



# TARGET2 Newsletter

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The **objective** of the TARGET2 Newsletter is to inform the user community and the general public about relevant issues surrounding the TARGET2 system in operation.<sup>1</sup> The Newsletter contains articles of special interest, and provides insights and opinions from relevant system participants.

## Introduction

The third issue of the TARGET2 Newsletter was published on 22 October 2010. Since then the TARGET2 system has continued to perform smoothly, with the TARGET2 Single Shared Platform (SSP) achieving 100% availability. In the second half of 2010, TARGET2 settled a daily average of 336,047 transactions with an average daily value of €2,281 billion. With a market share of 60% in terms of volume and 91% in terms of value, TARGET2 maintained its dominant position in the market for large-value payments in euro. The stability of TARGET2's market share confirms banks' strong interest in settlement in central bank money. In total, 23 central banks of the EU and their respective user communities are connected to TARGET2: the 18 euro area central banks (including the ECB)<sup>2</sup> and five central banks from non-euro area countries.<sup>3</sup>

The Eurosystem has recently finalised the implementation of system release 4.0 (November 2010) and has defined the content for system release 5.0 (November 2011). In system release 4.0, the Eurosystem has implemented internet-based access to TARGET2, which consists of an alternative connection mode to the SSP that offers direct access to the main TARGET2 services, but without requiring a connection to the SWIFT network. The service was developed mainly for smaller European institutions interested in holding an account with their central bank for basic services only, particularly in those countries in which proprietary home accounts (PHAs) are being phased out.

The Eurosystem has defined the final content of TARGET2 SSP release 5.0, which was communicated to TARGET2 users on 15 November 2010 via the TARGET2 website and via the national user groups. In line with the regular release management process for SSP releases, the user community was closely involved

- 1 In the following paragraphs, the references made to the first-generation TARGET system (which was in operation from January 1999 to May 2008) are also applicable to its second-generation successor, TARGET2 (which has been in operation since November 2007). Indeed, the second-generation system continues to provide euro RTGS services, but with significant improvements. This is the reason for both the first and second-generation systems being referred to as "TARGET" in many instances in this newsletter, i.e. no distinction is made between TARGET and TARGET2.
- 2 The central banks of Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Portugal, Slovenia, Spain and the Netherlands, as well as those of Malta and Cyprus, which joined the euro area in January 2008, Slovakia, which joined the euro area in January 2009, and Estonia, which adopted the euro on 1 January 2011.
- 3 Denmark, Poland, Latvia, Lithuania and Bulgaria.



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throughout the whole process in defining the content of this annual release. The 2011 release mainly comprises a limited number of enhancements to the maturing TARGET2 system. In addition, the release will install a contingency network between the central banks of the Eurosystem to ease the processing of critical payments on behalf of TARGET2 users in the event of a regional or global SWIFT outage. The release will go live on 21 November 2011.

### **About the TARGET2 Newsletter**

The fourth issue of the TARGET2 Newsletter contains two special interest articles: the first, prepared by Domenico Scaffidi of Iccrea Bank (Italy), is an overview of the SWIFTNet InterAct service for small and medium-sized banks; and the second presents an analysis of retail payments in TARGET2. There are also two boxes: one providing information on items recently published on the TARGET2 website; and one providing information on the main TARGET2 indicators in the second half of 2010, together with two charts depicting TARGET2 traffic trends in detail. The final part of the Newsletter includes a calendar of events and details of where to find further information on TARGET2.

The fifth issue of the TARGET2 Newsletter is scheduled for publication in the third quarter of 2011.

### **Recently published on the TARGET2 website**

<http://www.ecb.europa.eu>

- 04/03/2011: SSP release 4.01 from 21 March 2011 in production. Updated list of pending bugs
- 02/03/2011: Delivery of User Detailed Functional Specifications (UDFS) SSP release 5.0 - Books 1, 2 and 4 and related documentation
- 21/02/2011: Communication to the user community on SSP release 6.0 - First user consultation and main milestones
- 13/01/2011: Summary of the joint meeting of the TWG and the WGT2 (November 2010)
- 10/01/2011: BACS and CC&C (IE) ceased operations
- 07/01/2011: New country profile for Romania (will connect to TARGET2 in July 2011)
- 03/01/2011: List of TARGET2 participants
- 22/11/2010: Information guide for TARGET2 users (version 4.0)
- 17/11/2010: Revised table with settlement times of ancillary systems
- 16/11/2010: Go-live confirmation of the SSP release 4.0 as scheduled on 22 November 2010
- 15/11/2010: Final release content of the SSP release 5.0
- 10/11/2010: Errata UDFS v.4.01 for the SSP release 4.0
- 09/11/2010: Update of AS profile for EUR-EKS (LV)
- 05/11/2010: Update of AS profile for BISERA7-EUR (BG)
- 05/11/2010: Revised table with settlement times of ancillary systems
- 02/11/2010: Routing and mapping of payments and ancillary system transactions, version 3.0
- 02/11/2010: UDFS v.4.01 for the SSP release 4.0
- 28/10/2010: Update of country and AS profiles for Estonia
- 28/10/2010: Update of AS profile for LCH CLEARNET (FR)
- 22/10/2010: TARGET2 Newsletter issue number 3, October 2010

## Special interest article

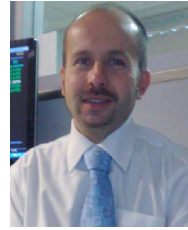
### SWIFTNet InterAct – diving into the present (and future) with small and medium-sized banks

By Domenico Scaffidi

Head of Applications Settlements Office and Operative Desk Target2

PF EBA Emergency Procedure

Iccrea Bank



Many of you may well remember bank treasury departments of not even ten years ago, the frenetic, and sometimes chaotic, activities of treasury staff taking payment orders and investment instructions via telephone, fax and email, sticking notes to desks and computer screens haphazardly located around the office, inserting and ejecting PC diskettes as they tried to deal with their clients' requests in a patchwork world of emerging, and dying, technology and IT systems that could not or would not talk to each other.



I have been working on the development of IT systems for banks since those exciting though difficult times and I can remember very well how things used to be. Indeed, how could I ever forget! Whilst treasury department staff certainly had their share of challenges working in such conditions, it was down to us IT chaps to sort out this confused scene. And so, after hours, days, entire weeks and even months spent in the treasury department watching how things were done, talking with dealers about their needs and difficulties, holding meetings to try to unscramble a set of solutions that could bring order to this chaotic world, off I went with my colleagues to conjure up something that would help my bank to operate more efficiently in the new era of electronic financial services.

