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TARGET Newsletter

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Introduction

The time when large-value payment systems differed greatly between countries is gone for good. In Europe, the area of large-value payment systems has undergone deep changes in a relatively short time span. One example of this is TARGET.

The creation of TARGET established an EU-wide RTGS system for the settlement of our currency, the euro. Since day one, TARGET has been an essential vehicle for the implementation of the Eurosystem's monetary policy and has helped to create a single money market within the euro area.

Economic integration has been, and will continue to be, vigorously backed by the European Union and regulators in the area, and has been widely supported by the market. In response, the second-generation system, TARGET2, introduces a uniform wholesale payment infrastructure by means of a single technical platform. This further levels the playing field and provides the euro money markets with increased efficiency, greater harmonisation in business practices and the opportunity for further integration.

TARGET can be considered to be the backbone infrastructure of the whole economy. TARGET settles, in real time, the equivalent of the annual GDP of the entire euro area every 3.5 days. Thus, the smooth functioning of TARGET is of paramount importance for the stability of the financial system and is essential for the effective implementation of the single monetary policy.

More than ever, given the very demanding circumstances at present, confidence is key and the availability of liquidity, together with the ability to shift it around, is crucial. The Eurosystem is well aware that the robustness and smooth operation of TARGET is indispensable for the stability of the currency, the financial system and the economy in general. TARGET has been available 100% of the time since the global economy was hit in mid-September 2008. With TARGET, the Eurosystem will continue to offer a solid anchor of stability and confidence.

TARGET is a system which is in permanent evolution and which pays heed to the needs of the market. In today's financial markets, risk reduction, efficiency, cost consciousness, resilience and practicality will clearly receive more attention than before. An interest in these issues is likely to remain. Thus, development plans for TARGET are expected to follow the same path. At the same time, a focus will be placed on mitigating systemic risk even further.

This is the first issue of the TARGET Newsletter. The objective of the Newsletters is to inform the user community and the general public about relevant issues surrounding the TARGET system in operation. The Newsletters will contain articles of special interest, which will provide insight and opinions from relevant system participants.

It is anticipated that the Newsletters will be published at least twice a year. The second issue of the TARGET Newsletter is scheduled for publication in the fourth quarter of 2009.

About the TARGET newsletter

This first issue of the TARGET Newsletter contains two articles of special interest, namely "TARGET: a treasurer's perspective" and "Release management in TARGET". After the articles, three boxes provide bulleted information on the main TARGET indicators in 2008, the main findings concerning the financial turmoil's impact on TARGET and the main effects of the migration to the second-generation TARGET system (TARGET2) respectively. The final part of the Newsletter refers to relevant information for the user community: the "Information guide for TARGET2 users" and the "User information guide to the TARGET2 pricing". A calendar of events and details of where to get further information are also included at the end of this issue.

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, 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 why, in many instances in this Newsletter, both the first and second-generation systems are referred to as "TARGET", i.e. no distinction is made between TARGET and TARGET2.

Special interest articles

TARGET: a treasurer's perspective[1]

By Mr Ludy Limburg,
Vice President Market Infrastructures, ABN AMRO/RBS

Recently I had to move to a new office in the same building. This was not a huge exercise but it was enough to have to empty my drawers and cupboards. A huge pile of old files and papers on Topview, RTGSplus, etc. to look at and… throw away. At the bottom of my drawer and in the far corners of the cupboards, there they were again, my old friends from the past: Deutsche Mark, Belgian and French francs, lire, pesetas, etc. I remembered them from an earlier move in 2002, when I also found them at the bottom of my drawer but could not throw them away (obviously the guilders were exchanged for euro, being Dutch). At that time, in 2002, I could still remember the value of these coins and the business attached to them, so I gave them a prominent place at the top of my drawer. Over time, they seem to have turned into silent witnesses of progress, buried under piles of paper on TARGET2, being pushed to the bottom again by thousands of pages of UDFS, becoming relics of the past. And yet again I picked up these coins and still could not throw them away. But this time it was not the value or the business I remembered; I saw them simply as symbols of the past, helping us to realise what we had achieved.

