be established which do respect the different collateralization and delivery techniques (pool pledge with asset servicing in the market infrastructure on one hand and repo on the other hand).

4.5. Question 5

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)?

Technical requirements should include but are not limited to the following areas:

- Technical access through industry standards, esp. S.W.I.F.T. collateral management messages.
- Real-time reporting capabilities
- Real-time access to all securities reference data (EAD) (i.e. full description, issuers, haircuts, prices, any information required for valuation, ...) and counterparty information (e.g. close links)
- Submission of collateral requests from the Eurosystem
- CCBM2 should be open and operating on a 24h basis as it needs to cover processing hours of security settlement systems, i.e. also during the night to accommodate for example self-collateralization techniques.
- A special assessment is needed to identify the functional and operational requirements around the end-of-day deadlines of the security settlement systems and Target 2.

4.6. Question 6

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?

In order to deliver short term benefits to the market participants, in a first phase CCBM2 should be decoupled from T2S which is scheduled for launch in 2013 earliest. However, there is an obvious dependency on the T2S project in subsequent phases of CCBM2 and this is what is actually expressed in principle 2.

4.7. Question 7

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)?

Given the specific nature of the collateral topic and the need to deliver short term benefits to the market, we request to set-up a separate coordination group on a European level including business representatives of market participants, infrastructure providers and the Eurosystem.