It was a challenge that truly fascinated me. I would even say that it fascinated me almost as much as my passion for scuba-diving around Sardinia, the island from which I come. There is actually a surprising parallel between my IT work with banks over this last decade and my favourite hobby. In both I have had to dive and delve deeply into uncharted waters, observe and note what I have seen, before resurfacing with a mental map. For my scuba-diving the map serves mainly to recall my dives. In the more serious banking world, where there is so much at stake for banks and their clients, and where minutes or even seconds can make a difference to service quality and the bottom line (and very often both), that map is an initial blueprint for a new tool to help operators navigate their way among the reefs, gullies and often stormy waters of the world of financial services.

SWIFTNet InterAct is a tool which, I can confidently say, has managed to achieve this with flying colours. Initially launched in 1996, it has been revamped and now offers a wide range of functions that will make life much easier for the staff in treasury departments and for their customers. My treasury colleagues will already be familiar with some of these functions, so I will focus only on a few aspects of this new system.

### **Access to SWIFTNet InterAct**

SWIFTNet InterAct enables banks to access the TARGET2 SSP directly from their own systems. This can be done using either of the two access modes – user-to-application (U2A) and application-to-application (A2A).

The information and control module (ICM) is the interface through which access to interactive services offered by the platform is obtained. Within the ICM, the SWIFTNet Browse service allows the system to query and obtain information in real time relating to, for example, queued payments, the participants in the system (TARGET2 directory) and account balances and to execute certain management operations (e.g. cancelling of queued payments, changing the status of priority payments, managing of cash reserves, etc.) .

The ICM also enables liquidity transfers to be made between deposit accounts and payments module (PM) overnight liquidity reserves for the settlement of ancillary systems, liquidity to be moved to/from home accounting module (HAM) accounts and payment orders to be executed in backup situations.

### **Messaging services on SWIFTNet InterAct**

SWIFTNet InterAct is a messaging service for financial institutions to exchange messages formatted in accordance with the XML-based SWIFT MX standards. SWIFTNet InterAct offers increased flexibility: in addition to store-and-forward messaging, it also supports real-time messaging and real-time queries and responses.

SWIFTNet InterAct should be used by those business areas for which the new XML-based MX standards are more suitable. With SWIFTNet InterAct, institutions and communities can exchange messages in an automated and interactive way, i.e. an application sends a request message to another application and receives an immediate response message.

It is important to note that SWIFTNet InterAct has now overcome a message size limit that characterised previous versions of the A2A oversized data management and had caused users some difficulties. Until recently, the submission of an InterAct request over 100 kB would trigger a rejection response from the system. In the new ICM module, if the request exceeds the 100 kB limit by 10 to 100 kB an alert response is generated, but the request will still be transmitted by the system via the SWIFTNet FileAct service.

Lastly, it is worth noting that for the banks that are already connected to the SWIFT network the infrastructure investment required is minimal. In fact, the only update expected on networking products SAA and SAG is in regard to the security phases.

### **The following is a list of the main messages handled by the ICM module:**

- GetAccount and ReturnAccount
- GetTransaction and ReturnTransaction
- ModifyTransaction and CancelTransaction
- GetLimit and ReturnLimit
- DeleteLimit
- GetMember, ReturnMember and ModifyMember
- GetBusinessDayInformation and ReturnBusinessDayInformation
- GetCurrencyExchangeRate and ReturnCurrencyExchangeRate
- GetGeneralBusinessInformation and ReturnGeneralBusinessInformation
- LiquidityTransfer
- BackUpPayment
- ModifyStandingOrder

**The principal functions are as follows:**

- Liquidity management
- Account information
- Credit line
- Liquidity transfer
  - between accounts of the same participant
  - between two accounts of a group of accounts
  - between the RTGS account of a co-manager in the PM and co-managed accounts
- Standing order liquidity transfer
- get, define and modify standing order liquidity transfer
- Limit management
- get, define, modify and delete limit, standing order limit and current limit
- Reservation
- get, define and modify reservation, current reservation and standing order reservation
- Management of the payment queue
- Get payment
- Cancel payment
- Reordering of payments
- Change priority
- Change execution time

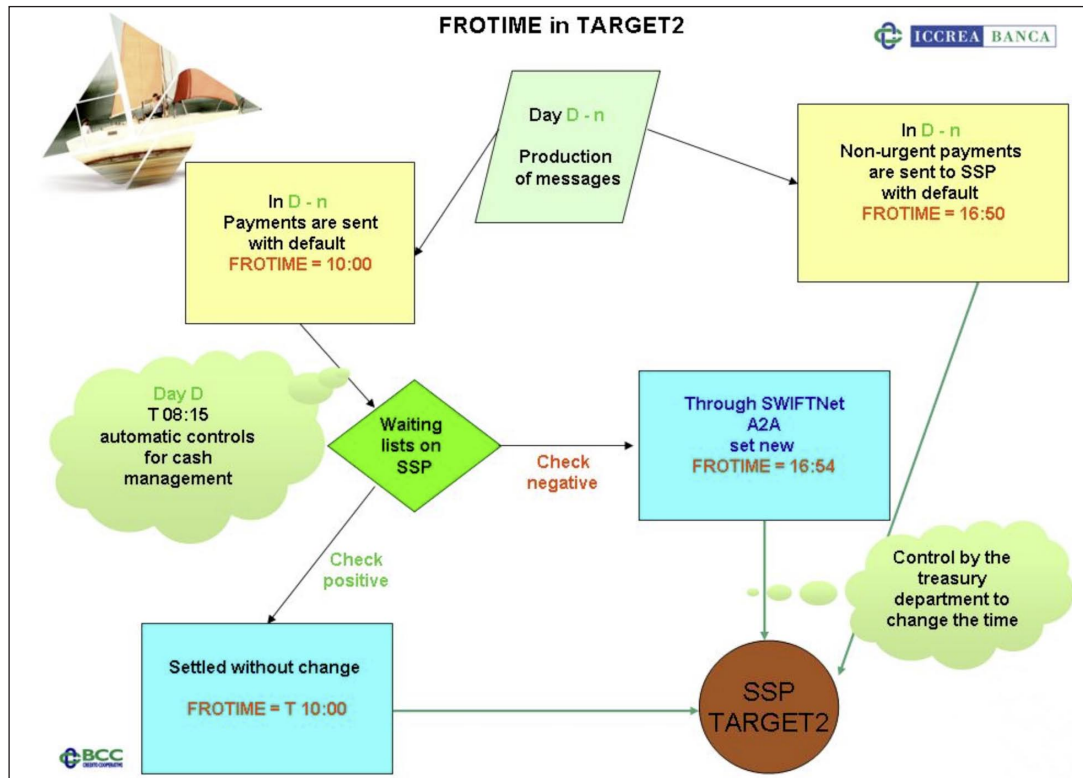
Let us look briefly at four key functions that SWIFTNet InterAct provides to banks in Europe. These are offered through four different modules within the SWIFTNet InterAct system:

