

Prioritisation methodology for Collateral Management Harmonisation Activities

1. Introduction

According to the work plan of the CMH-TF agreed in its meeting on 24 August 2017, the CMH-TF should, by Q4 2017, develop a methodology for the prioritisation of Collateral Management Harmonisation Activities (CMHAs) which are currently being analysed by the CMH-TF. This note sets out a proposal in this respect. The proposal is for discussion by the CMH-TF.

The proposed prioritisation methodology to be applied to the CMHAs (to be agreed) is largely based on the framework that is used in the context of the T2S harmonisation agenda¹, but is amended and complemented with the harmonisation needs for collateral management. The prioritisation methodology for CMHAs also takes into account dependencies between different activities that could affect their successful implementation.

This note begins by providing an overall structure for prioritisation, according to which the (to be agreed) activities could be classified into two priority groups (Section 2). The note also explains the elements that need to be taken into account in the classification into one of the two priority groups. Finally, the prioritisation process is explained (Section 3).

2. Overall structure

The following overall structure should be applied for prioritising CMHAs:

- **Priority 1:** are activities that are necessary for the safe and efficient functioning of collateral management arrangements in T2S markets. These activities are directly related to collateral management arrangements of markets/market participants that operate in T2S markets, i.e. involving the Eurosystem, collateral management service providers (CMSPs) and users of collateral management services (UCMS) in T2S markets². These activities should be feasible to be implemented taking into account the timing of the Eurosystem's deliberations on a common Eurosystem Collateral Management System (ECMS) and the timing of the Action Plan on Building a Capital Markets Union (CMU) of the European Commission.

¹ The T2S harmonisation agenda is using the following high level approach: Priority 1 activities are necessary to ensure efficient and safe cross-CSD settlement in T2S. The HSG focuses on these activities as first priorities for resolution and implementation prior to the markets' migration to T2S. Priority 2 activities are not essential to ensure safe and efficient cross-CSD settlement in T2S, but they are key for the enhancement of the competitive environment and the efficiency of T2S, and could continue to be pursued after the markets' migration to T2S.

² The CMHAs also cover collateral management for assets made available in T2S via links between Investor CSDs (in T2S) and Issuer CSDs (outside T2S). The scope therefore covers the management of assets issued outside T2S markets, but which are maintained by CSDs in T2S via CSD-links.

- **Priority 2:** are activities that are beneficial but are not necessary for the safe and efficient functioning of collateral management arrangements in T2S markets. The activities involve CMSPs and UCMS interactions which are beyond the activities in T2S markets. These activities are beyond the time considerations of priority 1.

Priority 1 activities cover necessary/critical harmonisation activities, which relate to two types of arrangements in T2S markets, i.e. (i) Eurosystem-related collateral management practices and (ii) other practices for operations between market infrastructures and market participants and between market participants. Eurosystem-related collateral management arrangements and activities involving (I)CSDs and Eurosystem counterparties are not always harmonised and often depend on case- and country-specific practices. At present, the Eurosystem does not interact, transact and communicate with Eurosystem counterparties and market infrastructures in a harmonised manner. However the Eurosystem is investigating the business case for an ECMS which could replace the current set-up of NCBs' individual local collateral management systems and in this vein has identified heterogeneities in existing collateral management practices and services which often adversely affect (I)CSDs and market participants and which have to be overcome. Priority 1 activities also cover other market transactions/operations in T2S markets involving UCMS and CMSPs (e.g. repo/securities lending, or exchanging collateral) where deemed critical by market stakeholders.

Priority 2 activities cover arrangements in T2S markets, which are deemed less critical for the safe and efficient functioning of collateral management arrangements. The activities also cover arrangements beyond T2S markets, with participation of UCMS and CMSPs in global/international collateral markets and across jurisdictions (involving UCMS/CMSPs beyond T2S markets), e.g., sourcing of collateral from multiple global venues to TPAs or other international/ICSD initiatives to improve/automate the management of collateral.

A number of elements should be taken into account in order to determine the relevance of each CMHA (vis-à-vis the other CMHAs). These elements could be related to importance/benefits and dependencies:

- Importance/benefits of the activity, i.e., the benefits for stakeholders as a result of achieving the CMHA, i.e. for providers (CMSP) and users (UCMS) including the Eurosystem (i.e. euro area NCBs and the ECB).
- Dependencies of the activity upon other activities.