The euro is a unique currency from a global treasurer's perspective. No currency in the world is operated in more countries or with so many cross-border differences. Therefore, comparison of the euro with the pound sterling or the US dollar from a payment system perspective would not do justice to the achievements of TARGET2, but does tell us something about how treasurers are used to looking at the way they manage a currency, i.e. in one central place for the group as a whole. This is largely a front-office approach, but achieving central treasury management is mainly an operational and organisational issue. Theoretically, the central approach was already possible from the moment the euro was introduced, but practically, there were many hurdles to overcome before a centralised treasury for the euro could be achieved. Driven by these internal and external hurdles, banks have made different choices with regard to their migration process towards a central treasury for the euro. From this angle, we can look at TARGET2 as a tool for the operational set-up supporting the central treasury function. As such, we can analyse which hurdles have been addressed in moving from TARGET to TARGET2 (T2) and also look ahead to the next steps.

From TARGET to TARGET2

A number of significant changes have been brought about by moving from TARGET to TARGET2, but we have to realise that no two banks are the same and therefore, not all changes will be considered beneficial for all banks. Those changes which involve the euro area cross-border management of euro liquidity will typically be of benefit for banks with businesses in more countries. Being part of a bank with businesses in most euro area countries, I'll more or less focus on the following cross-border aspects:

- the virtual liquidity pool
- information pooling, ICM and the application-to-application mode
- ancillary system settlement in T2
- the single platform and its effect on the level playing field

The virtual liquidity pool

In the first-generation TARGET system, all accounts were still operated on a separate basis. If, for instance, liquidity was needed in Germany but only available in France, money needed to be moved between the two accounts. Obviously, the introduction of the euro already gave us opportunities to centralise as many euro cash flows as possible via one central bank connection, but a certain part still remained local (for organisational or operational reasons, for example). In order to manage euro liquidity in one place from a treasury perspective, funds were distributed all over Europe in the morning in order to provide local liquidity capacity for daily business in the specific country. During the day, the levels of liquidity were monitored and, if needed, funds were transferred, and then, at the end of the day the individual accounts were managed at an appropriate level in the light of reserve management requirements.

This has all become much easier with T2. During the day, the available liquidity is checked against the total contents of the virtual liquidity pool; this takes away the need to distribute euro liquidity to all countries. The major benefit of this change is within operations and risk. The operational burden of making numerous manual transfers each day (including the internal accounting) is nowadays limited to only the distribution at the end of the day (for reserve requirement management), and the risk of a liquidity shortage on a local level during the day is reduced to almost zero. There is a theoretical liquidity efficiency

1 *The views expressed in this article are personal and do not necessarily reflect those of the European Central Bank.*

gain in using the virtual liquidity pool, but the actual savings are hard to measure and/or calculate. The savings on operational activities are far more evident.
Before using the virtual liquidity pool, banks must make sure they control the use of liquidity in a centralised way. As the pool allows any account to use the overall available liquidity, internal controls must be in place in order to avoid unexpected and large amounts of liquidity to be used on a local level without the involvement of the central treasurer. With this in mind, T2 also allows certain accounts to be managed outside the virtual pool in order to control the maximum use of liquidity where the full control of liquidity usage is not guaranteed (for example in the case of security settlement bank services for third parties).

Information pooling, ICM and the application-to-application mode

Managing liquidity from a single place in Europe was an operational nightmare with the first-generation TARGET system. In order to gain an overview of all central bank accounts, it was necessary to have connections to the local central bank systems. In most cases, a stand-alone PC needed to be installed in order to be able to deal with local connection standards, which usually did not fit the bank's network. A number of computers and screens, different user IDs and password protocols, differing functionalities, different contingency procedures, and systems in local languages were some of the problems. In some cases, we were even unable to access the local RTGS from a central country.
T2 offers us the possibility of pooling all the information in a single application. A clear overview can be obtained via a single user interface for the whole euro area. In the application-to-application mode, we are even able to integrate information into our own tools and take full advantage of the availability of this pool of information. This enables multi-country banks to fully centralise their liquidity management from an operational perspective.

