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Contribution from Danish credit institutions and the Danish CSD on CCBM2 – eligibility of Danish euro denominated debt instruments

Referring to the initial consultation that was launched on 26 April 2007 on the next generation of Collateral Management, please find below a joint contribution from the Danish Bankers Association, the Association of Danish Mortgage Banks and the Danish CSD (VP).

We very much welcome this opportunity to provide comments to the future Eurosystem collateral management handling procedures. As you know these procedures are crucial elements in our joint efforts to facilitate certain euro denominated debt instruments issued with VP as eligible collateral for Eurosystem credit operations. A CCBM2 solution that will facilitate this will strengthen the Danish capital market as an integrated part of the European capital market as well as support our current preparations on access to TARGET2 as from 2008.

Due to the technical restraints described in further detail below, VP is not currently able to present to our issuers a solution that will allow their euro denominated debt instruments issued with VP as eligible collateral for Eurosystem credit operations. Finding such a solution is a major and urgent concern in the Danish capital market. We therefore very much welcome any initiative that may allow this in a short term perspective.

Euro denominated debt instruments represents an important part of total bonds in circulation with VP with a total market value exceeding 3 trillion DKK (equal to 0.4 trillion euro) by end of 2006. According to "General Documentation on Eurosystem Monetary Policy Instruments and Procedures", chapter 6.2, the majority of these euro denominated instruments are eligible as collateral, provided they are usable in a cross-border context in the whole euro area. This implies that all Eurosystem counterparties must be able to use such assets either through links with their domestic SSSs or through other eligible arrangements to receive credit from the national central bank of the Member State in which the counterparty is established.

As the correspondent central banking model (CCBM) under which national central banks act as custodians for each other is only available for management of eligible assets issued and deposited in the euro area, until 2005 the only available settlement procedure for instruments issued with VP was opening of eligible links between VP and each of the current 12 domestic SSSs established in the euro area. By then, only two links to VP (from Euroclear Bank and Clearstream Luxembourg) were considered eligible and the investment in the necessary further links difficult to justify under concerns on economical efficiency.

We were therefore pleased to know the decision of the Governing Council in January 2005 that relayed links between securities settlement systems under certain conditions may be used for the cross-border transfer of securities used as collateral for Eurosystem credit operations. However, since the preparations of the T2S since June 2006 further progress on relayed links has proved difficult. Therefore, as seen from a Danish capital market user and infrastructure point of view this lack of eligible procedure in our opinion is the main imperfection that should be addressed in the CCBM2.

We are therefore in particular pleased to see that according to Principle 6, the CCBM2 will be able to take collateral through all eligible SSSs and eligible related linkages between them, hereunder also collateral issued with VP.

As regards the time plan, according to Principle 2 the CCBM2 will be developed in parallel with T2S which according to the current time plan is expected to be implemented in 2013.

In the near future we expect an increased activity in the Danish market for euro-denominated debt instruments due to changes in legislation on capital requirements to credit institutions on loans backed by covered bonds. This is expected to have major impact on the current Danish euro-denominated bond market in a medium- and long term perspective.

In order to avoid a situation where VP is no longer able to present to our issuers a solution that will allow their euro denominated debt instruments issued with VP as eligible collateral for Eurosystem credit operations, in our opinion an ideal solution would be to **allow a combination of an eligible link from an EU securities settlement system with the currently available CCBM procedure**. In practice this could imply opening a link between VP and a central bank in the Eurozone and managing eligible collateral issued by VP and held in this link via the current CCBM collateral management procedures with this central bank.

This would significantly ease international investor access to euro denominated securities issued with VP. We are of course aware that such a suggestion may need to be addressed by the ECB Governing Council as a modification to the current legal framework on custody risk but ideally the issue could be addressed as an interim solution as part of the CCBM2 implementation plan.

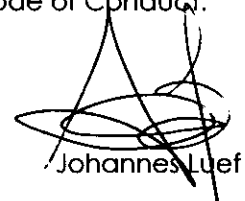
Finally, let us underline that finding a settlement solution that will allow euro settlement via VP and allow internationally active investors access to use euro denominated securities issued with VP as collateral for Eurosystem credit operations is a real concern in the Danish capital market. Finding a solution could also have a very positive impact on current market initiatives on the removal of the Giovannini-barriers and ease our work on ensuring increased interoperability as envisaged in the Code of Conduct.

Yours sincerely


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