

THE COLLATERAL CENTRAL BANK MANAGEMENT PROJECT (CCBM2) – A SINGLE PLATFORM FOR EUROSISTEM IN MANAGING COLLATERAL FOR DOMESTIC AND CROSS – BORDER OPERATIONS

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1. The former Correspondent Central Banking Model (CCBM)

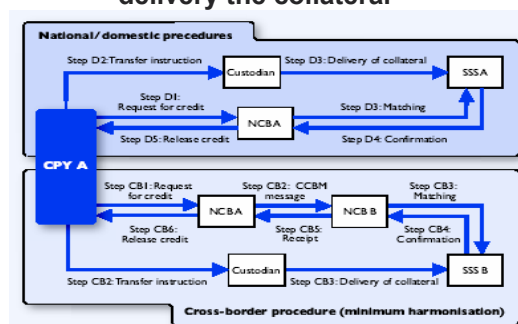
With the introduction of the euro, there emerged a need for a mechanism enabling the cross-border use of collateral for the Eurosystem's monetary policy operations and TARGET intraday credit operations. In the absence of market alternatives, the Eurosystem implemented the Correspondent Central Banking Model (CCBM) as a medium term solution. Eurosystem counterparties can only obtain credit from the central bank in the country in which they are located by collateralizing eligible assets. With the CCBM, counterparties can obtain credit from the central bank in their country (the home central bank – HCB) on the basis of collateral issued in other countries and transferred to another Eurosystem central bank (the correspondent central bank – CCB). The CCB holds the collateral on behalf of the HCB granting the credit to the counterparty.

Despite the success of the CCBM, market participants identified some drawbacks to this procedure, namely the varying degree of automation among central banks, the differences between domestic and cross border procedures and the resulting lack of standardisation (the use of various communication protocols).

Furthermore, the increase in cross-border use of collateral, which rose from around 10% in 1999 to 50.1% in 2007,

emphasized the need for reconsidering the existing arrangement.

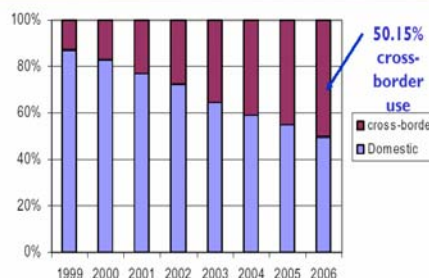
Figure 1. Former framework for delivery the collateral



Source: European Central Bank

Notwithstanding the existence of links between CSDs, the CCBM remains the major channel for the cross border use of collateral for Eurosystem credit operations: in 2007, 82% of cross-border operations were channeled via the CCBM, while the share of collateral transferred via links amounted to 18%.

Figure 2. Situation of the CCBM



Source: European Central Bank

2. The main principles of the Correspondent Central Banking Model project (CCBM2)

CCBM 2 was created for the covering collateralized credit provision for the National Central Banks of the Eurosystem via three channels, namely: the first consists in providing collateral handling functionalities, the second wants to improve the handling of an important part for a successful monetary policy and the third channel is important for allowing intraday credit in central bank money for a fine tuning of the TARGET 2 system.

The principles of the CCBM2 project comply with the user requirements, were established from the discussions and the debates under the staff and experts of the Eurosystem and confirm by the market consultation in July 2007 organized by the European Central Bank. According to the *User Requirements Version 3.0 from 21.01.2008* the CCBM2 project principles are the following:

➤ Principle 1 - *The CCBM2 will provide central banks with an IT platform for the management of eligible collateral used for Eurosystem credit operations, whilst complying with the principle of decentralization of access to credit.* The IT platform provided to the National Central Banks by the CCBM2 sustains the decentralized structure for both credit and collateral relation with the correspondent monetary policy counterparties.

➤ Principle 2 - *CCBM2 is fully compatible with TARGET2 and T2S, in particular the communication interfaces and settlement procedures used by T2S for the mobilization of the securities.* In the future CCBM2 will interact both with the TARGET2 and Target 2 – Securities transactions, through offering standardized interfaces and harmonized messaging protocols.

