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REPO
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**Eurosystem CCBM2 Project –
Integration of ICSDs' triparty collateral management services**

User Requirements definition - December 2007

The European Repo Council ("ERC"), Euroclear and Clearstream International are pleased to be given the opportunity to comment on the Eurosystem CCBM2 project and, more specifically, to present the benefits and synergies that could result from the use of the existing triparty collateral management systems provided by the ICSDs, i.e. Euroclear Bank ("EB") and Clearstream Banking Luxembourg ("CBL").

Some CSDs (e.g. Clearstream Banking Frankfurt) are already providing triparty collateralisation solutions used for Eurosystem credit operations purposes. We present this paper with the understanding that such techniques will continue to exist for any interested CSD and would be operating under the same conditions as suggested in this document for the triparty collateral management services of the ICSDs.

Triparty collateral management services in ICSDs

Triparty collateral management services provided in ICSDs' environments allow market counterparties to gain in efficiency and to mitigate the operational risks related to the processing of a growing number of collateralized transactions, across different market segments. Collateral practitioners typically face the following tasks to be performed:

- Matching of transaction details
- Collateral screening(eligibility checks and automatic allocation)
- Collateral transfers (for the settlement of collateral movements related to new transactions, margin calls, substitutions etc...)
- Collateral valuation
- Custody (processing of market claims, corporate actions)
- Reporting



CCBM2 – Triparty inclusion – User requirements

On top of the possible automation of the above tasks, users of ICSDs' triparty collateral management services can also optimize the allocation of their collateral across an increasingly wide range of transactions.

CCBM2 consultation - Removal of the repatriation requirement

The outcome of the first market consultation on CCBM2 highlighted a strong request for the removal of the repatriation requirement and the ERC, EB and CBL welcome the Eurosystem's willingness to consider this request, i.e. that any collateral location eligible for the Eurosystem vis-à-vis the National Central Bank ("NCB") of a specific country will also be accepted as such by any other NCB outside this country. This should allow those Eurosystem counterparties who wish to do so to pool collateral in one single location for Eurosystem credit operations purposes. But it should also help addressing other issues like the capacity for market participants to integrate the allocation of collateral to the Eurosystem with existing market solutions like ICSDs' triparty collateral management systems.

Indeed, such infrastructures offer today already efficient, scalable and risk-controlled collateral management environments and, as presented in this paper, the CCBM2 system could interoperate with existing collateral management systems. The usage of these systems will de facto meet another issue identified by market participants, namely the capacity to use their collateral for other purposes like repo transactions or guarantees to CCPs. It is recognized that these functionalities can be for commercial bank money purposes and might be competing with other service providers. And finally, standard SWIFT messages and protocols already used today in these environments could also be retained for the definition of the communication interface with the new CCBM2 platform.

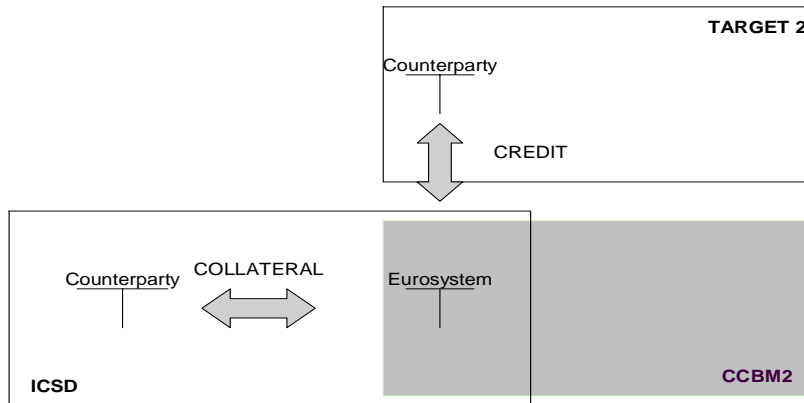
CCBM2 – Integration with ICSDs' triparty collateral management systems

The ERC has expressed the requirement to integrate the CCBM2 platform with the ICSDs' triparty collateral management systems.