Ancillary system settlement in TARGET

With the introduction of the first-generation TARGET system, banks had the possibility of centralising as many cash flows as possible. Banks could opt to centralise their flows via one hub and as such, to a large extent, create a central pool of euro liquidity. There are many reasons why banks did not choose to migrate their cash flows (e.g. system changes, or organisational or commercial reasons), but for the ancillary system settlement it was simply not possible to settle against an account outside the country.
In principle, T2 makes it possible to settle ancillary systems against the chosen account. This enables a bank to further centralise the flows into a single pool. I say "in principle" because the use of proprietary home accounts for ancillary system settlement still prevents full migration on this point, and also because for some ancillary systems, the use of "foreign" T2 Payments Module accounts is still restricted.

Single platform – level playing field aspects

The introduction of a single platform resulted in a more "level playing field" in Europe. One example of an improvement is the equal availability of tools to manage liquidity within the platform. The use of bilateral or multilateral limits and reservations at different levels may have been available in the past to some local RTGS systems, but they could not be used by all countries or against all participants.
Important from a treasury perspective is the availability of the platform. Whereas in the old days a single country could be closed and even extended opening could be limited to one country, now the availability of the system is the same for us all. In addition, there is a uniform approach with regard to contingency arrangements (tools and procedures). This helps to limit market stress and prevents difficult compensation situations.
Although less important from a specific treasury perspective, the uniform pricing must also be mentioned as an achievement resulting from the introduction of T2 in relation to the creation of a level playing field.

What's next?

As mentioned earlier, it would not be fair to compare the euro with other currencies like the pound sterling or US dollar owing to the unique cross-border aspects in the euro area. However, if we look at the RTGS systems around the world, we can truly say that the Eurosystem has managed to build a single platform which can easily measure up to or outperform the other known RTGS systems.
Is that it? Job finished? Of course not! T2 is just one tool for optimally addressing the cross-border difficulties we experience. However, some aspects that have an impact on the central treasury function are not arranged within T2, but in other tools. As such, CCBM2 and T2S are equally important developments to further break down the walls between euro area countries and strengthen the link between liquidity, collateral and settlement. But it's not only about tools. Far more difficult are the changes needed regarding issues with a political and legal dimension, such as those below.
- Monetary policy: Although monetary policy is managed on a central level, its actual execution takes place within each individual country, together with all the

related local operations. In order to truly become a European domestic currency, multi-country banks should be able to maintain a single reserve requirement in T2.

- Legal and tax issues: There are still good reasons (tax and legal issues, as well as product and service levels) why our clients want to hold accounts in all countries where they do business. While this gives rise to commercial opportunities, it also causes liquidity to be spread over several systems and on a domestic level.
- Oversight: We have come a long way within the euro area with regard to the harmonisation of oversight, but we must now ensure cross-currency harmonisation. This represents a real challenge given the worldwide pressure on oversight in light of the current market conditions, where "local" control seems to prevail and less time is available for a coordinated approach.

On reflection, my old coins will probably be buried in my drawer again, most likely under papers on CCBM2, T2S and new releases of T2. However, I'm confident that they will also witness further harmonisation and the building of a domestic euro area with regard to the other aspects mentioned. This will take cooperation and coordination, but first and foremost, time. When I find the coins again, I'm sure I still won't throw them away, because the more we achieve in Europe the more valuable our history becomes.

TARGET release management

By the Eurosystem

Introduction

The Eurosystem endeavours to keep the second-generation TARGET system in line with the various business changes in the field of large-value payments. This continuous interest in the system's evolution is seen as a necessity to further increase its level of service and the satisfaction of its participants. For this reason, it is of great importance that all stakeholders be involved in the release management process in a proper and timely manner.

In general, TARGET releases take place annually and coincide with the annual standard SWIFT releases in November. In exceptional circumstances, however, it is possible for an intermediary release to be scheduled (i.e. two releases in the same year) or no release to be issued in a given year.

The annual TARGET release is a long process, which takes place over a 21-month period in order to give all parties enough time for discussion, prioritisation, implementation and testing. Furthermore, information is made available to participants early enough to allow for proper planning and budgeting of all changes.

