

EUROPEAN REPO COMMITTEE

Ms. D. Russo
European Central Bank
Payment Systems and Market Infrastructure

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London, 24th April 2008

Dear Daniela,

Ref.: Correspondent Central Banking Model (CCBM2) Response by the European Repo Committee (ERC) to the User Requirements

The ERC welcomes the opportunity to respond to the consultation on the Eurosystem Correspondent Central Banking Model (CCBM2) User Requirements that reflects the six guiding principles of CCBM2. This present response supplements our initial contribution – with the ICSDs – to the user requirements definition, dated December 18, 2007.

The ERC has, from the outset, followed closely the development of the common platform for Eurosystem collateral management. The ERC has welcomed the opportunities to engage directly with the ECB at various occasions, and the ongoing bilateral discussions. Our December contribution specifically dealt with triparty collateral management services, this letter covers more grounds in this respect.

CCBM2 and the Target-2-Securities project

The ECB has mentioned many times the independence of these two projects that are being worked on in parallel. However to exploit all possible synergies, the ERC expects that in practical terms, opening hours of CCBM2 will be aligned with those of T2S for all CSDs and ICSDs – and in turn those opening hours should match as closely as possible those of Target2. Accordingly the ERC sees full harmonisation, including that of a Target calendar that will not comprise national public holidays, as a necessary step to achieve a full functioning settlement system in all domestic markets.

However, as discussed later in this letter, we expect CCBM2 to act as the leading worldwide Central Bank facility as far as global collateral management with other Central Banks is concerned. As the recent crisis clearly demonstrated, one has to think outside the box. The ERC encourages the Eurosystem to continue to be forward looking. New systems can only perform when they are tested to their full and widest possible application. Thus, in line with the current work done within CPSS/IOSCO and other forums, CCBM2 should look beyond the Euro-zone borders from its very start. This in turn would require the availability of CCBM2 beyond the Target opening hours.

Repo Processing in T2S

In our response to the T2S User Requirements consultation dated April 7, 2008, the ERC noted that Target-2-Securities will accept, both, single messages (relating to both legs of the transaction) and two messages.

The ERC favours a unique solution whereby two instructions are in separate messages (one with the opening and the other the closing leg of a repo). Indeed this solution provides flexibility as in case of a change to the second leg, e.g. in a rollover situation. Obviously this doesn't affect the first leg.

We understand that some markets use a unique pair of instructions for closed repo, but this practice remains limited to certain markets and does not bring much advantage. The ERC expects harmonisation through the creation of T2S, and a single solution will certainly foster such an endeavour.

Although the ERC recommendation for a single solution based on two messages should not, in principle, affect CCBM2, from our viewpoint single messages jeopardise the free, unexpected desire of movement of collateral for CCBM2 reasons, as original trades cannot be redirected, refinanced or reinstructed. As such, T2S might create an unnecessary barrier to a wider application of the CCBM2 platform.

Credit claims

In reference to chapter 3 of the user requirements, the ERC favours the creation of a secondary market for credit claims. Indeed after the, reasonable, initial doubts from some stakeholders as regards the need for credit claims, evidence has proved it to be a highly valuable tool for the collateralisation of adequate funding to the European banking sector. The ERC is of the opinion that after the initial establishment of the CCBM2 platform, priority should rapidly be given to the full harmonisation of settlement through the platform.

This exercise should be similar to that executed in the case of the replacement of the two-tier legacy collateral list to the single collateral framework since January 2007. This may be accomplished by using a common identification code tool. Such tool is already in use in Belgium and the Netherlands through the NBB/DNB settlement system and seems to be working very well. This initiative will show that the Eurosystem is committed to the overall European exercise of removing the Giovannini barriers, in particular Barrier 8.

Eligibility of assets

The ERC favours a tighter grip on the checking of the eligibility of assets, including haircuts, in order to ensure that counterparties have the necessary amount of cash available in the monetary and payment areas. CCBM2 should also improve *in fine* the accessibility of the checking of eligibility of assets.

As the ERC and ICSDs explained in their joint letter dated December 18, 2007 on tri-party collateral management services, market solutions such as those currently provided by the ICSDs have already created efficient, scalable and risk-controlled collateral management environments. As the ERC and ICSDs further clarified the CCBM2 system should be compatible with existing collateral management systems, notably the tri-party services.

Tri-party collateral management services provided in ICSDs' environments allow market counterparties to gain in efficiency, and to mitigate operational risks related to the processing of a growing number of collateralised transactions across different market segments. Users of ICSDs' tri-party collateral management services can also optimise the allocation of their collateral across an increasingly wider range of transactions. As explained in our December letter, the ERC favours the integration of the CCBM2 platform to ICSDs' tri-party collateral management systems. Two models of integration constituted the core of the discussion of the paper – attached for your convenience.

Collateral outside the Eurosystem scope

The CCBM2 project team should also be considering questions about collaterals outside the normal scope i.e. outside the Eurosystem scope that may be used as emergency measures. Questions should also be raised at possible collateral substitution in a cross-currency environment. As with T2S, the scope of non-euro collateral should be endorsed and technical measures should be in place from the outset, facilitating the extension of the collateral range that can be used.

Ultimately the use of cash as collateral for emergency lending in another currency zone should be possible through CCBM2. This technique has already been used in some specific cases in the tri-party market, but lacks the possibility of central bank money in the most extreme situations. The ERC would like the CCBM2 project team to consider the freezing of collateral in case of emergency (e.g. default of a counterparty). Specifically, the ERC considers necessary the possibility of freezing of collateral following collateralisation requests from both, outside the Eurosystem and outside the Target time zone (that may include other countries activities on Target holidays). A possible option, if such questions were considered, would be the establishment of a hotline which would allow existing instructions to be cancelled immediately in an emergency situation.

Repo and pledge techniques

The ERC welcomes the fact as stated in Chapters 1 and 3 that CCBM2 will be able to handle both pledge and repo techniques.

**European Repo Council response to
CCBM2 USER REQUIREMENTS DOCUMENT**

The ERC regards the CCBM2 project as highly important in light of the Lisbon agenda, and this response should be considered bearing this in mind. The Eurosystem is in a unique position whereby it can lead by example. In the many of both CESAME and MOG meetings, frustration by many is patent as progress by both the private and public sectors has been painfully slow.

We remain, as in the past, at your disposal, should you want to discuss our response and look forward for a speedy implementation of the project after the consultation period and approval of the ECB Governing Council.

With kind regards.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Godfried de Vidts', with a long horizontal line extending to the right.

Godfried de Vidts
Chairman
European Repo Committee