**Timed payments**

The innovative operational features of TARGET2 include the use of „timed payments“ (which can be timed either as „TILL“ or „FROM“). For instance, the “FROM” timing tool enables the bank to execute payments every single day at the most advantageous time for the bank, whilst ensuring that it fully respects all existing commitments and responsibilities within the settlements system. In addition, a counterparty to the bank (for example, Bank B which is expecting a payment from Bank A) is able to view a payment before it is unlocked (and hence settled in the counterparty’s PM account) in the knowledge that being able to view the payment is effectively a guarantee that settlement will occur.

Naturally this offers significant benefits to both banks using the system and also to the system as a whole. The liquidity management on any given day is optimised for the bank, the counterparties are reassured that payments due will be made and can therefore draw up their own settlement schedules, thereby greatly reducing the risk of detrimental knock-on effects – or even systemic failure – due to failed or delayed settlement of payments or, more simply, in the event of difficulties in sending messages over the network (if, for example, they have not been made available in the SSP).

The chart below depicts how Iccrea Bank processes the payments, using “timed payments”:



### Management priorities

The system allows the operator to determine rules used for the allocation of priority codes (i.e. high, urgent and normal) to payments, and check that these conform to the standard required for that specific payment transaction by the ECB. Priority codes can subsequently be modified (e.g. from “normal” to “urgent” or vice-versa) via the SWIFTNET InterAct service in A2A mode. The treasury service of the bank can, in turn, modify these rules in order to, for example, optimise the management of liquidity based on the pattern of payment provisions in the market. All this enables the bank to respond flexibly to changing priorities caused by changes in the market.

### Cash management

A wide range of interactive services are offered through this module, providing information on transactions and accounts, as well as enabling cash management prerogatives to be optimised.

#### These include, for instance:

- Liquidity management
- Account information
- Credit line
- Liquidity transfer
- Standing order liquidity transfer
- Limit management
- Reservation

#### Management of the payment queue

- Get payment
- Cancel payment
- Reordering of payments
- Change priority
- Change execution time

Last, but not least, it should be noted that the ICM module also enables the operator to continue to work on cash management even under contingency situations.

The screenshot displays the 'Cash Management' interface. The left sidebar contains a navigation menu with the following items: AMMINISTRAZIONE, CANALI E REGOLE, ANAGRAFICHE, TESORERIA (with sub-items: CONTO RTGS, CASH MANAGEMENT, QUADRO PREVISIONALI, QUADRO STATISTICO), PAGMENTS PROCESSOR, ESTRATTORE DATI, FUNZIONI DI SERVIZIO, MENU COMOVIMENTATE, MENU TRAMITATE, and MOBILIZZAZIONE ROB. The main content area is titled 'Cash Management' and includes a 'Data Riferimento' of 12/11/2010. It features several sections: 'Availability accounts', 'System Status', 'Credit Lines', 'Liquidity Transfer', 'Limits Management', 'Reserve Management', and 'Payments Management'. Each section contains a list of services with radio buttons and columns for request and response counts and times. For example, under 'Availability accounts', there are services like 'GetAccount\_PM', 'GetAccount\_RM', 'GetAccount\_HAM', and 'GetAccount\_SF'. The footer of the page reads: 'ICCREA Banca S.p.A. - Servizio Applicazioni di Mercato - E-mail: appregol@iccrea.bcc.it Tel. 06.7207.5530 - Build 8'.

## Co-management of HAM accounts

This specific service allows the transfer of funds between one HAM account and another HAM (or PM) account. Both of these operations can be made either within your own home country or to another country adhering to TARGET2.

In addition to the transfer of funds from the PM account to the co-managed HAM account of the same bank, this module also allows authorisations to be made for any entered HAM account transactions, and the display of any payments (debits or credits) made to/from the HAM account.

More sophisticated services are also available. Let us imagine, for example, that payments are stuck in an external list with a status of “pending” (due to insufficient funds in the HAM account); the application can automatically generate a payment from the PM account (debiting the corresponding co-managed account) to the co-managed HAM account of the relevant bank, thereby allowing the settlement of the transaction.

## The power of co-managed accounts

For obvious reasons, many banks, and not necessarily only smaller ones, prefer to focus their investments and manpower on the market, and probably do not consider it worthwhile structuring a treasury department specifically for the monitoring of a TARGET2 account. Indeed, in this case they will often opt to designate another bank to co-manage their HAM account.

The SWIFTNet InterAct service offers this facility to banks that offer a co-management service, enabling them to monitor in real time the HAM account balance of their client. Appropriate triggers can also be defined to, for example, identify payments that have not been settled due to a lack of available funds. Furthermore, the system allows these payments to be cleared through an automatic transfer (by an MT-202 SWIFT FIN message) from the co-managed PM account to the co-managed HAM account of the bank.

Co-managed accounts thereby enable client banks to access a range of tools without the need to make investments in technology themselves (all the tools are held by the co-manager bank – the client bank simply needs to access them).

### **Iccrea Bank – A successful experience with SWIFTNet InterAct**

Iccrea Banca S.p.A. (Iccrea Bank) is the company within the Iccrea Banking Group responsible for acting as an intermediary between Italian cooperative banks and other institutions in the settlement system. As such, Iccrea Bank is perhaps an ideal example of how SWIFTNet InterAct can be used to extend the use of vital services to smaller banks that would otherwise have to develop their own systems for these purposes.

To date 325 Banks have joined TARGET2 through Iccrea Bank:  
25 indirect participants in the HAM  
300 other indirect participants

Banks that have a HAM account but lack the technology to access it have granted Iccrea Bank the right to co-manage their HAM accounts, enabling them to make use of the following features/ services:

- Automatic coverage of pending operations
- Automatic surplus withdrawals
- Funds transfer functions

The TARGET2 project is an important milestone in an evolution (some would say revolution) that has occurred over a number of years and has drastically improved the way banks can work together in Europe. For Iccrea Bank in Italy, it has also led to many cooperative banks coming to us to use our services in order to access the RTGS system for their dealings with the ECB and with other Italian and European financial institutions.