Main applicable deadlines

All dates provided in this section are indicative and are confirmed by the Eurosystem for each annual release in the course of February of year Y-1. While an effort will be made to keep to these dates as much as possible, limited deviations may be allowed, if and when needed, and after consultation with the user community.

Year Y-1

mid February	Confirmation of final dates
early March - mid April	First user consultation
mid September – mid October	Second user consultation
mid November	Communication on the release content

Year Y

early March	Delivery of the UDFS
mid April	Delivery of the test plans and scenarios
end August	Start of user testing
mid November	Go-live

User involvement

Two consultations with the user community are organised as part of the discussions regarding the content of the annual TARGET release. In order to involve all TARGET users in the definition of the release content, the national central banks of countries connected to TARGET will contact their respective national user groups (NUGs) and, in parallel, the ECB will approach the TARGET Working Group (TWG) of the European Banking Federation.

- The first consultation aims to collect proposals for functional changes from all TARGET users. These changes are expected to be sufficiently detailed and to be beneficial for a large number of users. To facilitate this consultation, a list of functional changes proposed in the framework of earlier releases is provided as a background document, together with a number of changes suggested by central banks on an indicative basis. Proposals should describe the business case and the expected functional changes in a precise manner. A template is provided by the Eurosystem for the submission process.

  At the end of the first consultation, all proposals made by the NUGs and the TWG are carefully considered by the Eurosystem in order to identify a subset of changes on which a further cost/benefit assessment will be carried out.

- The second consultation aims to collect users' feedback on changes short-listed by the central banks as a result of the first user consultation. No new proposals for changes are possible during this phase. When applicable, pricing elements for the envisaged features are also provided.

  At the end of the second consultation, the Eurosystem considers all feedback received from users and forms a final view on the content of the annual TARGET release, which is communicated shortly thereafter[2].

Prioritisation and decision-making

When prioritising the various proposals received from users or when making a final decision on the release content, central banks give due consideration to the following criteria.

- For each individual change, a thorough cost/benefit analysis is carried out. This mainly looks at the feedback received from the user community during the consultation rounds, the benefits for the industry as a whole in terms of service brought about by the change, the expected usage of the feature, the investment and operational cost at stake, the sustainability of the new service from a cost recovery perspective, the complexity of the developments, and the possible risk of introducing regression bugs. Lastly, whenever it is relevant, central banks also consider the compliance of the change with the Eurosystem's policy or strategic stances on TARGET.
- For the release as a whole, the central banks aim to ensure that the release content is well balanced in terms of the benefits for the different types of user and that it complies with the workload and budget limits fixed for the annual release.

As a matter of transparency, after each consultation step, users will be provided with the necessary information as to why a change was selected or discarded.

Main TARGET indicators in 2008

- In 2008 TARGET had 747 direct participants, 3,806 indirect participants and 11,031 correspondents.
- TARGET settled the cash positions of 69 ancillary systems.
- TARGET processed a daily average of 369,966 payments, representing a daily average value of EUR 2,667 billion.
- The average value of a TARGET transaction was EUR 7.2 million.
- 65% of TARGET payments had a value of less than EUR 50,000.
- The peak day was 22 December 2008, with 576,324 payments.
- TARGET's share of total large-value payment system traffic in euro was 90% in value terms and 59% in volume terms.
- The availability of the system was 99.98%.
- TARGET payments were processed in an average of 40 seconds.
- The top five participants settled 16% of overall TARGET values.

Main findings concerning the financial turmoil's impact on TARGET

- As a key market infrastructure, the reliability of TARGET is critical to the smooth functioning of the European financial system in times of crisis.
- TARGET was available 100% of the time during the fourth quarter of 2008 and was able to open and close on schedule each day.
- The transaction values processed in the fourth quarter of 2008 set a record, representing an increase of 13% by comparison with the three previous quarters.
- Without being affected dramatically, the growth rate of TARGET volumes slowed towards year-end.
- The effect on participants' behaviour has been relatively limited, although increased recourse to overnight facilities and a sharp decrease in money market transactions at the end of the day has been observed.
- Closer coordination and enhanced communication among stakeholders has contributed to the timely sharing of information and allowed affected parties to react appropriately.

