Annual Payments Week 2007

Bahia, Brazil, November 27-30, 2007

From TARGET(1) to TARGET2

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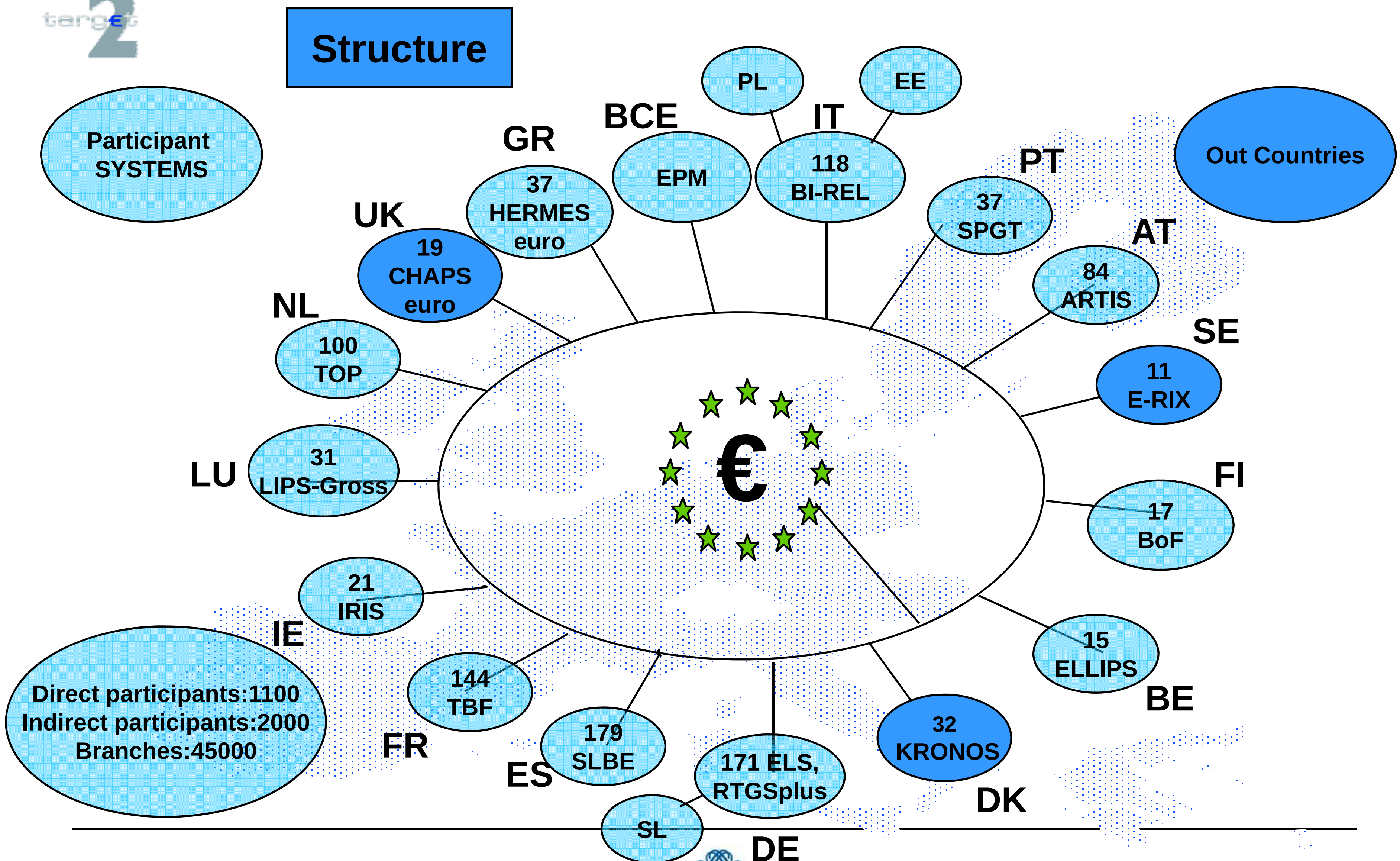
The introduction of real-time gross settlement systems

The development of RTGS was one of the guidelines set in the Report *'Minimum common features for national payment systems'* established by the Committee of Governors in 1993, as a strategy to be adopted in view of the launch of the Monetary Union and the transition to the Euro.