### **Conclusions**

We all know that the overdriving goal of banks today is to be as competitive as possible, offering the best possible level of service to their customers, whilst maximising the efficiency of their business processes. The SWIFTNet InterAct service allows banks to achieve substantial benefits in terms of personnel and time optimisation and reduced administrative costs, whilst at the same time significantly improving the traceability and transparency of payment transactions.

The key merits of SWIFTNet InterAct, in my opinion, are the new service possibilities it offers for small or medium-sized banks (of which there are still many in Europe) that otherwise, due to investment or other resource constraints, would be unable to take advantage of such an opportunity without having to make unviable commitments in terms of personnel, time, and money in developing their own alternatives. In the current economic climate, this is truer than ever; there is no time more suitable than now for banks to take a closer look at how SWIFTNet InterAct can help improve their services.

Obviously, much more can still be done to further improve our information systems in the future. But that is a topic for another article. Right now, there is just one small task left for me to take care of at the end of another challenging working day deeply submerged in the oceans of the banking sector's IT systems – to project myself ten years into the future, when all processes are automated and all platforms are seamlessly integrated. I am sitting ever so serenely in front of my screen, simply following the applications that communicate with each other, when, all of a sudden, the following message appears: „Warning! An error has been detected between the keyboard and the chair. Reinstall the user, and then restart Windows.” This is as good a moment as ever for me to put on my scuba-diving suit.

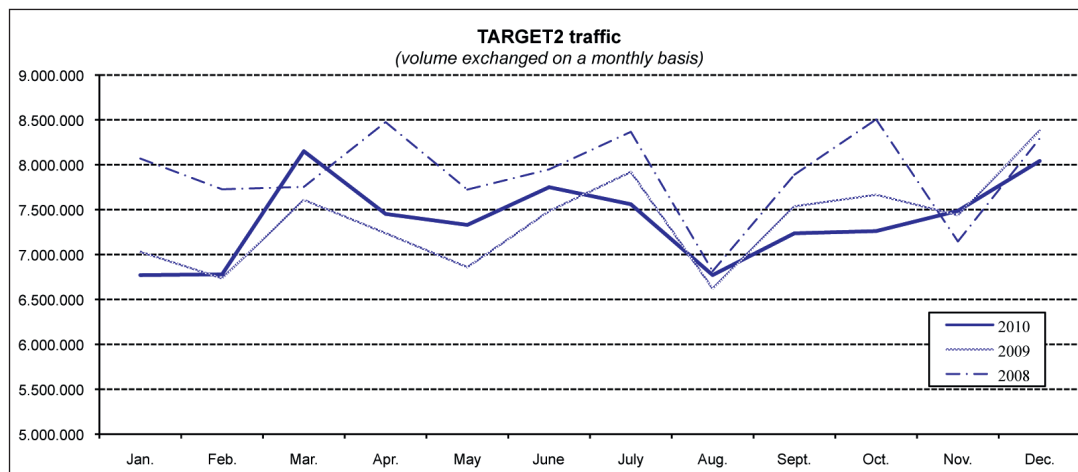


## Main TARGET2 indicators in the second half of 2010

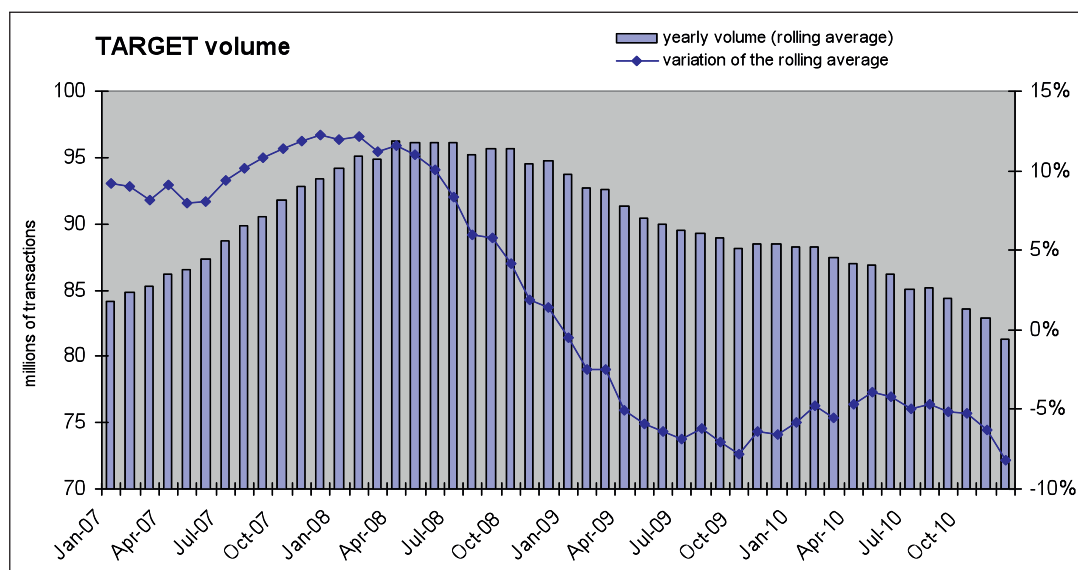
In the second half of 2010 TARGET2 processed a daily average of 336,047 payments, representing an average daily value of almost €2.3 trillion.

- The average value of a TARGET transaction was €6.8 million.
- 66% of TARGET payments had a value of less than €50,000.
- The peak day was 30 September 2010, with 475,913 payments.
- TARGET2's share of total large-value payment system traffic in euro was 91% in value terms and 60% in volume terms.
- The availability of the system was 100%.
- 99.99% of TARGET2 payments were processed in less than five minutes.

