

POSITION PAPER



ESBG response to the Eurosystem's Initial Consultation on "the Next generation of Collateral Management"

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WSBI – ESBG – The Global Voice of Savings and Retail Banking

WSBI (World Savings Banks Institute) is one of the largest international banking associations and the only global representative of savings and retail banking. Founded in 1924, it represents savings and retail banks and associations thereof in 89 countries of the world (Asia-Pacific, the Americas, Africa and Europe – via ESBG, the European Savings Banks Group). It works closely with international financial institutions and donor agencies and facilitates the provision of access to financial sectors worldwide – be it in developing or developed regions. At the start of 2006, assets of member banks amounted to more than €8,081 billion, with operations through more than 185,000 branches and outlets.

ESBG is an international banking association that represents one of the largest European retail banking networks, comprising about one third of the retail banking market in Europe, with total assets of € 5,215 billion (1 January 2006). It represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

WSBI and ESBG members are typically savings and *retail* banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their *region*. WSBI and ESBG member banks have reinvested *responsibly* in their region for many decades and are one distinct benchmark for corporate social responsibility activities throughout Europe and the world.



1. Introduction:

ESBG welcomes the opportunity to submit comments to the Eurosystem's Initial Consultation on "the Next generation of Collateral Management". It is ESBG's understanding that this is an initial consultation and that, in keeping with the Eurosystem's practices, further consultations would follow notably as regards e.g. detailed user requirements and functional specifications, and that establishing a project governance and interaction structure similar to other Eurosystem's projects is not excluded.

ESBG first and foremost wishes to highlight that the CCBM arrangement has served its purpose since its introduction and proven to be a pragmatic yet workable response to a new but not yet stable environment. With the certain deployment of TARGET2 on the doorstep, the ambitious work initiated on TARGET2-Securities (T2S) continuing industry and authorities work on the implementation of the Code of Conduct for Clearing and Settlement, and the removal of the Giovannini Barriers, time has certainly come to debate a "next generation" Collateral Management system.

The present ESBG position paper has been structured as follows:

- First some general remarks
- Second comments are provided regarding the proposed principles of the next generation of collateral management;
- Third views are expressed on the specific questions raised in the initial consultation

2. General Remarks

ESBG supports the objective of the CCBM 2 project, which is to increase the efficiency of the Eurosystem's internal systems for collateral management at domestic and cross-border levels by optimising as far as possible the cost of mobilising collateral and enhancing liquidity management. As mentioned in the introduction, the timing of the debate is also appropriate.

ESBG would however like to emphasise that the timeline for the design and implementation of CCBM2 should not be dependent on the evolution of T2S in particular, which is currently understood to be implemented in 2013 at the earliest. ESBG believes that subject to a positive feasibility study and impact assessment, and intensive consultation of the market on project definition and user requirements, the CCBM2 project should be implemented as quickly as reasonably possible. The project's costs and business case aspects including funding also must be dealt with in a transparent manner. Costs should be charged back to users on a fair cost– recovery basis, with charges for CCBM2 usage being transaction-based rather than collateral- or market value-based.

ESBG urges the Eurosystem to ensure that CCBM2 avoids duplication of investments by users and capitalises on synergies with existing or planned projects such as TARGET2 and T2S. ESBG notes that the use of CCBM2 will not be obligatory for national central banks (NCBs), yet needs to emphasise that the adherence of a critical mass of NCBs is a critical prerequisite for the feasibility of the project.

As regards eligible collateral, ESBG would urge the Eurosystem to consider very seriously the possibility of extending the collateral framework to include government bonds issued in currencies other than the euro. This would be a useful additional source of high quality collateral, which can only help to improve the functioning of the market. Accordingly, ESBG would request that the design of CCBM2 allows for using currencies other than the euro right from implementation start.



3. Remarks as to the proposed 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 principle of the move to a single platform is welcome. It is however stressed that – assuming that a CCBM2 is not likely to go live in less than 3 years – such a platform – even though complying with the principle of decentralisation of access to credit – should otherwise feature all the characteristics of a single platform, thus truly supporting harmonization. In other words, CCBM2 should enable a virtual single pool of collateral that can be used to obtain liquidity across all markets, both intraday and overnight, where a bank is eligible to obtain central bank liquidity for both monetary policy operations and intraday credit. Such a system must be built upon the principles of simplicity and efficiency with the highest safety standards.

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.

It is essential that CCBM2 be fully compatible with TARGET2 and T2S, to the farthest extent possible. The remarks made for Principle 1 above also apply.

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.