The European scenario: the TARGET(1) system



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The European scenario: TARGET1, why and how?

Why did we build TARGET?

- To contribute to the smooth conduct of monetary policy and the singleness of the money market
- To increase the efficiency of cross-border payments in euro
- To improve the soundness of payment systems (reduction in systemic risk)

How did we build TARGET?

- Decentralization principle (settlement accounts held with NCBs)
- Minimum approach with regard to harmonization of national RTGS systems

The European scenario: TARGET1, why and how? (2)

- **AREAS OF HARMONIZATION**
  - INTRADAY LIQUIDITY
    - Free, unlimited, wholly collateralized
    - Based on overdraft or repo
    - Same kind of securities to be used for monetary policy and payment systems
  - FEES
    - Cost recovery
    - Avoid negative effects on the conduct of the monetary policy
    - Guarantee uniform conditions to participants
  - OPERATING HOURS
    - Facilitate the conduct of the common monetary policy
    - Reduce *Herstatt* settlement risk

The European scenario: the TARGET1 system

The main achievements

- Levelling of European monetary market rates

- Increased efficiency of the payments system: *retail payments increased from 16% of the total amount of transactions settled in TARGET in 1999, to 53% in 2006*

- In 2006 about 60% of the total amount of large-value payments in euro (90 % in terms of value) were settled in TARGET (70% in terms of value and 52 % in terms of volume in 1999)

- Large technical availability of the system *(99,8% in 2006, compared to 99,4 foreseen in the Target Guideline)*

- TARGET is the biggest payment system in the world: *from end 2006, on average 2,003 billion euro (314,000 in figures) settled per day (more than USA Fedwire)*

The European scenario: the TARGET2 system

Principles and structure of TARGET2

(Decisions of the ECB Governing Council of 24 October and of 21 November 2002)

- System based on many platforms, which will offer the same core services
- Implementation of a single shared platform (SSP)
- Possibility for single central banks to offer additional services at a domestic level
- Single fee scheme at European level for core services relative to domestic and cross-border payments; ad hoc fees for additional services
- Application of the 'full cost recovery' principle, attenuated to take into account the positive externalities of the system (so-called *public good factor*)
- Decentralized relationships between NCBs and the relevant banking communities

The European scenario: the 3CBs proposal for the Single Shared Platform

- Common proposal of Banca d'Italia, Banque de France and Bunsdesbank (='3CBs') for the concept, development and operation of the Single Shared Platform (SSP)
- Building Block approach: compromise between 'building from scratch' and using an existing system
- Neutral project and operational organization

The European scenario: the TARGET2 system

TARGET2 single platform

- October/November 2002: **the *Governing Council* decides on TARGET2 principles**

- JULY 2003: **Banca d'Italia, *Bundesbank* and *Banque de France* (3CBs) communicate to the ECB their decision to implement a new system to offer as a single platform (SSP) for TARGET2 (*building block approach*)**

- October 2003: **the SSP of the 3CBs is presented to the Eurosystem and to the banking community**

- September 2004: **the Eurosystem defines the *common governance* for TARGET2**

- December 2004: **the *Governing Council* approves the SSP of the 3CBs and mandates them to implement and operate the SSP**

- January 2005: **adhesion of the NCBs (with the exception of Sweden, later followed by the UK) of the SSP project**