## TARGET2 traffic



## Cumulative volumes



## Special interest article

### Retail payments in TARGET2

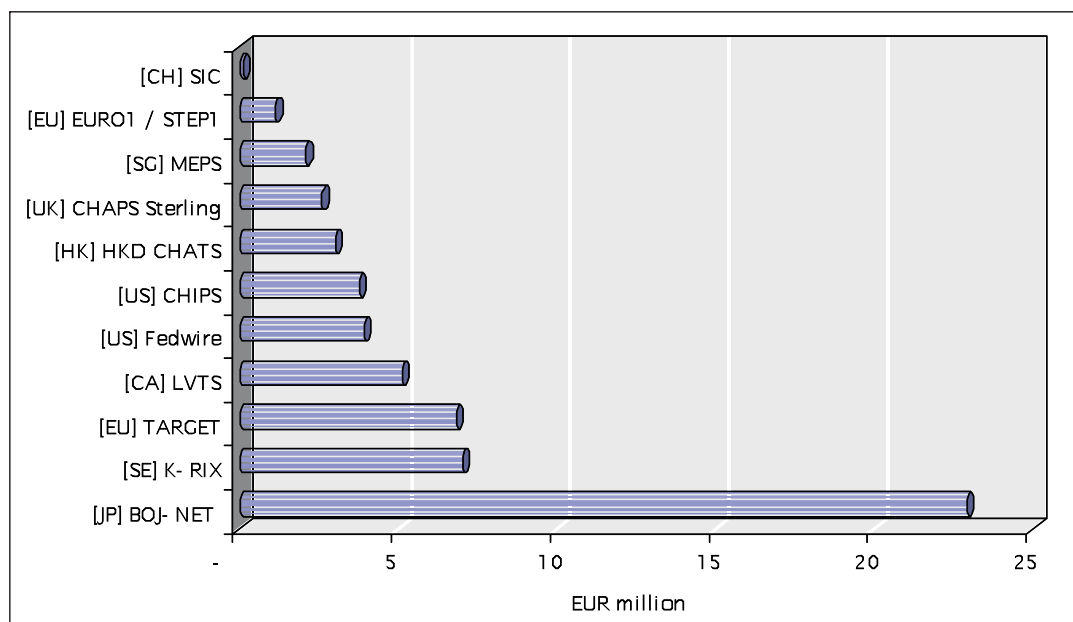
*The issue of settlement of retail payments in real-time gross settlement (RTGS) systems and the blurring of the boundary between large-value and retail payment systems has long been debated. Indeed, everywhere around the world it is possible to observe that large-value payment systems are increasingly being used to settle smaller transactions. The aim of this article is to investigate the trend in TARGET2 and how it may affect the future development of the system.*

In market infrastructure terminology, “large-value payment systems” (LVPS) are funds transfer systems which primarily handle transactions which are of large value and highly time-critical, whereas “retail payment systems” typically settle transactions of relatively low value and low urgency. A further difference between the two types of system is that transactions settled in LVPSs are mainly conducted between banks or between participants in the financial markets, while retail transactions are typically initiated by and made to individuals or non-financial institutions. However, although these definitions make a distinction between the two systems, as a rule no minimum threshold is set for payments made in large-value systems and such systems are in practice also extensively used to settle low-value transactions.<sup>4</sup>

#### The international trend

Looking at the payment traffic in the major large-value payment systems of countries which are members of the Committee on Payment and Settlement Systems (CPSS), it is possible to find evidence of the use of RTGS systems for low-value payments. Chart 1, for example, depicts the average value of transactions in the major RTGS systems in the world. There are clear differences between the systems at the two ends of the picture, namely the Swiss SIC and the Japanese Boj-Net, and the rest of the RTGS systems. The SIC is actually an integrated system, designed to process in real time both retail and large-value transactions on a transaction-by-transaction basis. This explains the low average value of payments, which is only €0.1 million. Conversely, Boj-Net is a pure LVPS which processes transactions only of large value and high urgency. The average values of payments in the other systems range from €1.1 million (EURO1) to €7 million (K-RIX, Sweden). TARGET2 is towards the higher end, just behind K-RIX, with an average payment value of €6.2 million.

**Chart 1: Average value per transaction (2008)**



Source: CPSS Red Book (2009).

<sup>4</sup> In the absence of a unanimously agreed definition, the threshold used to differentiate between low-value and high-value transactions is that used in Regulation (EC) No 2560/2001 on cross-border payments in euro, which is €50,000.

To better understand the striking difference observed between the Japanese system and the other systems, the distribution of payments can be split into value bands. This helps to identify whether the transactions processed are largely distributed around the average value or the distribution of payments is very wide (the former meaning that, besides large-value payments, the system processes a large number of low-value payments). Strong evidence of the latter is observed when considering the median payment of some of the systems under analysis. For instance, in Fedwire Funds and CHIPS (both United States) the median payment values were slightly higher than €28,000 and two-thirds of transfers were for amounts of less than €80,000.<sup>5</sup> In CHAPS (United Kingdom) and in LVTS (Canada) the median values are equivalent to approximately €35,000. In TARGET2, for which we have more recent data, the median value of payments is currently around €10,000, confirming that the large-value transactions are offset by a large number of smaller ones.

Regardless of definitions, in reality the world's largest RTGS systems process a very large number of low-value/retail payments that have de facto become part of their business model. Although RTGS systems were designed primarily for a different business model, the boundary between large-value and retail payment systems is clearly becoming blurred. More difficult to explain are the reasons why this is happening, especially when considering that the prices charged by RTGS systems are far higher than those typically charged by automated clearing houses (ACHs). Most probably, the features offered by RTGS systems in terms of finality, traceability and time-criticality better meet the needs of the submitting participants, notwithstanding the higher costs. RTGS systems could also present advantages in terms of reachability of the counterparty, which in some countries may be better than in ACHs, especially if the ACH has a strongly tiered structure with only a few direct participants. An additional reason for the use of RTGS systems for retail transactions could be the advantages associated with the use of a single channel. In some countries, banks have to be connected to the RTGS system for mandatory operations with their central banks. With such an interface already in place, some participants (i.e. small institutions) may prefer to also use it for retail transactions in order to avoid duplicating the channels for the settlement of their payments.

Overall, it is possible to conclude that there is a demand for retail/low-value payments in RTGS systems, and this is an international phenomenon that operators cannot ignore, in particular taking into account the fact that, presumably, systems operating on a cost recovery basis cannot recover costs without maintaining their share of retail traffic.

### **The trend in TARGET2**

The Eurosystem, as TARGET2 operator, has carefully monitored the evolution of retail traffic in TARGET2. Starting from the definition of retail payments as “transactions of low value that are typically initiated by and made to individuals or non-financial institutions”, the developments related to TARGET2 payment traffic were analysed from the perspective of the value of the transactions settled (i.e. low-value or large-value) and of the type of transaction settled (i.e. retail payments or wholesale/interbank payments). The analysis revealed that more than two thirds of TARGET2 traffic now consists of payments of low value, and that these are mainly payments between individuals/non-financial institutions.

