

CCBM2

Second Consultation

Position paper by Clearstream

The debate about CCBM2 continues to be of high importance to Clearstream and we welcome the opportunity to contribute to the second public consultation on the draft user requirements (URs).

Based on the position paper submitted in the initial consultation Clearstream had numerous discussions with both market participants and representatives of the Eurosystem. We are pleased about the open and constructive dialog that has evolved since. Jointly with ICMA and Euroclear Bank we handed in a concept for the inclusion of triparty collateral services in CCBM2 which has been reflected in the URs.

It is our wish that going forward we can participate in further detailed discussions supporting the progress of this important project.

On the following pages we have formulated our comments regarding the URs.

Interface between CCBM2 and Triparty Collateral Management services

Clearstream very much welcomes the inclusion of external collateral management systems in the URs. As we had already pointed out in the first consultation, we believe it is essential, that CCBM 2 is open to existing collateral pools that are developed in close cooperation with the market and the NCBs.

This requirement has become even more important since the beginning of the market turbulences in the middle of 2007. Secured transactions are vital for market participants and ECB eligible collateral has become the dominant standard within the Eurozone. Not only does the existing infrastructure (Xemac, Euro GC Pooling) allow for an easy inter-bank exchange of liquidity and collateral, it is a stabilising factor which is evident through the dynamic growth in this segment over the last couple of months. The key advantages are anonymous trading, the possibility to achieve a very favourable treatment of regulatory capital through the usage of a central counterpart and last but not least the instant re-use of collateral received to the central bank.

The 'cancel and replace mode' described in section 3.10.1 of the URs could eventually accommodate the current interface between Xemac and the Eurosystem. As this is still a high-level description, we are very interested to enter into discussions to further detail the concept such that the current benefits and efficiencies can be ensured and even further improved.

During the initial consultation a number of respondents also suggested to integrate in CCBM2 existing triparty collateral management systems provided by the ICSDs. Jointly with ICMA and Euroclear Bank, Clearstream has submitted a conceptual paper describing how such integration can be achieved. We are pleased to note that this proposal was well received and reflected in section 3.10.2 (transaction by transaction mode).

Given the positive experience with the Xemac model in Germany enabling market participants to achieve the efficient allocation of collateral for multiple purposes also beyond the Eurosystem, Clearstream is a strong supporter of the model described in use case 1, i.e. a full integration in the existing standard triparty service.

We would like to emphasise that already today triparty gives access to a broad range of non-ECB eligible and foreign collateral making it easy for market participants to mobilise those assets. For emergency situations as described in section 8 of the URs, the triparty collateral systems of the ICSDs would be an efficient way to mobilise assets for the Eurosystem. In fact, already today a number of major central banks outside the Eurosystem, e.g. the Federal Reserve Bank of New York, make use of these facilities.

Static data

In future it is foreseen that reference data will be held in T2S as well as in CCBM2. We believe a single databases for CCBM2, T2S and T2 would be beneficiary in order to avoid any disruption of services delivered.

Already today, Clearstream makes use of information from the EADB to run its collateral services. For a CCBM2 environment it will be important to have continued access to this data and extent the scope to include complete price and close link information. This will also be relevant for the auto-collateralisation process where CCBM2 provisions this information to the connected SSSs.

Connectivity

Clearstream strongly supports any connectivity solution to follow ISO standards in order to keep implementation cost low for market participants. We would like to reiterate that we consider the use of the S.W.I.F.T. collateral management messages as beneficiary.

Auto-collateralisation / self-collateralisation

Self-collateralisation on flow was introduced for the German Market in Q4 2007. Design and functionality of this service were discussed and agreed in close cooperation between market participants, Deutsche Bundesbank and Clearstream Banking. One of the key achievements is the smooth integration of self-collateralisation in the existing settlement processing whilst ensuring an optimal use also from a liquidity management point of view. This means amongst others, that self-collateralisation on flow is invoked with the lowest priority and returned as early as possible. The transfer of collateral on Deutsche Bundesbank's securities account is executed and reported once the settlement process is finalized.