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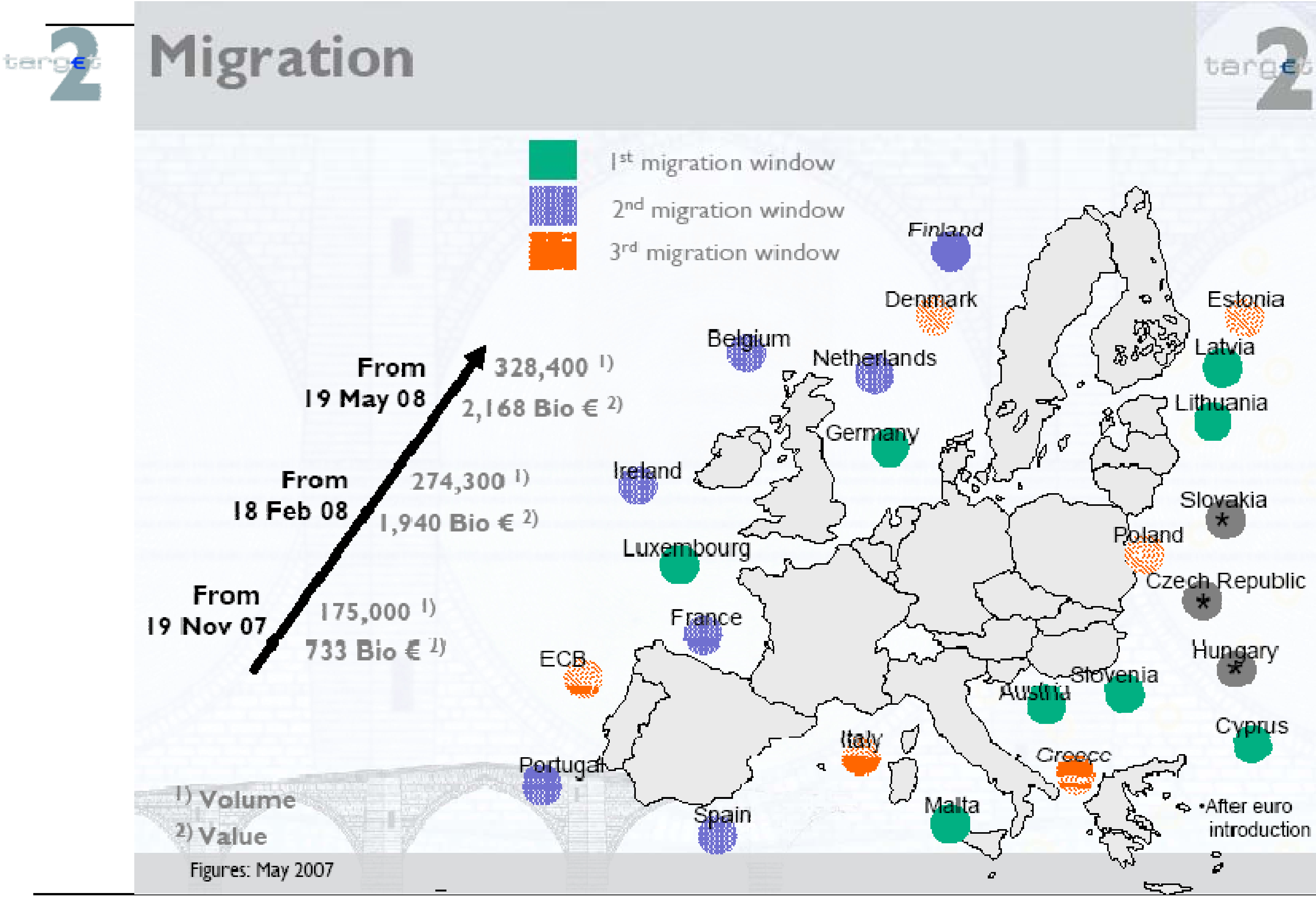
The European scenario: the TARGET2 system

The *governance*

Level 1	ECB Governing Bodies	Strategic direction and control of TARGET2 as for legal framework, financing, core services and their fees, common methodology to record costs, risk management, migration
Level 2	PSSC	Decision on matters delegated by L1 as for additional services and their fees, platform design and development, service level agreement with L3, budget, cost analysis
Level 3	3CBs	Support participating NCBs, draw up administrative and technical documentation, test, migration, SSP evolution