The assumptions supporting the models presented in this paper are the following:

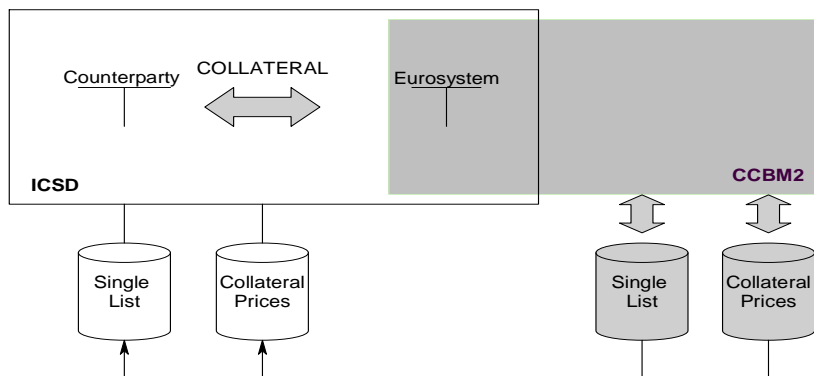
1. EB and CBL are eligible SSSs for use in Eurosystem credit operations.
2. Some existing links with other SSSs are eligible for use in Eurosystem credit operations.
3. The Eurosystem continues to support assessed and relayed links and improves the process and limits the time required for the approval of new links.
4. The repatriation requirement is removed.
5. The models must be compliant with the principle of decentralisation of access to credit.

CCBM2 – Triparty inclusion – User requirements



Operating Models – Generic principles

- In line with the principle of decentralisation of access to credit, the withdrawal of collateral will have to be authorized by the CCBM2 platform, following a check on the credit position of the counterparty.
- Standard SWIFT messages and protocols would be retained for the definition of the communication interface with the new CCBM2 platform.
- The CCBM2 platform will maintain some key collateral information:
 1. the details of the Single List, defining eligibility of the collateral;
 2. prices and haircut levels, for collateral valuation purposes.



To ensure a maximum of processing efficiency, the ICSDs will maintain the same information in their collateral management platforms, one option being to feed their systems with CCBM2 data.

One specific issue to be addressed in this context is the management of **“close links”** that is a collateral eligibility criterion based on the ownership structure of the counterparty and/or issuer/debtor/guarantor of the collateral.

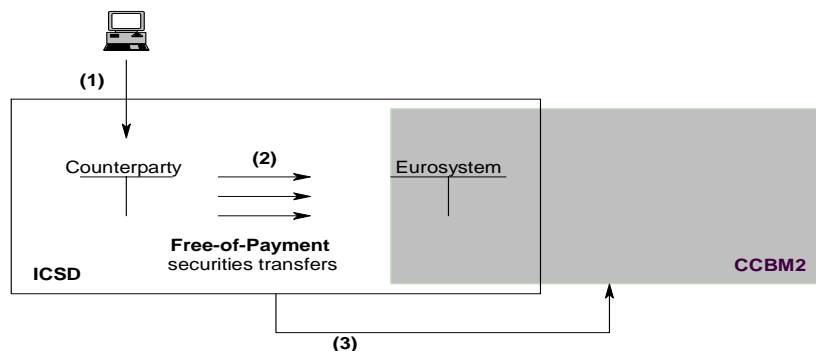
Based on these principles, two operating models can be considered.

CCBM2 – Triparty inclusion – User requirements

Operating Model #1 – Standard triparty

Under this model, the Eurosystem becomes party in a standard triparty agreement within the respective ICSDs. The collateral management will then follow the standard operating procedures defined by the ICSDs for the processing of the collateral in their respective triparty platforms. This model implies the outsourcing by the Eurosystem of the eligibility checks and valuation of the collateral being processed.

Initial allocation and top-up

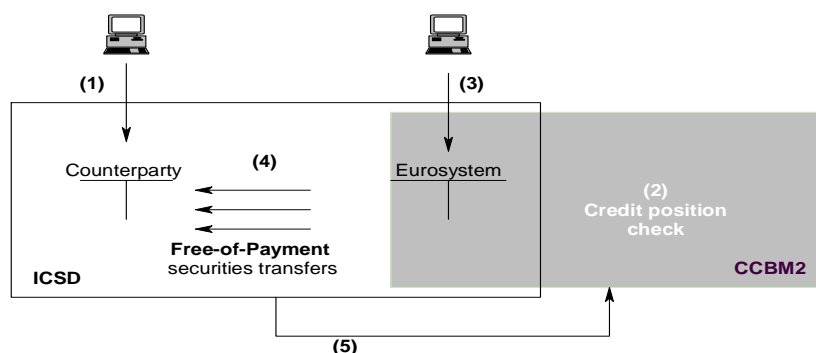


(1) The counterparty requests the ICSD to process transfer on a Free-of-Payment basis a basket of eligible collateral to the CCBM2, for a pre-defined total value.