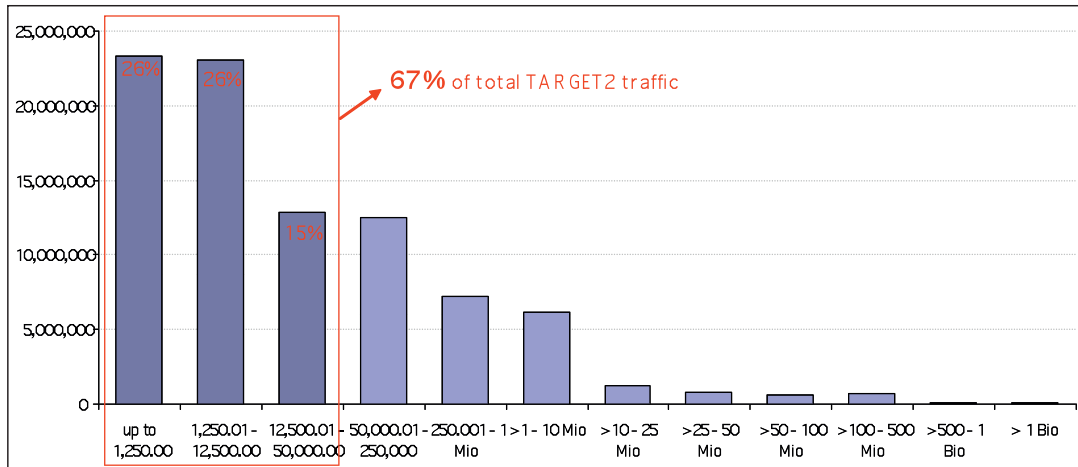
Before looking into the details of this analysis, it may be useful to recall that at the launch of TARGET2 the Governing Council of the ECB chose to keep the system open “downwards” for low-value payments and to set no value limit. While there was no deliberate intention to become a major actor in processing retail transactions, the Eurosystem acknowledged that this decision could contribute to the efficiency of cross-border settlement in the EU without adding costs to the system. Indeed, TARGET2 costs mainly originate from the operational and development work required for the processing of large-value payments, while the higher volume generated by retail payments increases only marginally the overall costs of the system.

<sup>5</sup> Federal Reserve Board, A summary of the roundtable discussion on the role of wire transfers in making low-value payments, May 2006 (<http://federalreserve.gov/paymentsystems/lowvaluepay/default.htm>)

*Low-value and large-value transactions in TARGET2*

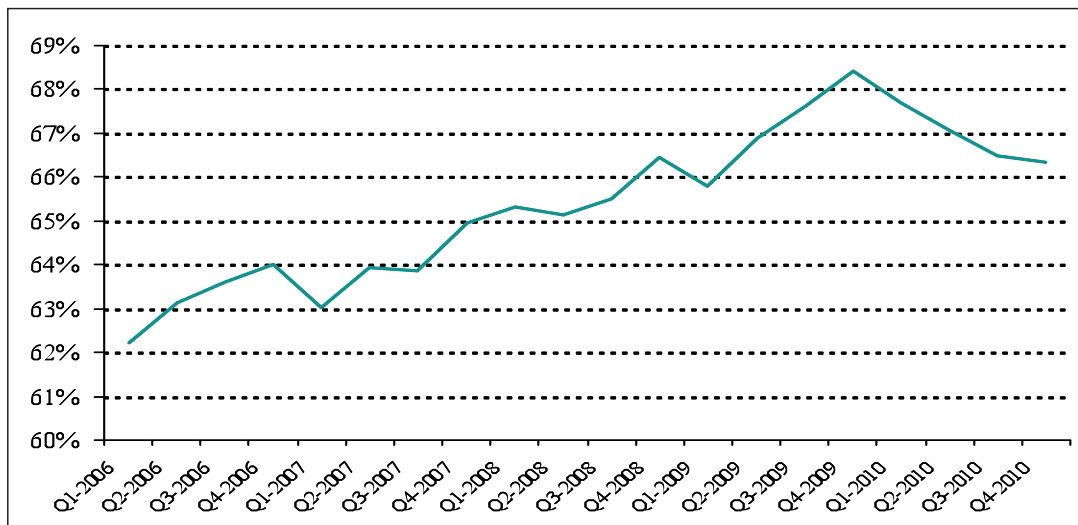
The Governing Council decision proved to be appropriate and accommodated market demand. Looking at the value of the transactions settled in TARGET2, it is possible to observe that 67% of the payments had a value below €50,000 in 2010, and that more than half of the traffic was composed of payments of less than €12,500 (Chart 2). Moreover, Chart 3 shows that the percentage of low-value transactions in TARGET2 traffic has increased over the years (by 4 percentage points since the first quarter of 2006), notwithstanding the efforts made by payment service providers, in the context of the Single Euro Payments Area (SEPA) project, to facilitate the processing of retail payments in Europe. Given their large number, low-volume transactions make a considerable contribution to TARGET2 revenues, and this contribution has become essential to achieve cost recovery.

**Chart 2: Number of payments per value band (2010)**



Source: ECB.

**Chart 3: Share of transactions below €50,000 in the total TARGET2 volume**



Source: ECB.

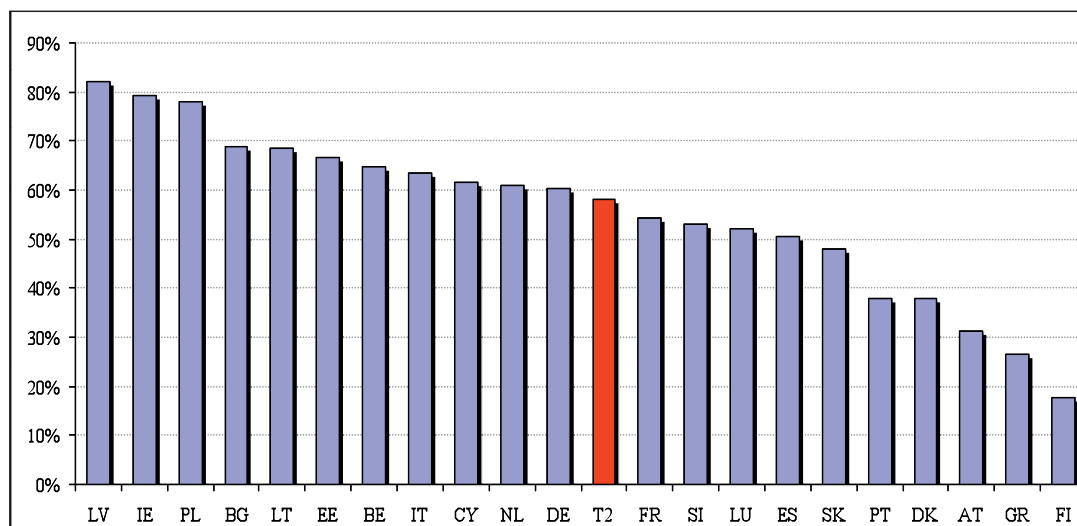
These results reconfirm, as also observed at international level, that there is a business case for making retail payments in TARGET2. There may be several reasons for this growing preference. Besides the advantages associated with the use of any RTGS system, the additional benefits offered to TARGET2 customers may play a role. For example, TARGET2 offers enhanced liquidity management features, enabling participants to prioritise their payments according to urgency and to actively manage the queues. TARGET2 also provides immediate finality and settlement in central bank money. It may also be significant that via TARGET2 it is possible to address more than 50,000 institutions, including many outside of Europe.