Whilst this principle is supported, it is however suggested that work be undertaken in advance of the introduction of CCBM2 to consider whether a harmonization of central bank practices, as, for example, the eligible amount as well as handling solutions for cross-border credit claims, could not be beneficial. At any rate the “user pays” principle should find application here as well.

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

This principle is supported. In addition to traditional collateral it is important that credit claims can be supported (being accepted that CCBM2 will not be the single infrastructure for the secondary market for non-marketable assets). Reference is also made to the proposal to extend eligible collateral to non Euro government bonds in this context. CCBM2 could in fact be the first step to institutionalise the cross-border use of collateral between central banks in different currency zones. This would be particularly welcome to offset a potential liquidity crisis with a specific participant or in a specific system.

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.

This principle is supported.

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

This principle is supported. CCBM2 should also streamline the NCB-SSS process in order to avoid a “spaghetti”-like architecture and improve the links that exist today



4. Remarks as to the specific questions

4.1- 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?

As repeatedly expressed by market participants, the CCBM was considered as open for improvements in terms of efficiency, although it had proven more reliable than link in terms of same day settlements. A key issue for market participants in CCBM is the ability to settle core transactions as early as possible within a given day in order to deliver the related collateral later that same day. This implies that practices that exist in certain countries such as the need to pre-deposit collateral the day before should be eliminated. Repatriation of collateral should also be abolished as it is cumbersome, time consuming and error prone. This will require NCBs to open a custody account with all CSDs/ ICSDs as it will be necessary to collect collateral on a multi-country basis.

Another issue is the difference of practices for domestic and cross-border collateral.

4.2- 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 CCBM2 principles formulated above are generally considered as fitting the requirements of our membership. Considering that CCBM2 would only apply – in opposition to other single market developments - to market professionals, it is important to stress that the harmonisation that CCBM2 will trigger should not translate into a decrease of efficiency – a slide towards the lowest common denominator.

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

In keeping with the general principles underpinning the construction of an internal market the CCBM2 should contribute to enabling financial institutions to implement a true concentrated approach to liquidity and collateral management, including centralised controls from an operational and an organisational perspective, and support flexible tools to manage institutions' liquidity.

In this context the “philosophy” of a “single platform” should be pushed as far as possible (i.e. a replication of the TARGET2 concept of “PHAs” should be avoided).

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

It should be possible to maintain sub-collateral accounts. This would facilitate the possibility to manage several collateral providers within one group and could also allow indirect participants to use this facility to provide collateral to support their business. Consideration should also be given to ways and means to transfer collateral between the central bank and the commercial (repo) markets, both in terms of the system requirements as well as the procedures around CCBM2. Recourse to triparty services or collateral management agents should also be possible - although in a ring-fenced environment outside of CCBM2 in order to avoid the spreading of risks.



4.5- 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)?

The principle that technical requirements whenever possible are to be fully aligned with the technical requirements supporting TARGET2 and T2S is proposed.

It is important that banks are provided with liquidity tools to manage 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 through the ICM module of TARGET2. This facility should also be available outside of TARGET2 opening hours. CCBM 2 should also have a multi– market, multi– instrument capability to allow a central evaluation of collateral held by the different CSDs.

4.6- 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?

Ongoing work on the implementation of the Giovannini barriers related to connectivity issues and, in particular, the EU-wide protocol to eliminate national differences in the information technology and interfaces used by clearing and settlement providers (Barrier 1) will have a positive impact on the design and business case for CCBM2.

The implementation of the pan-European Code of Conduct for Clearing and Settlement by European CSDs, ICSDs and CCPs, notably as regards its access and interoperability dimension (provided the recommendations of the Code are really transposed) should also have a positive impact on CCBM arrangements.

4.7- 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 European levels or would you like to suggest another level of interaction (e.g. a contact group at Eurosystem level)?

ESBG would suggest that, as for other Eurosystem undertakings e.g. TARGET2 and T2S, it could be of value to distinguish the project phase from the future operation of the system. Accordingly during the project phase leading up to going live, the principles for project governance and modes of interaction with market participants should be very much aligned with the governance and interaction established for the TARGET2 and T2S projects. The CCBM2 project should be managed independently from the latter 2 projects, yet with the appropriate bridges. These could, for example, include regular progress reports at the T2S Advisory Group as well as at the T2S information meetings for market practitioners organised by the ECB.

ESBG would in particular be in favour of ad hoc information meetings at various crucial stages of the project. The first such meeting could usefully take place once the ECB has collated the findings from this initial consultation. Invitations to such a meeting could be extended to the members of the ECB's relevant Market Contact Groups (securities settlement and liquidity/ treasury experts) as and/or coordinated through the European Credit Sector Associations (the ECSAs), as appropriate.