(2) The triparty collateral management system generates the corresponding Free-of-Payment securities transfers using available automatic allocation modules and following eligibility checks (including close links) and valuation of the collateral.

(3) Securities transfers are confirmed to CCBM2.

Withdrawal



(1) The counterparty requests the ICSD to process the transfer on a Free-of-Payment basis of a basket of eligible collateral from CCBM2, for a pre-defined total value.

(2) The Eurosystem performs a check on credit position of the counterparty taking into account the total value to be withdrawn.

(3) The Eurosystem confirms approval of the request to the ICSD.

(4) The triparty collateral management system generates the corresponding Free-of-Payment securities transfers using available automatic allocation modules and for the required total collateral value.

(5) Securities transfers are confirmed to CCBM2.

CCBM2 – Triparty inclusion – User requirements

Collateral substitution

Collateral substitutions will be credit neutral and will therefore be automatically processed by the ICSDs. The corresponding Free-of-Payment collateral movements will however be processed in such a way that the withdrawal of collateral will only be processed upon successful transfer of the substitution collateral.

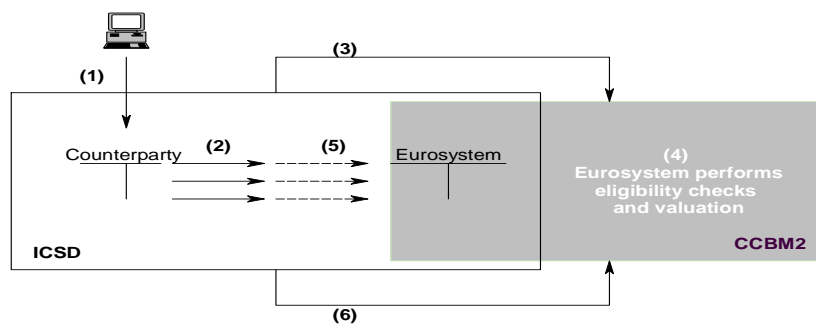
Operating Model #1: Eurosystem assessment

The outsourcing of the collateral eligibility checks and valuation implied by this first model will require an assessment by the Eurosystem of the ICSDs' triparty platforms. According to the principles highlighted above, the Eurosystem will remain the owner of the data used by the ICSDs to perform eligibility checks and valuation tasks.

Operating Model #2 – Interfaced triparty

Under this second model, the Eurosystem (via CCBM2) will perform eligibility checks and valuation of any proposed collateral movement generated by the triparty systems.

Initial allocation and top-up



(1) The counterparty requests the ICSD to process transfer on a Free-of-Payment basis a basket of eligible collateral to the CCBM2, for a pre-defined total value.

(2) The triparty collateral management system generates the corresponding transfer requests, using available automatic allocation modules.

(3) The collateral management system requests matching of the proposed transfer requests to CCBM2.

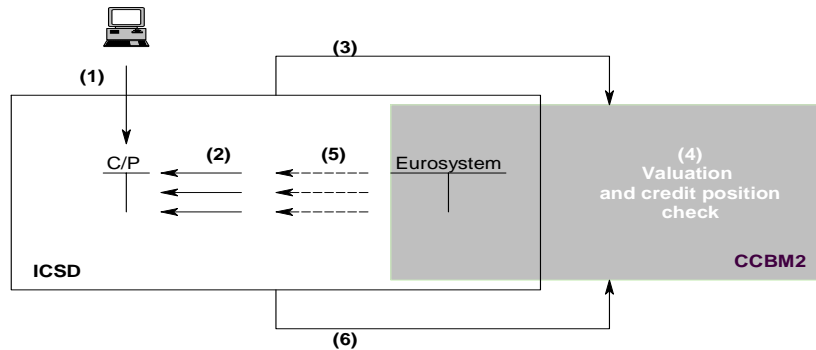
(4) CCBM2 performs eligibility checks (including close links) and valuation of the proposed collateral.

(5) CCBM2 system authorizes the transfer requests by matching them.

(6) Securities transfers are confirmed to CCBM2.

