

TARGET2 – the new payment system for Europe

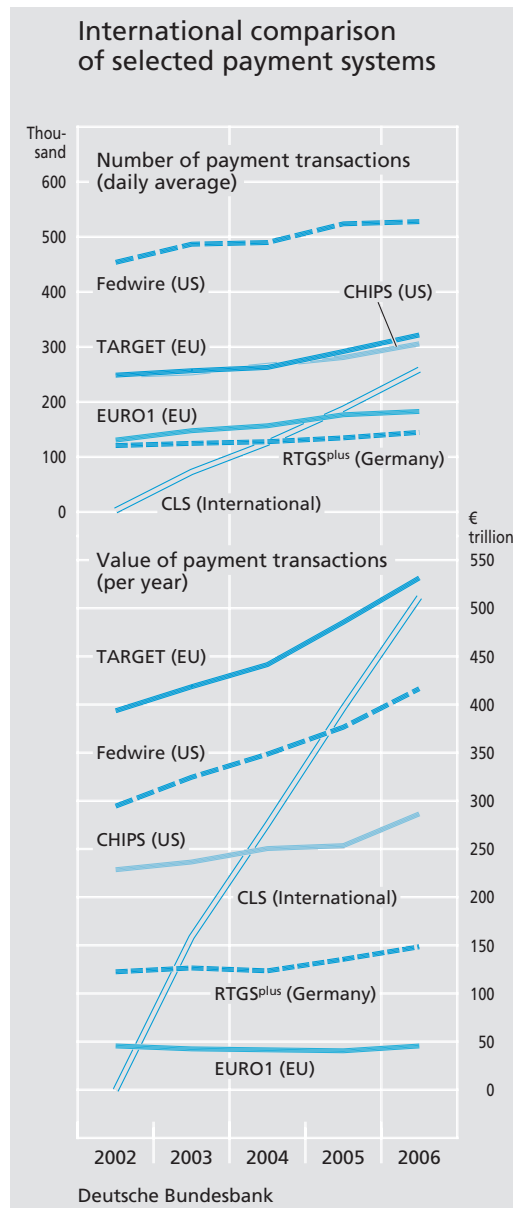
On 19 November 2007, the new TARGET2 system for settling urgent payment orders in real time will come into operation. In so doing, it will replace the current TARGET system, which for the eight years since the start of the European monetary union has made it possible to transfer euro balances between accounts held at European central banks in a matter of minutes. This has been instrumental in laying the basis for a single European money market. The Bundesbank's RTGS^{plus} system, which represents the German component of the TARGET system, will cease to operate after the close of business on 16 November 2007 and be superseded by the new system. Around 150 RTGS^{plus} participants are currently preparing for the transition from the "old" RTGS^{plus}-TARGET environment to TARGET2. Following on from past Bundesbank monthly reports already focused on RTGS^{plus} and recent developments in the area of individual payments (September 2005), the following article describes the most important elements which make up TARGET2 and its advantages for the European financial market. The article is particularly effective in illustrating the considerable importance of this new TARGET generation to the Bundesbank, the German banking industry and those involved in the business of securities settlement in Germany.

Importance of TARGET in individual payments in euro

Global and European importance

Handling more than 350,000 transactions every day with a value of €2.4 trillion, the TARGET¹ system, operated by the European System of Central Banks (ESCB), is of paramount importance to the European financial infrastructure. Using TARGET it is possible to transfer balances held at a central bank to another account in Europe at great speed. Not least owing to the large volume of transactions involved and the wide range of centralised functions it offers, TARGET has acquired great systemic relevance.

- TARGET is used for the purposes of settling Eurosystem monetary policy operations, supplying market participants with central bank money and absorbing excess central bank liquidity.
- The trading of central bank balances between banks, also known as money market activity, is also settled using TARGET.
- Other, privately operated settlement systems, for example in the area of foreign currency payments and securities trading, settle their transactions via bank accounts held at the central banks and likewise use TARGET to achieve this.
- Bank customers can also use TARGET for the settlement of domestic or European credit transfers that need to be settled as speedily as possible owing to their special urgency. In addition, banks frequently use TARGET to settle payments arising from



their correspondent banking activity in non-European countries.