➤ Principle 3 - *The scope of CCBM2 covers both domestic and cross-border use of collateral, as well as different collateralization techniques*

(such as pledge and repo, pooling and earmarking), depending on the practices of each National Central Bank. The IT platform conferred by the CCBM2 has the main purpose which consists in domestic and cross-border collateral.

➤ Principle 4 – *CCBM2 handles all eligible collateral: both securities and non-marketable debt instruments.* The main functions of the CCBM consists in: keeping records of mobilized securities and making the necessary bookkeeping entries on custody accounts, as well as to process all of the relevant assets services in accordance with local practices.

➤ Principle 5 - *CCBM2 processes collateral transactions in real time on a straight through-processing (STP) basis, permitting the movements of collateral and the related credit adjustments in TARGET2 in real time.* The Swift standard message represents the main communication channel for the communication between counterparties and CCBM2.

➤ Principle 6 - *CCBM2 will be able to take collateral through all eligible (Securities Settlement System) SSS's, and eligible related linkages between them.* The Governing Council of the European Central Bank consider that the links which are eligible for the Eurosystem represent a true alternative for the former CCBM as well as an alternative of collateral after the successful implementation of the CCBM project.

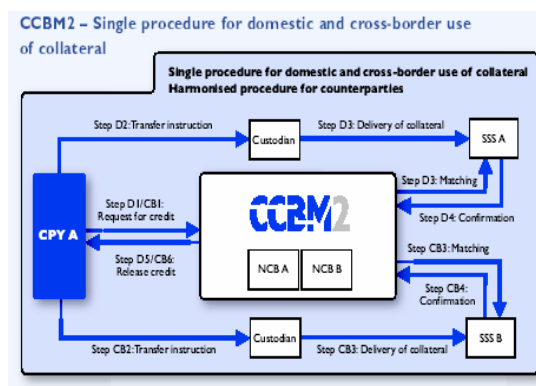
3. The functional modules of the CCBM2

CCBM2 will be a common platform for Eurosystem collateral management, providing greater efficiency and a harmonized level of service across the euro area. First and foremost, it will be a collateral management facility for the Eurosystem, but it will also provide significant opportunities for Eurosystem counterparties to further reduce back-office complexity, optimize the cost

effectiveness of mobilizing collateral and enhance liquidity management.

CCBM2 will offer a centralized IT solution while preserving the decentralized account relations with counterparties. The scope of CCBM2 will go beyond that of the CCBM, which is restricted to cross-border use only, in that it will provide for a single set of procedures for all eligible collateral (both securities and non-marketable assets) used both on a domestic and cross-border basis.

Figure 3



Source: European Central Bank

CCBM2 will realize efficiency gains in that it will operate in real time and on a straight through processing (STP) basis. It will be based on the Euro Collateral Management System (ECMS) platform shared by the Nationale Bank van België / Banque Nationale de Belgique and De Nederlandsche Bank. Furthermore, CCBM2 will be fully compatible with TARGET2 and Target2 Securities, in particular with the communication interfaces of both these platforms and the settlement procedures of Target 2 Securities for the delivery of securities.

Participation in CCBM2 will be voluntary and a modular approach will be adopted. There will be four modules:

(i) the message router (handling all communication, particularly with external parties);

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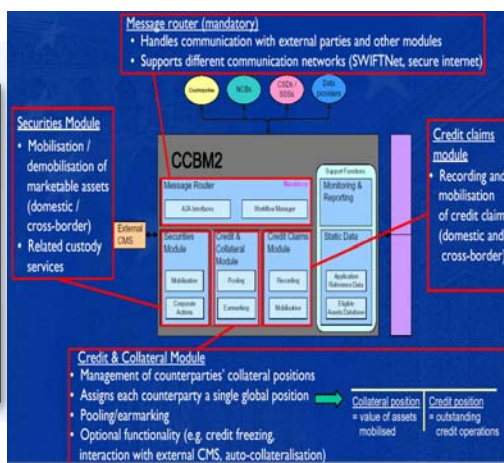
(ii) the credit and collateral module (managing counterparties’ collateral positions);

(iii) the securities module (mobilizing marketable assets);

(iv) the credit claims module (recording and mobilizing credit claims).