The European scenario: the TARGET2 system



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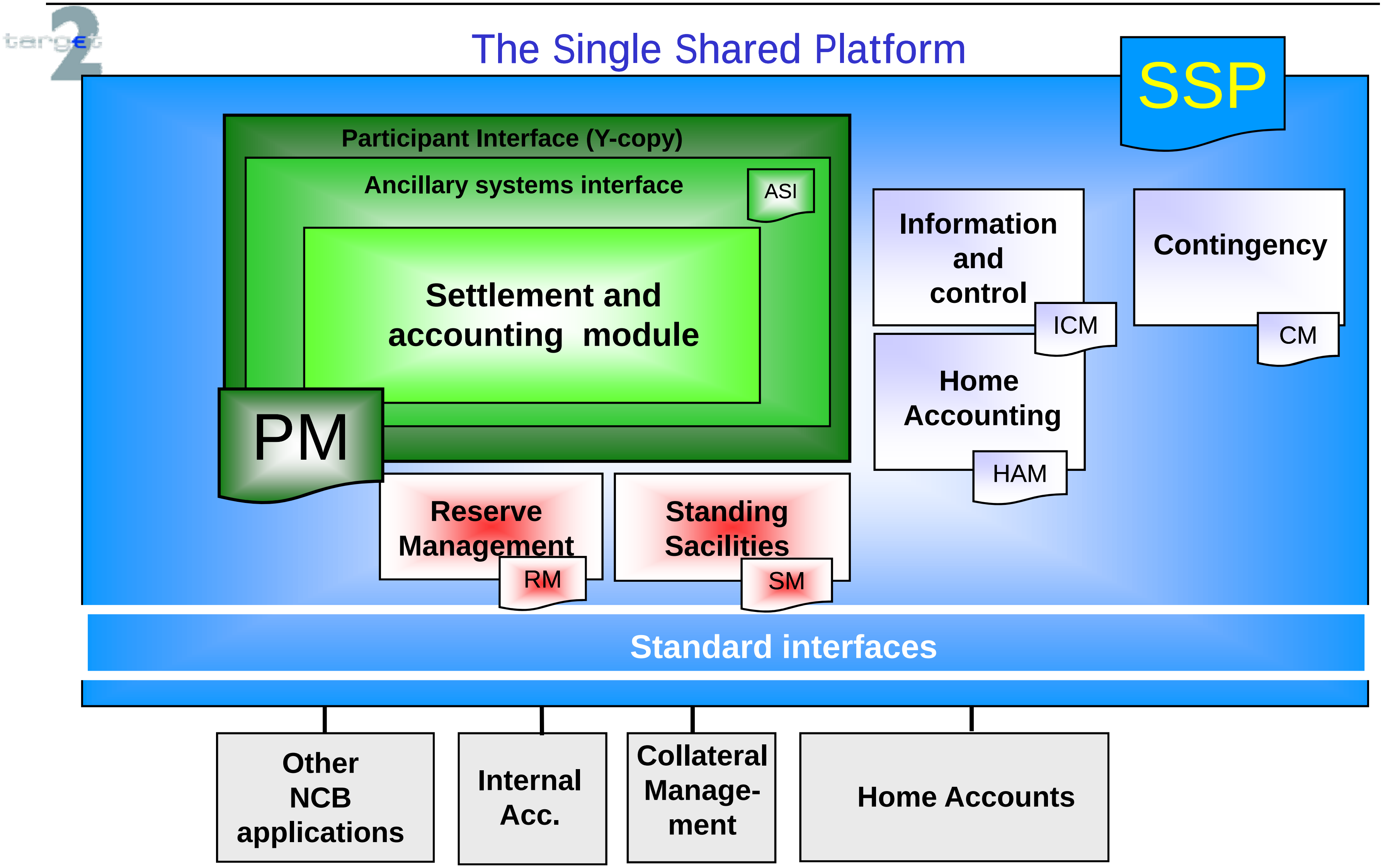
The European scenario: the TARGET2 system



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The European scenario: the TARGET2 system

Single Shared Platform (SSP) components

Mandatory use

1. **Payment module (PM)**
   - Participation
   - Operations
   - Liquidity management
   - Liquidity pooling (optional use)
   - Ancillary system settlement
   - Fees structure
2. **Information and control module (ICM)**
3. **Contingency module (CM)**

Optional use

1. **Home accounting module (HAM)**
2. **Reserve management module (RMM)**
3. **Standing facilities module (SFM)**
4. **Data Warehouse (DW)**
5. **Customer Relationship Management (CRM)**

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The European scenario: the TARGET2 system

SSP: PM Participation

Direct participants

- have direct access to the PM (using its own SWIFT interface or using a service bureau)
- have an RTGS account in the PM
- have access to real-time information and control measures via ICM
- ... and can provide an indirect connection to the PM for other institutions as ...