Accordingly, security plays a major role in connection with payments settlement. This includes, in particular, the immediate (ie real-

¹ Trans-European Automated Real-Time Gross Settlement Express Transfer system, which links up the ESCB's individual Real-Time Gross Settlement (RTGS) systems.

time) clearing and settlement (ie “gross”) in central bank money.

With an annual volume growth of 9% and a corresponding value growth of 35%, TARGET has developed very positively over the past five years. In the area of “individual payments”, TARGET enjoys approximately a 90% share of the European market in terms of value and a market share in excess of 60% in terms of volume. Most of the remaining share is handled by the EURO1 system operated by the Euro Banking Association. In terms of international standing, TARGET ranks alongside the Federal Reserve Bank’s Fedwire system, the private US dollar clearing system CHIPS² and the global foreign exchange settlement system CLS³ as one of the world’s largest individual payment systems.

The Deutsche Bundesbank and TARGET

*Bundesbank
as a system
operator*

The Bundesbank’s official mandate enshrined in section 3 of the Bundesbank Act since 1957 stipulates that the Bundesbank has to arrange for the execution of domestic and cross-border payments. The Bundesbank fulfils this function *inter alia* by operating its own payment systems. With RTGS^{plus} the Bundesbank operates an innovative Real Time Gross Settlement (RTGS) system. RTGS^{plus} also functions as the national TARGET component. TARGET comprises 16 national RTGS systems together with the ECB payment mechanism (EPM). The individual national components are connected with one another via technical interlinking. The importance of the German TARGET component

is reflected in the fact that approximately 45% of all domestic and cross-border TARGET payments are settled using RTGS^{plus}. Measured in terms of volume, the share is just under 30%.

Transition from TARGET to TARGET2

As early as October 2002, the Governing Council of the ECB adopted the main principles for the next generation of the TARGET system. Accordingly, individual EU central banks were allowed to decide for themselves whether to continue operating their own real-time gross settlement system or to take advantage of the Single Shared Platform (SSP). All Eurosystem NCBs – including those of Malta and Cyprus, which will join the Eurosystem on 1 January 2008 – have since opted to use the new SSP.