A migration to CCBM2 should attempt to at least retain the benefits and features currently available to market participants and infrastructures. Regarding the model on auto-collateralisation described in the URs (section 3.11) we fear this proposal

could lead to a less efficient process for "interfaced" models. Especially we would like to point out:

- In our opinion the use case described on page 78 ff. refers to auto-collateralisation 'on stock'. We would appreciate the inclusion of an additional use case for 'on flow' auto-collateralisation in case of an interfaced model.
- In case Target2 Procedure 6 is used the described liquidity provision confirmation process in step 4 (on page 79) needs to also include an information flow to the SSS.
- Option 2 in step 6 (page 80) states that at pre-defined steps (one or more) an automatic process is activated to return collateral. In today's CBF environment customers have the possibility to recover collateral on a continuous basis throughout the day (on stock & on flow).

Those aspects will become particularly relevant should CCBM2 be launched ahead of T2S.

We recognize that the topic of auto-collateralisation has also been addressed with more detail in the T2S URs (Chapter 8). We recommend adding a second use case in the CCBM2 URs for an integrated model in order to demonstrate how benefits delivered by the current auto-collateralisation solutions will be continued or even further enhanced.

Direct and relayed links

In the initial consultation Clearstream pointed out the need to improve the approval process for direct and relayed links, esp. with respect to its duration. We appreciate, that in the meantime 5 relayed links have been accepted by the Eurosystem. However, we see still significant room for improvement. Clearstream applied for the assessment of a direct link CBL to Euroclear France and a relayed link CBF via CBL to Euroclear France in September 2007. Although the ad-hoc assessment was scheduled for a maximum duration of 3 months, there is still no feedback available from the Eurosystem. Given the continued importance of interoperability, amongst others supported by the Code of Conduct, we await more requests for direct and relayed links emerging and consider a slow and lengthy approval process of the Eurosystem as a barrier to the European harmonization.

Time-to-market

We feel the need for an early implementation of CCBM2 has increased since the initial consultation and would benefit the whole market. One of the lessons learned from the current crisis is that mobilization of collateral is essential, especially towards central banks that play a vital role in stabilizing and strengthening the financial system.

The Eurosystem should consider launching CCBM2 as soon as possible and very much ahead of the T2S implementation in 2013 in order to address the current issues of cross-border mobilization of assets. Should this not be achievable with the full scope targeted in the URs, a phased approach should be considered focusing on securities first which continue to be the most important asset class utilized by market participants.

End-of-day

Synchronization of CCBM2 with other applications within the Eurosystem - esp. T2 and T2S - will be important in order to achieve a smooth operating environment. In that respect we regard a thorough assessment around the end-of-day deadline as very important. The impact on market participants, ancillary systems and the Eurosystem itself needs to be understood and managed.

Custody functions

It is foreseen that CCBM2 will offer custody services which are widely acknowledged to be complex due to the lack of harmonization in European legislations and tax regimes. Constant investments are required to keep up with ongoing changes and developments in this area.

In case collateral is provided through an integrated Triparty solution (e.g. Xemac or Standard Triparty – use case 1 in section 3.10) custody services will automatically be dealt with by the CSD and there is no need for CCBM2 to take any action.

Clearstream understands that such functionality is needed in CCBM2 in case the collateral is directly custodized with an NCB. In this case it should be assessed, if the custody services can be outsourced to the respective CSDs that already offer such core asset services today. This will offer one technical process for the participants and avoid both, duplicated investments and the risk of reconciliation issues. Link Up Markets, recently launched by seven leading CSDs in Europe, leverages such existing core asset service processes at the domestic CSDs.

Legal aspects

The URs distinguish between pooling and earmarking whereby the latter is defined as collateral unequivocally linked to a specific credit operation (page 34 of the URs). From our perspective this is a very narrow definition of earmarking which could lead to misinterpretation. In the legal debate, earmarking is commonly understood as a "designated entry", i.e. as a mean to create/display security interests with respect to certain (usually) blocked security credits in a security account of the collateral provider. Important legal harmonisation projects dealing with intermediated securities and cross-border security settlement such as UNIDROIT on the international level and the Legal Certainty Group of the EU Commission define and use the notions "earmarking" and "designating entry" in the same functional meaning. Specifically,

earmarking is considered to be an alternative technique to book-entry credits and shall be equally protected and privileged.

In that sense, we see both techniques (pooling and earmarking) mentioned in the URs as a mean of "designated entry" applied on the level of the collateral that has been made available by the participants.