2 *It should be noted that the Eurosystem may announce changes relating to SWIFT at a later stage, when the final content of the SWIFT FIN and CAMT standard release is known. In addition, if the release contains the correction of bugs, those amendments will be communicated at a later stage as well.*

Main effects of the migration to the second-generation TARGET system

- The migration to the second-generation TARGET system (TARGET2) has not caused any discernible discontinuity or disruption in general traffic trends. In particular, the objective of 93.1 million transactions for the first year is still realistic.
- Neither the flow of payments nor participants' behaviour has been significantly affected by the migration.
- The consolidation of the payment activities of multi-country banks has shifted around half a million commercial transactions from "intra-Member State traffic" to "inter-Member State traffic", thereby further blurring the distinction between these two segments.
- The value of intra-Member State traffic has been artificially inflated by "technical" transactions (i.e. liquidity shifts between different accounts held by the same participant), which will have to be eliminated in forthcoming statistics on TARGET.
- In connection with the consolidation efforts, the number of direct participants has decreased by around one-third compared with the first-generation system, while the number of addressable institutions increased.

Information guides

Information guide for TARGET2 users

The "Information guide for TARGET2 users" aims to provide banks and ancillary systems using TARGET with a standard set of information in order to give their operators a better understanding of the overall functioning of the system and enable them to make use of it as efficiently as possible. It answers the most frequently asked questions relating to TARGET and tries, in particular, to give users a clear understanding of those features that are common and those that are specific to each country. In addition to information on the operational procedures in normal circumstances, the information guide also provides information for abnormal and contingency situations.

Additional documentation on country-specific features can be found on the websites of the respective national central banks. The information guide is intended purely to provide information on the second-generation TARGET system and should not be seen as a legal or contractual document.

A link to the information guide for TARGET2 users on the ECB's website:

http://www.ecb.europa.eu/pub/pdf/other/target2progressreport5-a1-informationguidetarget2usersen.pdf

Information guide for TARGET2 pricing

The "User information guide to the TARGET2 pricing" provides TARGET users with a comprehensive overview of the pricing schemes for the second-generation TARGET system (core services, liquidity pooling and ancillary system services) and detailed information on the billing principles for the various types of transaction, as well as the entities to be invoiced. This information guide serves as reference documentation on pricing and billing issues, but does not confer any legal rights on operations or entities.

A link to the information guide for TARGET2 pricing on the ECB's website:

http://www.ecb.int/pub/pdf/other/target2progressreport5-a2-target2pricingen.pdf

Calendar of events

Implementation dates for new SSP releases:
Release 2.1 on 11 May 2009 and release 3.0 on 23 November 2009.

The Eurosystem at Sibos 2009
(Hong Kong, from 14 to 18 September 2009)
At this year's Sibos exhibition in Hong Kong, the Eurosystem will present the latest information on the TARGET system, as well as on the TARGET2-Securities, CCBM2 and SEPA projects. Come and visit us at the Eurosystem stand (number 3G19) or come along to any of our presentations.

We look forward to seeing you in Hong Kong!

Next meetings with user representatives
Cooperation with the user community has continued beyond the migration phase. The Eurosystem maintains close relations with TARGET users and regular meetings are held at 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. A joint meeting took place in Stuttgart on 12 May 2009. The next joint meeting is scheduled to take place in Frankfurt on 9 September 2009.

Further information

More detailed information on TARGET can be found in the "Information Guide for TARGET2 users" *http://www.ecb.int/pub/pdf/other/target2progressreport5-a1-informationguidetarget2usersen.pdf* and in the TARGET Annual Report 2008 (published on 15 May 2009) *http://www.ecb.europa.eu/pub/pdf/other/targetar2008en.pdf*

All relevant documents and reports can be accessed from the ECB's website at *http://www.ecb.int* and the websites of the national central banks.[3] Further information is also available from *target.hotline@ecb.int*

3 *http://www.ecb.europa.eu/home/html/links.en.html*