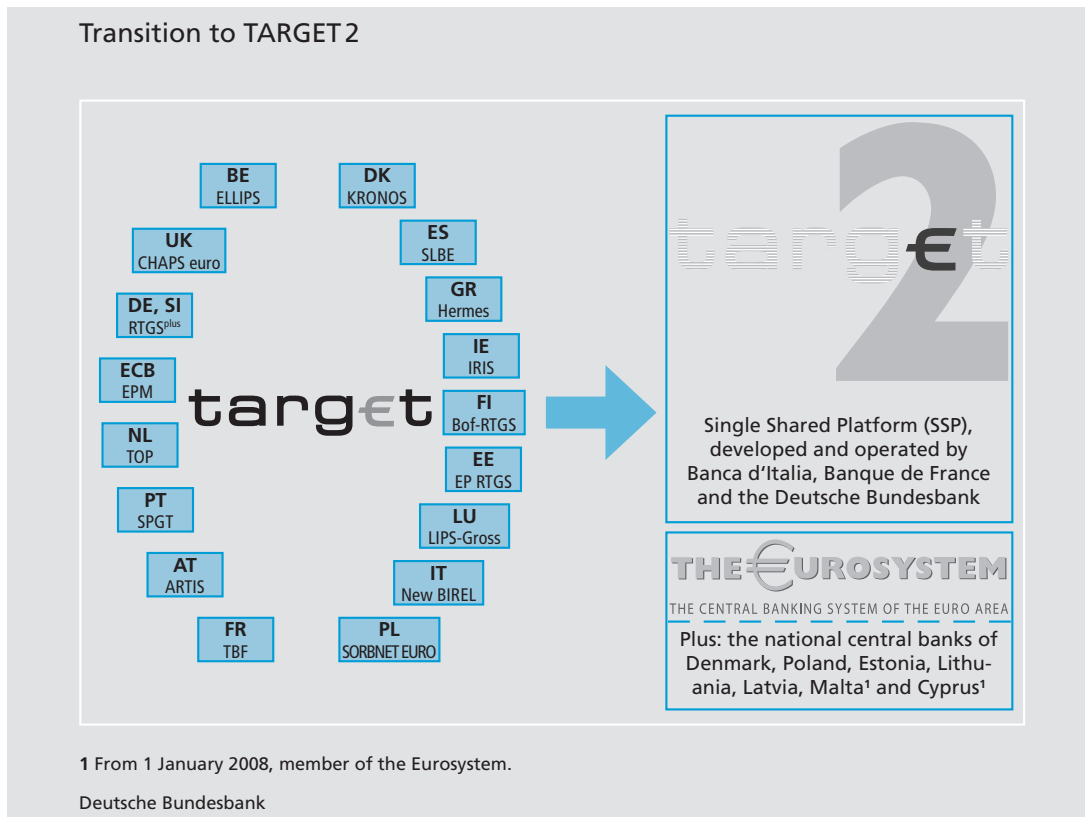
*From the RTGS
network ...*

In addition, the central banks of Denmark, Estonia, Lithuania, Latvia and Poland will also be joining TARGET2. The remaining EU countries are not expected to take advantage of the SSP until they join the euro area. However, banks in these countries can participate in TARGET2 by means of remote access via a participating TARGET2 central bank.

In order to reduce migration risk, participating countries will link up with TARGET2 on a gradual basis, migrating in three different windows on 19 November 2007, 18 February 2008 and 19 May 2008. Germany will switch to TARGET2 with the first group of countries.

² Clearing House Interbank Payments System.

³ Continuous linked settlement system.



... to the single technical platform

The most significant conceptual innovation of TARGET2 is the way in which it consolidates the existing decentralised TARGET infrastructure. The creation of a single technical platform promises the following results

- A standard Europe-wide interface to connect to TARGET via SWIFT⁴
- Complete harmonisation of the range of TARGET services, thereby guaranteeing all European credit institutions the same level of service
- Elimination of the difference in the treatment of domestic and cross-border euro payments

- Enhanced opportunity for participants to control central bank liquidity throughout Europe
- Standardised prices for all TARGET2 countries

Considerable flexibility in liquidity management

When TARGET2 was being designed, the European banking industry attached special importance to offering an extensive range of individual, appropriately tailored and easy-to-

Growing importance of liquidity management

⁴ Society for Worldwide Interbank Financial Telecommunication. SWIFT operates a secure, high-availability communication service and plays a major role in the area of standardising message transmission in the financial sector.

use liquidity management features. Available liquidity is to be used as efficiently as possible as the demands on liquidity management have steadily multiplied in recent years. For example, the CLS system requires “pay-ins” of central bank money to be injected precisely to the minute. Equally, in times of scarce liquidity in the money market, possibly as a result of sudden changes in market participant behaviour triggered by a crisis of confidence, it is very important to make particularly efficient use of the liquidity that is available. With RTGS^{plus} the Bundesbank had already implemented a system that incorporated benchmark-setting liquidity management elements. TARGET2 will retain several of the essential basic elements already familiar to users of RTGS^{plus}.

Use of tried and tested RTGS^{plus} elements

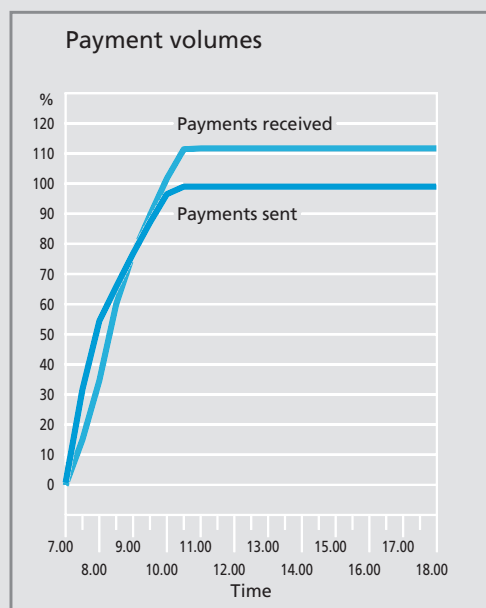
- Liquidity-saving elements ensure an optimised supply of liquidity during payment processing. This means that in addition to account balances and intraday facilities, use is made of “offsetting payments” as cover for processing payments. In the case of submitted payments, for example, the system examines whether payments placed in a queue by the beneficiary may also be used as cover and executed at the same time. Moreover, all participants’ “queues” are continuously optimised.
- By setting limits, a direct participant can restrict the amount of liquidity he uses for “normal” (non-priority) payments to other participants. A bilateral limit enables the direct participant to control his use of liquidity for the settlement of “normal” payments vis-à-vis another direct partici-