CCBM2 – Triparty inclusion – User requirements

Withdrawal



- (1).The counterparty requests the ICSD to process transfer on a Free-of-Payment basis a basket of eligible collateral from CCBM2, for a pre-defined total value.
- (2) The collateral management system generates the corresponding transfer requests, using available automatic allocation modules.
- (3) The collateral management system requests matching of the transfer requests.
- (4) Valuation and credit position checks are performed by CCBM2.
- (5) CCBM2 system authorizes the transfer requests by matching them.
- (6) Securities transfers are confirmed to CCBM2.

Collateral substitution

A collateral substitution is a combination of one withdrawal movement and one (or several) movement(s) for the allocation of substitution collateral and these movements will therefore follow the processing presented in the two previous points for allocation and withdrawal.

Operating Model #2: CCBM2 Service Level requirements

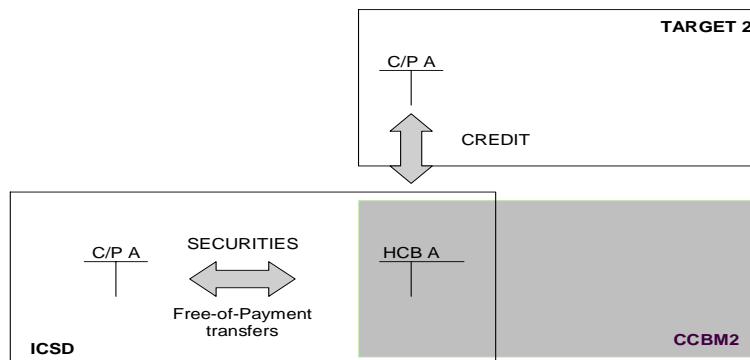
In order to reach a sufficient level of processing efficiency under the Operating Model #2 that is an interfaced model between triparty systems and CCBM2 platform, the following requirements should be considered:

- Infrastructure and adequate procedures must be in place to keep key data (eligibility criteria, prices, haircuts and potentially “close links”) aligned to the maximum extent between CCBM2 and the triparty systems.
- Whenever applicable, CCBM2 should provide real-time feedback.
- On the basis of the automated and STP features, a support by CCBM2 of substitution operations on a 24/24 hrs basis should be considered. Such operations will imply processing of allocation and withdrawal movements as presented in this model, but the assumption is that there is no ‘negative’ impact on the credit position, i.e. the overall collateral value provided by the counterparty does not decrease.

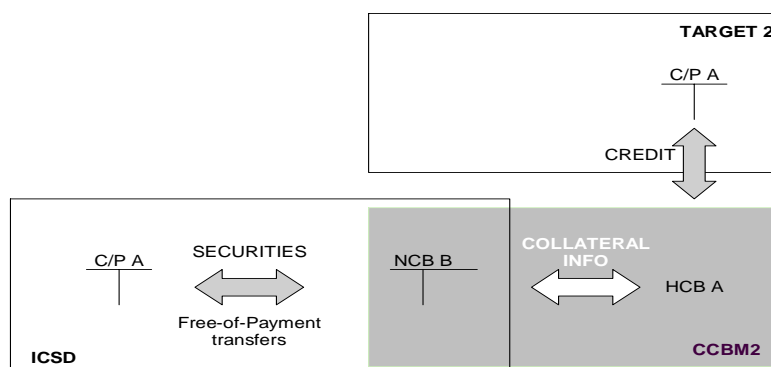
CCBM2 – Triparty inclusion – User requirements

Account structure

Under a **first possible structure**, the Home Central Bank (“HCB”) of the counterparty holds an account in the ICSD and utilizes the CCBM2 platform to process and monitor the collateral received from its counterparties. Credit is then granted accordingly, in TARGET2.



The **second possible structure** is closer to the current CCBM in the sense that a “correspondent” National Central Bank (“NCB”), which may be connected remote, i.e. from another country, holds an account in the ICSD and utilizes the CCBM2 platform to process and monitor the collateral received from the HCB counterparties. The correspondent NCB then relays to the HCB, again using the CCBM2 platform, all the key collateral information required for the HCB to proceed with the release of the corresponding amount of credit in TARGET2.



The choice of the structure will be a decision of the Eurosystem.



CCBM2 – Triparty inclusion – User requirements

We hope that above input into your work on this very important project is of value to you and your team and we are of course available to you for any further discussion.

With kind regards,

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

Godfried De Vidts
Chairman, European Repo Council and Committee