For central banks wanting to join CCBM2, only participation in the message router module will be compulsory.

Figure 4. The functional modules of the CCBM2



Source: European Central Bank

4. CCBM2 procedures for market tradable assets

If a counterparty wishes to collateralize eligible marketable assets with their HCB, it instructs the SSS in the country in which the assets are issued to transfer the assets to the central bank of that country (CCB) for the account of the HCB.

The CCB provides the necessary information to the HCB on the delivery and eligibility of the securities, while the HCB processes that information, conducts the valuation process and provides liquidity to the counterparty by means of a cash payment or by increasing a counterparty’s overdraft limit. The HCB will not advance funds until it is certain that the counterparty’s

securities are eligible and have been safely received by the CCB.

If we make an example, the situation will be the following: a Spanish bank wishes to obtain credit from the Banco de Espana (the Spanish central bank) on the basis of marketable assets that it holds in the Italian central security depository. The steps involved will be:

Step 1 – The Spanish bank contacts the Banco de Espania (the HCB), requesting the credit and stating that it intends to use the CCBM2 to mobilise marketable assets that it holds in Italy.

Step 2 – On the basis of the information provided by the counterparty, the Banco de Espana sends a CCBM message to the Banca d'Italia (the Italian central bank) requesting that it receives Italian securities from the counterparty on its behalf. At the same time, the counterparty issues instructions for the marketable assets to be transferred (or instructs its custodian in Italy to transfer them) to an account managed by the Banca d'Italia at Monte Titoli. In this example, therefore, Banca d'Italia acts as the CCB for the Banca de Espana, the HCB.

Step 3 – Once the Banca d'Italia has received the Banco d'Espana CCBM message, it takes all the necessary action to ensure that the marketable assets arrive at its account at Monte Titoli. In the meantime, the counterparty (or its custodians) delivers the marketable assets to the Banca d'Italia account according Monte Titoli's delivery procedures.

Step 4 – If settlement is successful, Monte Titoli sends a confirmation message to the Banca d'Italia.

Step 5 – As soon as the Banca d'Italia receives the confirmation message from Monte Titoli it carries out certain internal procedures, for example finding the price of the assets. It then sends a notification of receipt to the Banco de Espana. The Banca d'Italia holds the securities on behalf of the Banco de Espana, thus effect acting as its custodian.

Step 6 – Having received te notification of receipt, the Banco de Espana grants credit to the Spanish bank.

To improve the level of service provided by the CCBM2, the European Central Bank's Governing Council decided that from January 2004 the HCB and the CCB should aim to carry out their internal procedures (i.e. Steps 2 and 6 for the HCB and Steps 3 and 5 for the CCB) within 30 minutes. This assumes, however, that counterparties and their custodians submit their instructions correctly and that some allowance is made for possible delays at peak times.

As in many cases, custodian banks play an important role in the CCBM processing chain by delivering the marketable assets to the CCB on behalf of the counterparty, the major European credit sector association (the European Banking Federation, European Association of Co-operative Banks) have established *best practices* for custodian banks involved in CCBM2 transactions. These best practices help market participants to make the CCBM2 more efficient, for example: time benchmarks, clear input deadlines and communication channels.

Accordingly, the best practices for market participants involved in CCBM2 operations as agreed by the European Banking Federation, the European Savings Bank Group and the European Association of Co-operative banks are:

1. Custodians shall ensure that customers are informed of their rules and procedures for CCBM2 related instructions. These rules and procedures shall be based, to the largest extent possible, on the official local market practices. Customers must abide by these rules and procedures to ensure a swift and efficient processing of their instructions.

2. Whenever possible, the processing of CCBM2 instructions should rely on automatic procedures. In this respect, electronic communication channels between custodians and their

customers shall be used to the largest extent possible and instructions shall be based on ISO 15022 standards.

3. Under normal circumstances and on a best effort basis, custodians shall submit their customers' CCBM2 related instructions to the local SSS within 30 minutes of their receipt, provided that the instructions are complete and correct and that the customer has the securities to be delivered.