pant. A multilateral limit can be used to the same effect vis-à-vis those participants to whom he did not apply a bilateral limit. Limits result in a high degree of transparency and ensure early finality in payment processing. They also enable participants to submit payments early without running the risk of unlimited unilateral outflows of liquidity. Furthermore, they provide bilateral partners with an incentive to submit their own payments early. By means of such offsetting, payments can be executed in finality with little recourse to liquidity and channelled to the recipient as early in the day as possible. This contributes to the optimal deployment of liquidity and has a positive effect on financial stability.

- Like RTGS^{plus}, TARGET2 rigorously embodies the tenet that a high degree of efficiency is best achieved if participants are responsible for managing their own liquidity. To this end, participants are given a variety of “tools” for liquidity management. One such tool is transparency with regard to incoming payments that are still parked in queues. This assists participants in planning the management of their own liquidity positions. Furthermore, participants have the opportunity – as in the case of RTGS^{plus} – to manage the processing situation interactively to suit their changing needs. For example, they can adjust limits or rearrange the order of payments waiting in a queue.

Payment behaviour when setting bilateral limits

Direct RTGS^{plus} participants generally set bilateral limits vis-à-vis some of their counterparties. The chart below clearly illustrates the positive effects of these limits. One advantage is that participants can submit their entire payment volume at an early opportunity without incurring any risk. This is why the number of payments submitted is around 50% higher than the number of payments received during the first RTGS^{plus} operating hour, thus prompting the other participant to act in a similar fashion and submit his payments, too. After another operating hour incoming and outgoing payments are already in balance, and by 11.00 the complete payment volume for that day has, in practical terms, already been processed. In addition, this reduces the risk of damage in the event of a service disruption.



Deutsche Bundesbank

TARGET2 will also offer a number of functional improvements to performance with regard to liquidity management.

TARGET offers additional benefits

- The ability to assign priorities and utilise liquidity reserves allows direct participants to manage their payment flows in line with their own individual needs. TARGET2 offers three different classes of priority. These are: “highly urgent”, “urgent” and “normal”. “Highly urgent” payments (eg for CLS and securities settlement) as well as “urgent” payments (eg those for time-critical interbank payments) have priority access to liquidity. What is more, liquidity for these kinds of payment can be reserved so as to guarantee immediate settlement in every case.
- In future, TARGET2 participants will also have the option of combining various accounts – including those held at different central banks – to form an account group for the purpose of consolidated information or central processing (“virtual account”, “aggregated liquidity”). In the case of a virtual account, the available liquidity of all members of an account group will be aggregated in a liquidity pool during the business day. Each account holder within the group will therefore have the possibility of making payments through his own account up to the total level of intraday liquidity available to the account group. In the case of the consolidated information option, only consolidated information will be offered to the account group. Processing will still be

carried out exclusively at the individual account level.

Participants will be aided in their liquidity management by an Information and Control Module (ICM) which enables them, for instance, to view their current liquidity position, payments status or ingoing and outgoing queues as well as to carry out control operations at any given time.

*Enhanced
liquidity effi-
ciency through
single platform*

The centralised European TARGET2 platform will eliminate the fragmentation of current flows in individual payment transactions in euro and euro-denominated liquidity holdings. The associated improvement in the utilisation of offsetting payment flows should further boost the effectiveness of liquidity-saving features. In addition, in contingency situations, which past experience has shown to be accompanied by a liquidity shortage, the liquidity-saving model can mitigate negative effects. Participants greatly benefit from the improved information content which results from the merging of separate liquidity flows in Europe into just one technical system. Another positive aspect is that in future, limits to the active management of liquidity outflows can be defined individually for each direct TARGET2 participant, not just in national terms but also on a Europe-wide basis.