Regarding *importance/benefits*, the assessment should consider all potential benefits for stakeholders of harmonising currently different collateral management practices, including the CMHA's ability to reduce operating complexity, reduce the complexity of interacting with the Eurosystem (also in view of ECMS considerations), achieve a level playing field across CMSPs and UCMSs, increase the efficiency of the business processes within the CMSPs and UCMSs, improve implementation of risk control measures (e.g., harmonised management of situations of under collateralisation in relation to corporate action events).

Regarding *dependencies*, it should be assessed to which extent the CMHA has a dependency upon other activities. For example, the CMHA triparty collateral management may introduce changes to other workflows and messaging activities. The CMHA related to corporate actions may be closely associated with the CMHA on handling of taxation forms.

Beyond these elements, there is also the question on the possibility for the AMI-SeCo to influence the harmonisation work of the activity beyond its remit, i.e. to what extent changes may be required for stakeholders other than those involved in AMI-SeCo. For example, standard setting bodies or market practice groups could be involved during or after the definition process (e.g. ISO standard setting bodies, ISO registration authority, market practice groups setting best practices, etc.). In addition, stakeholders may be involved that are indirectly impacted. However, this is not an element for consideration in the prioritisation, but it is rather a governance and implementation.

3. Prioritisation process

According to the CMH-TF work plan, the work of the CMH-TF is planned to consist of two sequential phases. Each phase of the work should have 'responsible actor(s)' to ensure responsibility for the process according to concrete deadlines (similarly as in T2S):

- Phase 1 is to deepen the analysis of the HSG's initial deliberations on collateral management harmonisation needs with a view of establishing CMHAs by Q4 2017;
 - *Definition and prioritisation process*: Responsible actors are entities responsible for defining the CMHA and their prioritisation. The 'responsible actor' is AMI-SeCo.
- Phase 2 is to work on next steps toward implementation (subject to AMI-SeCo approval of Phase 1).
 - *Implementation process*: Responsible actors are entities responsible for ultimately implementing changes and adapt to. The 'responsible actors' are (I)CSDs, TPAs, and/or may involve other entities such as standard setting bodies or market practice groups.
 - *Monitoring process*: Responsible actors are entities responsible for monitoring that stakeholders are complying with the CMHAs. The 'responsible actor' is AMI-SeCo.

The AMI-SeCo is the 'responsible actor' for the definition and prioritisation of CMHAs. This means that The AMI-SeCo will be asked to endorse the definitions and prioritisation assessments provided by the CMH-TF and agreed by the AMI-SeCo HSG. Only after the AMI-SeCo's endorsement of the definitions and prioritisation assessments, the implementation and monitoring processes will start.

As part of the prioritisation process, the responsible actors should assess each activity on its priority taking into account the elements mentioned above. The box 1 provides an example of an assessment of a CMHA. However, the CMHAs are still being defined, so this example should only be seen as an illustration.

Box 1: Example of prioritisation assessment - Triparty collateral management (for interactions of TPAs with collateral takers).

For example, a harmonisation activity is defined to harmonise certain workflows of triparty agents involving interactions with collateral takers such as the Eurosystem.

1. Importance/benefits

- Successful harmonisation of triparty workflows may result in a single workflow being implemented for all triparty arrangements. It would reduce the alternate workflows in the existing models which would reduce the complexity and time required to implement triparty functionality in the collateral management.
- The CMHA's potential to reduce the complexity of implementing triparty suggests that the greatest benefits can be reaped from achieving harmonisation in time with other large market developments to increase efficiency (e.g. new standards and services).
- Harmonisation triparty would allow standard procedures could be used for all triparty models thus offering a simplified service for users/UCMS. It could also help simplify the current CCBM triparty messaging workflows.
- It could contribute to achieving a level playing field [...].

2. Dependencies

- The CMHA is dependent upon other activities, e.g. the relevant triparty agents and (I)CSDs initiating changes to other workflows as part of an overall transition plan.
- [...].

The CMH-TF is invited to discuss the proposal for the prioritisation methodology for CMHA.