*Commercial payments and wholesale payments in TARGET2*

Changing the focus of the analysis from the payment value to the transaction type, a very similar trend can be observed. Chart 5 shows that in 2009 67% of TARGET2 traffic consisted of customer payments, namely SWIFT message types MT103(+). Across the euro area countries, however, the composition of payments is diverse. In 2010 the share of MT103(+) messages in traffic generated at national level ranged from less than 20% in Finland to around 80% in Latvia and Ireland. It is worth noting that in countries which make a higher contribution to total TARGET2 volume, such as Germany, the Netherlands, Italy, France and Spain, more than half of the traffic consists of customer payments. In Germany, Italy and the Netherlands, 60% or more of total traffic is composed of MT103(+) messages.

The variation across member states may depend on the availability of alternative channels for processing retail transactions. In particular, ACHs are set up to process non-time-critical retail payments and normally do not meet the specific requirements of banks and corporations as regards the settlement of urgent and/or critical retail transactions. The ability of ACHs to meet the requirements of the domestic market depends on their history and legacy, as well as the characteristics of the market. ACHs were traditionally established at national level, but recently they have increased their reachability in the light of the SEPA initiative and some may have already achieved reachability in several European countries by creating links with other ACHs based on the interoperability framework developed by the European Automated Clearing House Association (EACHA). It should be noted, however, that the higher reachability does not seem to be a factor that influences market preference, as a considerable amount of retail payments continue to be settled via TARGET2.

**Chart 5: Share of customer payments in total TARGET2 volume by country (2010)**

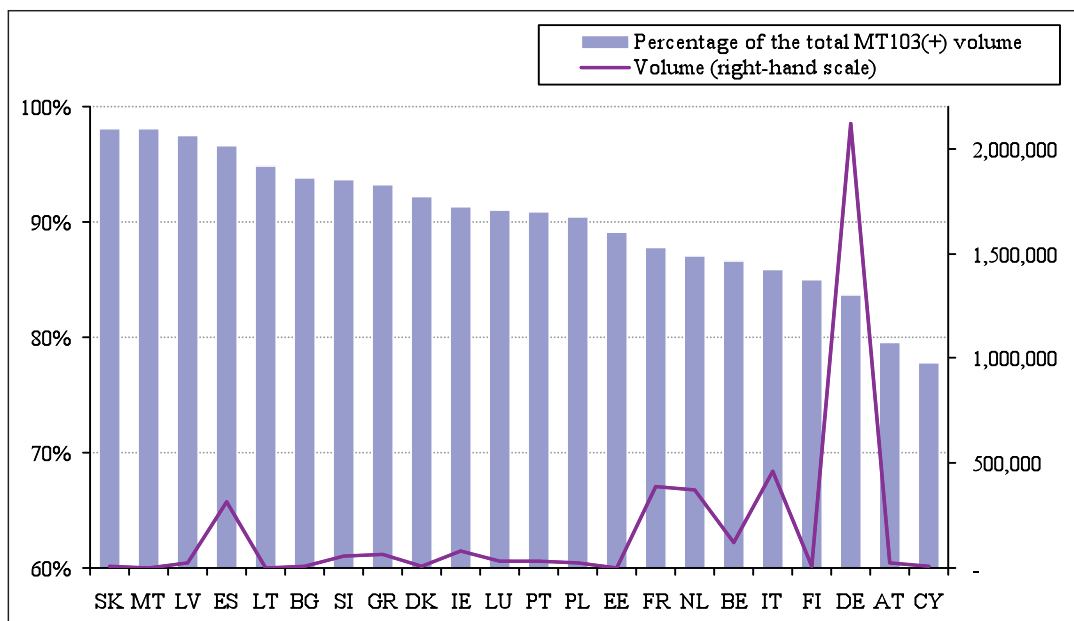


Source: ECB.

Breaking these shares further down on the basis of the residence of the originator and the beneficiary of the transaction, it was possible to observe that in September 2010 86% of customer payments in TARGET2 took place between EU residents, whereas the remaining 13% consisted of payments where either the originator or the beneficiary was located outside the EU. These payments are part of so-called “two-leg” customer transactions between European parties that fall within the SEPA perimeter.

The pattern at country level is shown in Chart 6. In relative terms, the share of intra-EU customer payments ranged from 78% of total MT103(+) traffic in Malta to 98% in Slovakia. In percentage terms, with the exception of a few countries, the behaviour of participants is relatively uniform. It is more interesting to look at the absolute number of transactions. In Germany, the main contributor to TARGET2 traffic, more than 2 million customer payments falling within the scope of SEPA were processed in September 2010, and there were between 300,000 and 500,000 operations each in France, Italy, Spain and the Netherlands, making a total of more than 4 million transactions in one month. Considering that the total number of payments settled in TARGET2 in the same period was a just over 7 million, intra-EU customer payments represented 58% of the monthly volume.

**Chart 6: MT103(+) falling within the SEPA perimeter by country (Sep 2010)**



Source: ECB.

Although low-value payments account for a significant proportion of TARGET2 volumes, it is worth pointing out that this phenomenon is quite small compared to the total volume of retail payments in the EU. It is estimated that in September 2010 the transactions settled in TARGET2 accounted for less than 0.5% of the total volume of retail transactions processed in the EU.<sup>6</sup> This is not surprising when comparing the prices associated with the use of RTGS systems with those of ACHs. Typically, the prices charged by RTGS systems for settlement services are significantly higher than those charged by ACHs. For instance, TARGET2 charges at least €0.125 per transaction, whereas the prices of ACHs normally range from less than one cent to only a few cents.<sup>7</sup>

<sup>6</sup> This estimate was made by comparing the number of low-volume payments in TARGET2 with the total number of retail transactions in Europe as reported in the Blue Book.

<sup>7</sup> “Size matters: economies of scale in European payments processing”, DNB working paper, No 155, November 2007.

The analysis shows that TARGET2 provides the banking sector with a service responding to a real market demand that other systems cannot entirely satisfy. As the volumes exchanged are marginal compared to the overall traffic in ACHs, it is possible to conclude that TARGET2 offers a complementary service to the other market infrastructures serving the retail payments sector without directly competing with them.