Interface reduction and settlement by ancillary systems

*Complexity
of settling
ancillary
systems*

The settlement of cash leg transactions (eg securities and foreign exchange operations as well as retail payments) coming through

other (ancillary) systems is being increasingly effected in "safe" central bank money. For this reason, in recent years there has also been an increase in the interdependencies between these ancillary systems and TARGET. As a general rule, the participants in such ancillary systems are required to hold an account with the central bank responsible for that system within the national RTGS framework in order to initiate cash settlement. Hence, at a European level, a highly complex entity has evolved within which the multiple interlinked RTGS systems maintained by the various NCBs are in turn connected with a number of ancillary systems for the purpose of cash settlement. The individual interfaces and procedures involved differ in shape and form. At present, more than 50 ancillary systems use TARGET to carry out their cash settlements.

TARGET2 will greatly simplify the complex structure described above. One reason is the reduced number of interfaces. In future, all ancillary systems will be able to conduct settlement directly in the SSP using central bank money. As a matter of principle, settlement can be executed using any central bank account belonging to the TARGET2 SSP. This will also make it much easier for banks to use remote access to link up with securities and retail payment systems elsewhere in Europe while opening up new business opportunities for the ancillary systems themselves. Consequently, TARGET2 will make a significant contribution to the closer integration of European financial markets.

*Improved
interaction with
ancillary
systems*

*Additional
advantages for
settlement by
ancillary
systems*

The following elements are further proof of the improved processing offered by TARGET2.

- In future, ancillary systems can take advantage of standardised access and clearing procedures. In this context, the Ancillary System Interface (ASI) will offer a special range of services featuring additional functions tailored to meet the requirements of ancillary systems. Banks will therefore be informed in advance (for example, 30 minutes prior to actual clearing) about the balances to be settled in TARGET2, for instance in the case of multilateral settlement processes, where transactions need to be booked on several different participant accounts at the same time. This will have the effect of reducing settlement risk.
- The better liquidity efficiency offered by the common platform will also have a positive impact on the settlement by ancillary systems.
- TARGET2 will allow for night-time securities settlement. In some countries – including Germany – the lion's share of securities transactions is already being processed during the night without any repercussions on standard payment transactions.

However, in terms of risk factors, the new options available for the settlement by ancillary systems warrant close monitoring by the Eurosystem. It is precisely for this reason that the Eurosystem has sought and publicised information on the settlement times involved in

ancillary systems as well as on their dependence on other ancillary systems. This will increase transparency for market participants and reduce the risk of conflicting demands for access to the liquidity that will be centrally maintained in the platform. What is more, adequate contingency provisions on both sides will have a vital role to play, precisely in the event of interaction with other systems, as any serious disruption, particularly at critical periods, might have a resoundingly adverse impact on the European – and possibly even the international – financial markets.

Improved business continuity

The current TARGET environment, with its decentralised structure and large number of participating national RTGS systems, can give rise to operational risks. These can be offset by applying the appropriate contingency measures. Owing to the interconnected nature of the system, however, these risks will be inclined to affect other TARGET components as well. The SSP will eradicate such dependencies. Nevertheless, to ensure that this works there must be a guarantee of high SSP availability as in future any such disruptions will have a direct effect on all TARGET2 participants. Another reason behind this need for a high level of business continuity is that in future TARGET2 will be reopened for the overnight processing of securities transactions as early as 90 minutes after the close of the last business day, primarily for the night-time processing of securities transactions.

*TARGET2 offers
high downtime
security*

The TARGET2 system is therefore based on a two-region model where, in the event of a regional disaster, each region is equipped to take over full live operation within a short period of time. Within each region two separately located operational sites are available to guarantee uninterrupted operation if local problems arise. Should it be necessary to relocate operations from one region to the other, time-critical payments, for instance, CLS liquidity “pay-ins”, can be handled by using a special standby contingency module.

Operational demands on participants

TARGET2 will also place greater importance on the contingency measures which participants are required to apply. Participants who are major players on account of the scale of their business are particularly affected by the future requirement to prove that they have access to a substitute facility at a second location. This regulation is not least a reflection of the increasingly exacting standards applying to payment systems supervision. In order to allow enough time for internal adjustments, however, the rules will not take effect until the second half of 2010. If a participant’s internal IT application suffers a system failure, he has the further option of using the Information and Control Module to make targeted liquidity transfers to other participants or generate payments for settlement within certain ancillary systems.