4. Custodian deadlines for the same-day processing of their customers' CCBM2 related instructions shall be 30 minutes before the deadline of the relevant local SSS. However, as good practice, customers are encouraged to submit their instruction queues and to provide the custodian with sufficient time to react to mistakes or unforeseen problems.

5. Market participants shall ensure that information is readily available to their customers to enable them to monitor the status of their CCBM2 instructions.

6. Custodians shall agree with their customers on the usage of the code „CNCB“ – for Central Bank Collateral Management – as a way of identifying and prioritizing CCBM2 related instructions. This code based on the ISO 15022 standards and it indicates that the transaction relates to a CCBM2 collateral delivery/receipt to a national central bank.

7. Given that „CNCB“ code allows custodians to recognize CCBM2 instructions as such, they shall inform their customers, on a best effort basis, of settlement problems within 15 minutes of their discovery.

5. CCBM2 procedures for non-marketable assets

In drawing up the single framework for eligible assets in the monetary policy and intraday credit operations of the Eurosystem, it was decided to include no marketable assets, in particular credit claims. The eligible criteria for these assets are listed in the

implementation of monetary policy in the euro area: General documentation on Eurosystem monetary policy instruments and procedures, ECB, November 2008.

Credit claims transfer, pledge or assignment on behalf of and in the name of the HCB

The transfers/assignments/pledge on behalf of and in the name of the HCB, known as the agency model is the procedure used by the mobilization of credit claims. Under this procedure, the collateral is provided by the counterparty and taken by the CCB on behalf of and in the name of HCB. Non-marketable assets governed by the law of another euro area country can be used by counterparties to obtain credit from their HCB.

The HCB decides, from among the techniques offered by the CCB, whether it prefers to use a transfer of ownership, an assignment, floating charges or a pledge. Counterparties have the possibility to communicate with the CCB via their HCB if the latter is willing and able to provide this service in accordance with the procedures of the CCB.

Non-marketable retail mortgage-backed debt instruments

The assets concerned are non-marketable debt instruments, governed by Irish law, in the form of residential mortgage-backed promissory notes secured by a deed of charge (floating) over a pool of residential mortgage assets held by the issuer. These promissory notes may be used by the counterparties in the context of Eurosystem monetary policy operations of intraday credit operations; these assets are not listed on a regulated market.

In the case of the CCBM2, a counterparty of the Central Bank and Financial Authority of Ireland (CBFSAI), having entered into an agreement with a counterparty of another HCB (an eligible counterparty) may issue mortgage-

backed debt instruments to the CBFSAI as nominee for and for the account and benefit of that eligible counterparty, on the basis of an outright transfer.

The counterparty of the CBFSAI and the eligible counterparty may then instruct the CBFSAI to hold the mortgage-backed debt instruments for the account of another HCB. On receipt of this instruction the CBFSAI informs the HCB that it holds the mortgage-backed debt instruments for the account of this HCB and the mortgage-backed debt instruments are no longer held for the account of the eligible counterparty.

6. Conclusions

In order to maximize the synergies with the T2S project, the Eurosystem decided to launch both projects in parallel. On the one hand, CCBM2 could benefit from the envisaged T2S platform in terms of the settlement services and, on the other, T2S could make use of some of the CCBM2 services in terms of self-collateralization.

In order to meet the needs of all counterparties, the Eurosystem is developing CCBM2 in close cooperation with market participants. Work on the project has already benefited from two market consultations: one on the objectives of CCBM2 and one on the CCBM2 User Requirements. The feedback received has generally been very positive and supportive of the project. On 17 July 2008 the Governing Council of the ECB decided to launch the CCBM2 project and approved the CCBM2 User Requirements as a basis on which to draw up detailed technical specifications. It also assigned the development and operation of CCBM2 to the Nationale Bank van België / Banque Nationale de Belgique and De Nederlandsche Bank, with a view to commencing live operations either before or – at the very latest – at the same time as T2S, subject to the outcome of a further detailed analysis of the synergies with T2S.

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