Indirect participants

- send and receive payments to/from their direct participant
- are linked to one direct participant only
- have no own RTGS account in the PM, their payments are settled on the RTGS account of its direct participant

are registered in the PM and can be indirectly addressed

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The European scenario: the TARGET2 system

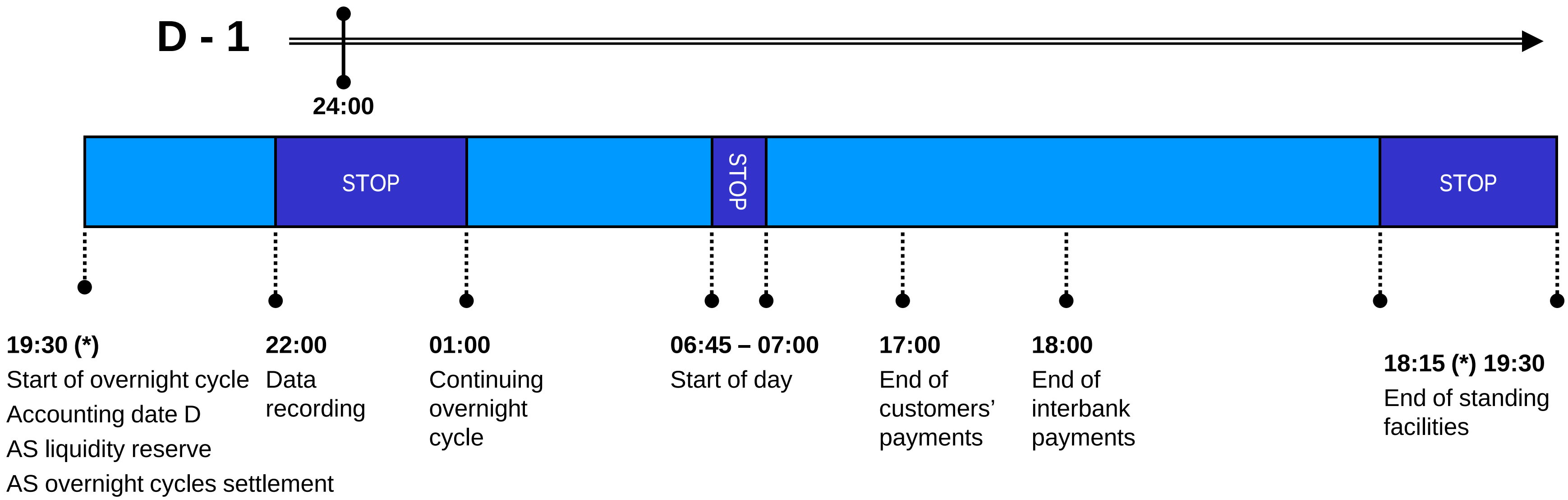
SSP: PM Operations

- **All RTGS payments can be processed**
  - Individual payments should be settled real-time and with central bank money
  - No limit amount
  - No processing of bulk payments

- **Processing of**
  - Credit orders
  - Direct debits

The European scenario: the TARGET2 system

The operating day



Unlike today, TARGET2 operating day will start on the preceding day in the evening.

The European scenario: the TARGET2 system

SSP: PM Liquidity management

Sources of liquidity

- Balances on RTGS accounts
- Provisions of intraday liquidity
- Offsetting payment flows (i.e. using algorithms to settle a number of queued payments)

Liquidity management tools offered to the participants

- Priorities
- Reservation facilities (highly urgent reserve, urgent reserve, dedicated liquidity)
- Limits (bilateral and multilateral)
- Timed payments
- Queue management
- Liquidity pooling

The European scenario: the TARGET2 system

SSP: Business continuity