TARGET2 pricing scheme

One price for domestic and cross-border payments

TARGET2 will not distinguish between domestic and cross-border payments. In future, the common pricing scheme shown on page 78

TARGET2 pricing scheme

Prices in euro

Option A

Fixed monthly fee	100.00
Transaction fee	0.80

Option B

Fixed monthly fee	1,250.00
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Price scale

Level	Monthly transactions		Fee
	Number	Cumulated	
1	10,000	10,000	0.60
2	15,000	25,000	0.50
3	25,000	50,000	0.40
4	50,000	100,000	0.20
5	more than 100,000		0.125

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will apply to “core services”. This approach pursues two particular objectives. Firstly, it should guarantee broad access to the system, ie small institutions should also be able to participate directly in TARGET2. Secondly, the pricing scheme should be attractive to major players who process a high volume of urgent customer payments (known also as “commercial” payments) and who account for a very large share of the current TARGET transactions. The significance of this participant group is underscored by the fact that, for example, in Germany the 10 biggest RTGS^{plus} participants account for about 65% of all transactions in RTGS^{plus} in terms of both volume and value. The processing of commercial payments in the secure TARGET environment will contribute to financial stability in the euro area and make better use of the system while

also offering cost recovery at reasonable prices, as envisaged by the Eurosystem.

Impact of TARGET2 on Bundesbank

*National
customer
connection*

To comply with the principle of decentralisation enshrined in the EU Treaty and to guarantee that their services are tailored as closely to customers needs as possible, the participating central banks will continue to be responsible for all operational aspects with regard to their customers despite the technically centralised nature of the TARGET2 system. Furthermore, from a legal perspective, the TARGET2 system will retain its multiple-layer structure, meaning that each central bank will be regarded as a separate system operator. Consequently, in Germany the relationship between a participant and the Bundesbank will be governed by German law and will be regulated by the TARGET2 conditions of the Bundesbank. The German system will be called TARGET2-Bundesbank (TARGET2-BBk).

To avoid competitive distortions in Europe and to provide a standardised service level, the Eurosystem also agreed that national regulations should be harmonised as far as possible. Exceptions are possible only in situations where a difference in national law makes this absolutely necessary. This approach will make it possible to retain the tried and tested system of participation under the national law of the respective countries and at the same time take into account the requirements of European integration.

In the autumn of 2003 the Bundesbank and the central banks of France and Italy submitted a joint proposal to develop and operate a TARGET2 platform, which was then adopted by the Governing Council of the ECB in December 2004. In designing and developing the TARGET2 payment system, the Bundesbank drew on its experience gained in setting up and operating RTGS^{plus} and further enhanced the main features of the system to reflect the requirements of European market participants. Moreover, together with Banca d'Italia the Bundesbank will have primary responsibility for SSP operations while some specific modules used mainly by central banks (eg Datawarehouse) will be offered by the Banque de France as a supplementary service. TARGET2 presents a first-time opportunity to realise a service centre concept within the ESCB. It will capitalise on the expertise, resources and technical infrastructure that are already to be found in national central banks by applying these to generate a common range of services for the ESCB where previously these would have been provided individually by each and every central bank.

*Bundesbank as
joint operator
of SSP*

At present about 190 institutions participate in the German RTGS^{plus} TARGET component on a direct basis. Numbered among these are banks and central banks from Slovenia, Cyprus and Malta, which prior to TARGET2 had, for reasons of cost, been against creating their own euro-based RTGS systems and instead decided to use an existing RTGS system. All in all, by the end of 2006 approximately 1,000 European financial institutions had made use of TARGET as direct participants.

*Participation
via TARGET2-
Bundesbank*

There will be no great change in substance from the forms of participation offered by the current RTGS^{plus} and TARGET concepts. However, since TARGET2 has standardised technical access across Europe, it enables multinational banks, in particular, which still participate in several different TARGET components in various countries to focus their TARGET2 access on a single country and thus consolidate the settlement of their payments.