### **The TARGET2 strategy**

There are two main things to take into account when considering the strategic positioning of TARGET2 vis-à-vis retail payments and what this can mean in terms of system development. The first one is internal demand, which is quite high, especially taking into account the fact that the price charged is up to 200 times the cost of alternative channels. The second one is the influence of external factors. Relevant, in this case, is the pressure of technological advancement. Green field projects in the area of payment systems, such as TARGET2-Securities (T2S) and the newly introduced SEPA payment schemes, make use of ISO 20022 standards and XML language. TARGET2 already uses XML messages for its ancillary systems interface (ASI) and its information and control module (ICM), with formats that are very close to ISO 20022. The close linkage of TARGET2 to T2S and, in a wider sense, also to the SEPA initiative creates pressure and opportunities to considerably expand the use of ISO 20022 in TARGET2.

To respond to this combination of internal demand and external challenges, having considered various possibilities, the Eurosystem came to conclusion that the best option would be to keep the current business model. TARGET2 should therefore remain a system designed for large-value payments that continues to also meet market demand for settlement of time-critical retail transactions. However, maintaining the “status quo” does not mean leaving the system unchanged. At a time of technological advancements and in view of the ongoing discussion on the SEPA migration end-date, the Eurosystem reflected on the possibility of introducing ISO 20022 into the system.

Undertaking this step would have several benefits. The main objective would be to ensure the long-term viability of TARGET2. For instance, it would enable TARGET2 to continue to support its participants by providing settlement of urgent retail transactions using advanced industry standards. Furthermore, it would give users the opportunity to exploit the synergies with T2S once the project goes live. Obviously this major enhancement would entail significant investment; however the expected lifetime TARGET2 should still allow us to achieve cost recovery.

In the light of the key importance of the issue, the Eurosystem launched a market consultation to establish a dialogue with users on a possible strategy to facilitate and encourage wider usage of ISO 20022 in TARGET2. In the proposed strategy, the Eurosystem considered two challenges that TARGET2 is currently facing, namely the ongoing initiatives towards a SEPA migration end-date and the work necessary to interface with T2S, both of which involve ISO 20022-based technology. The two work streams were brought together in a single “action plan” aimed at expanding the use of ISO 20022 in TARGET2 in three steps: first, implementation of XML messages for customer payments; second, adaptations to T2S; and third, possible further compliance.

The responses to the consultation were fairly similar. The banks acknowledged the advantages associated with the use of ISO 20022 and in general expressed their support for its use in TARGET2. However, some concerns were expressed, in particular regarding the envisaged timing for the migration of retail payments to ISO 20022. On its side, the Eurosystem recognises that the move to ISO 20022 is a cornerstone in the development of TARGET2 and, for that reason, considers it an issue of strategic importance for the system. It also notes that banks might draw greater benefits from this migration if it is done in conjunction with their move to T2S. Consequently, it reviewed its initial strategy, inverting the first two steps, and proposes to implement ISO 20022 retail payments in TARGET2 after the adaptation to T2S, possibly in release 8.0 (November 2014).

The way the strategy will be finally realised will have considerable consequences for TARGET2. It is clear that the introduction of ISO 20022 is a very topical issue, and that the future of TARGET is linked to its ability to keep up with the challenges coming from internal demand as well as from technological advancement. It is desirable that TARGET2 maintains its position in the market and continues to serve its participants as one of the world's leading large-value payment systems. At the same time, the changing environment requires that TARGET2 adapt in order to continue supporting customers seeking to settle retail payments in an RTGS system.

## Calendar of events

### Implementation dates for TARGET2 new system releases

The 2010 release (version 4.0) was implemented in the production environment on 22 November 2010. The final content of the 2011 release (version 5.0), that was defined in close cooperation with users, was communicated to them on 15 November 2010. While comprising a limited number of enhancements to the TARGET2 system, the release will install a contingency network between the central banks of the Eurosystem for the processing of critical payments in the event of a regional or global SWIFT outage. The release will go live on 21 November 2011.

### Next meetings with user representatives

The Eurosystem maintains close relations with TARGET2 users, and regular meetings are held at the national level between the NCBs connected to the system and the respective national user groups. In addition to the cooperation at the national level, joint meetings of the Eurosystem Working Group on TARGET2 and the TARGET Working Group, which comprise representatives of the European banking industry, take place regularly at a pan-European level. There were four joint meetings in 2010, on 7 February, 12 May, 8 September and 25 November. Summaries of the joint meetings are available on the TARGET2 website.<sup>8</sup> The next joint meetings are scheduled to take place in Frankfurt on 15 February 2011 and 12 May 2011. The dates of the joint meetings have been arranged to fit in with the planning for the annual system releases.

### The Eurosystem at Sibos 2010

The Sibos 2010 exhibition took place in Amsterdam from 25 to 29 October. Sibos was a very good opportunity for the Eurosystem, in its catalyst role, to promote the Single Euro Payments Area (SEPA). Both the SEPA direct debit (SDD) and the SEPA credit transfer (SCT) schemes are now operational, and it is crucial to ensure migration and to achieve critical mass. At Sibos, the Eurosystem provided information on the latest developments (the SEPA migration end-date, SEPA as a reference for the standardisation of the retail payments market at a global level, the seventh SEPA progress report) and on the benefits of SEPA for all relevant stakeholders. The World Bank Payments' Week took place in Amsterdam the week before Sibos, with SEPA again high on the agenda. In terms of the Eurosystem's operational role, the topics covered at Sibos 2010 were the latest developments in the T2S and CCBM2 projects, which are both entering critical phases this year. The Eurosystem also provided information on TARGET2 and the latest system releases (versions 4.0 and 5.0).

<sup>8</sup> <https://target2.ecb.de/home/html/index.en.html>



## Further information

More detailed information on TARGET can be found in the “Information guide for TARGET2 users” [http://www.ecb.europa.eu/paym/t2/shared/pdf/infoguide\\_V3\\_I\\_0.pdf](http://www.ecb.europa.eu/paym/t2/shared/pdf/infoguide_V3_I_0.pdf) and in the most recent TARGET Annual Report, covering the year 2009. All relevant documents and reports can be found on the ECB’s website at <http://www.ecb.int>, as well as those of the NCBs.<sup>9</sup> For further information, please e-mail [target.hotline@ecb.europa.eu](mailto:target.hotline@ecb.europa.eu)

<sup>9</sup> <http://www.ecb.europa.eu/home/html/links.en.html>