Being able to concentrate the majority of business activities in one RTGS account will also greatly simplify the task of liquidity management. Once access has been consolidated in one main office, a number of foreign bank subsidiaries are likely to stop participating directly via TARGET2-BBk. Direct RTGS^{plus} participants from Slovenia and Cyprus will also participate in future in TARGET2 directly via their respective central banks.

In total, about 150 direct TARGET2-BBk participants are expected to take part in the launch.

Measured in terms of the total figure of almost 2,300 institutions in Germany, this low level of direct participation in RTGS^{plus} might come as a surprise. However, it is important to remember in this context that a majority of savings banks and credit cooperatives already choose to participate in RTGS^{plus} only on an indirect basis – ie via the relevant Landesbank or regional institution of credit cooperatives – in order to benefit from internal network synergies. Affiliated institutions take regular advantage of the direct access that is available to them through their parent company.

Generally speaking, it cannot be ruled out that indirect forms of access to TARGET2 may also gain in appeal for other institutions in the wake of rising price pressures, increased consolidation and further outsourcing. Frequently the actual implementation costs are not the only significant factor. A role is also played by the administrative burden which is associated with direct participation and which involves the ongoing monitoring and control of business activities inside the system. In the final analysis, however, the decision to participate or not depends on the fundamental, long-term strategy position of each institution. What remains important for the Bundesbank is that the design, technology and pricing of TARGET2 should not prevent smaller institutions from directly participating in this payments system. The harmonisation and stronger European integration that TARGET2 will induce are likely to lead to a sharp increase in competition for the custom of German and other European banks that are interested only in indirect access to the system as well as for correspondent banking services sought by institutions domiciled outside Europe.

The harmonisation within the Eurosystem that is bound to accompany TARGET2 will, in the medium term, oblige the Bundesbank to undergo some structural adjustments as well. As the situation stands at present, around 220 German credit institutions use the Bundesbank's Customer Access Mechanism (CAM) to participate indirectly in RTGS^{plus}. Under a joint agreement within the ESCB these arrangements will be tolerated for a maximum transitional period of four years,

Indirect access via TARGET2-Bundesbank even more important

Forms of participation in TARGET2

Forms of participation	Geographical area	Maintenance of own RTGS account	Submission and receipt of payments	Remarks
Direct	EEA	Yes	Direct	
Multi addressee access	EEA	No	Direct	Possible for the branches and subsidiaries of the direct participant; transaction settled through the direct participant's RTGS account
Indirect	EEA	No	Via the direct participant	Indirect participants are expressly recognised by the system and therefore benefit from the protection of the EU Settlement Finality Directive (SFD), depending on how this has been implemented in respective national law
Addressable BIC	Worldwide	No	Via the direct participant	No participation within the meaning of the system rules. A direct participant can, for instance, arrange for his correspondent banks or branches to be registered

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after which such "residual" payments will have to be settled using the TARGET2 SSP. Apart from the cost factor, the main explanation for this was the realisation that full enjoyment of the advantages which Europe-wide harmonisation aims to achieve will be possible only if all payment transactions are processed in their entirety by the SSP.

Initial use of platform limited to payments

The TARGET2 SSP comprises several modules. Among the "core services" to be used by all central banks are the payments module, including the management of TARGET2 accounts and the ICM. In addition to this, individual central banks can make use of optional components, such as a module for supple-

mentary central bank account management, for calculating minimum reserve requirements and for handling the marginal lending facility and the deposit facility. Central banks which do not use these modules perform the corresponding functions using their own applications outside the SSP. In the interest of distributing the burden and for reasons of migration safety, the Bundesbank has, for the time being, decided in favour of this option. As a result, the Bundesbank will remove the participants' liquidity from the SSP and return it to their home account management system shortly after the close of the business day at 18.00 – as in the case of RTGS^{plus} today. Following a close-of-day processing period that will be very short compared with the time expended today, participants will be required to make liquidity available to the platform again

Platform has modular structure

by no later than 19.30 as some ancillary systems – in particular, securities settlement systems – will need to access TARGET2 accounts in the course of night-time processing.

In the medium to long term virtually all of the central banks are likely to heed a marked trend within the ESCB towards using optional modules, thus accommodating a strong preference on the part of the banking business for this approach and cost-effectiveness considerations.

Securities settlement via TARGET2

Cash settlement via Clearstream

Approximately 80% of all securities transactions are now settled overnight by the German central securities depository, Clearstream Banking Frankfurt AG (Clearstream). For reasons of efficiency and security the model is based on the use of central bank money, which participants make available on the evening prior to the value date by reserving it in the respective accounts at the Bundesbank. To this end they can make use of any unused minimum reserves as well as the entire pool of unpledged collateral held by the Bundesbank. Utilising the statutorily guaranteed amounts that are reserved by the Bundesbank, Clearstream is able to settle its securities transactions securely and with immediate finality during the night. In the early hours of the value date the amounts to be credited and debited as a result of this settlement process are transferred within the Bundesbank's system of accounts, and the reservation is simultaneously lifted. Consequently, participants are given unlimited access to liquidity

again before the opening of TARGET. Shortly after the launch of TARGET2 Clearstream will likely use only the new TARGET2 functions along with the participants' TARGET2 accounts for this procedure. Foreign Clearstream participants will no longer need to hold an account with the Bundesbank and will instead be able to use the TARGET2 account that is maintained by their own national central bank. In the course of 2008, Clearstream same-day settlement as well as the German derivatives exchange, Eurex Clearing and the European energy exchange, European Commodity Clearing AG (ECC) will likewise switch to TARGET2 accounts for the purpose of financial settlement. Until such time, the respective settlement processes will be handled using the Bundesbank's home account system, as is currently the case.

As a consequence of the interdependencies which exist between securities settlement and payments transactions, the question of liquidity is becoming more and more important. In order to guarantee even greater efficiency in the area of securities settlement, to equip the banks with a more flexible and robust system of liquidity management and to provide a further liquidity saving option, the Bundesbank will offer a self-collateralisation procedure from the fourth quarter of 2007. Should there be insufficient liquidity for settling certain purchase transactions during Clearstream's night-time processing, this procedure offers banks the possibility of automatically borrowing on the strength of the securities underpinning the transactions in accordance with the general rules governing intra-day refinancing at the central bank. In

*Self-collateralisation option
means greater
efficiency*

such an event the Bundesbank makes the corresponding shortfall in liquidity – less haircuts – available to the participants.

Further consolidation of infrastructure probable

Integrated securities settlement in TARGET2-Securities

With TARGET2 the Eurosystem will make a major contribution to supporting the European financial infrastructure, especially in the form of enhanced euro liquidity at the European level and improved links with other settlement and clearing systems. This will make the settlement of transactions in central bank money much more efficient. Nonetheless, it is foreseeable that TARGET2 will be just the starting point of a medium to long-term process of development. The specific demands of market players in an increasingly interlinked European financial arena and the cost benefits that can be achieved in the Eurosystem by using common systems all bear witness to this fact. In this connection, the central banks of the Eurosystem are at present discussing, for example, the merits of setting up a joint system for managing collateral for monetary policy operations, to be known as Collateral Central Bank Management. In addition to this, the Eurosystem is currently working in close collaboration with market participants and CSDs to produce a set of user requirements for the TARGET2-Securities system. TARGET2-Securities (T2S) takes the concept behind TARGET2 and ap-

plies it to securities settlement using central bank money. Designed to provide a single, central platform for integrating both central bank money and securities transactions, it would greatly harmonise European securities settlement and offer an efficient and secure means of settling transactions in central bank money while contributing to the integration of the European capital market. By contrast, securities settlement as it is practised today in Europe is still highly fragmented, translating into relatively high costs for cross-border transactions. With T2S, the Eurosystem does not intend to create a European CSD. Rather, the safe custody of securities and the services associated with this should remain in the hands of national CSDs.

The Governing Council of the ECB has already decided that, conditional on its implementation, TARGET2-Securities will be made available on the SSP as an additional service. Among other things this will achieve cost synergies while also exploiting a benchmark-setting strategy for contingency provisions and allowing participants to enjoy the functional benefits offered by, say, liquidity management as well as by harmonised interfaces (for example, in the shape of the ICM). The Governing Council of the ECB is expected to decide on the final implementation of the project in the first six months of 2008, once the user requirements have been finalised and a public consultation has taken place.

Implementing TARGET2-Securities via the SSP