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## The TARGET2 world compared with today's RTGS<sup>plus</sup>/TARGET system

In October 2002, the Governing Council of the ECB adopted the main principles for the next generation of the TARGET system. It established that, in the future, there will be greater harmonisation of the service features and a single TARGET2 price structure for national and cross-border payments will be introduced. A subsequent public consultation, however, also revealed that the banking industry would much prefer a TARGET2 system with only one single (technical) platform. In order to accommodate this request, the Eurosystem then focused on developing such a single platform. In July 2003, the Bundesbank, Banca d'Italia and Banque de France (also known as 3CB) took the initiative and made a proposal to the European System of Central Banks (ESCB) to develop and operate the single platform. The Governing Council of the ECB accepted and approved this proposal in December 2004.<sup>1</sup>

Weaknesses in the current TARGET system will be eradicated in TARGET2. In particular, the heterogeneity of the present system network will be eliminated. Technical shortcomings and less efficient cost structures will be eliminated by the new common platform. TARGET2 will improve the liquidity management within the European banking industry ("more services") and enable cost-effective participation for all European credit institutions through the use of state-of-the-art technical standards ("more cost efficiency"). Standardised functionality, services and technical interfaces will be offered in all TARGET2 countries. Regardless of whether domestic or cross-border, a single price structure will apply to all TARGET2 payments.

In Germany, it is the current RTGS<sup>plus</sup> participants which will be primarily affected by the migration to TARGET2 since RTGS<sup>plus</sup> will shut down with the launch of the single platform.

The following differences to RTGS<sup>plus</sup> and TARGET will result.

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<sup>1</sup> Hence, the possibility provided for by the Council's decision of 2002 for individual countries to continue operating their own RTGS System (which, however, had to fulfil the harmonised features) is meaningless.

## 1. Settlement of payment orders

- Owing to lack of demand, the settlement of multiple customer payments (MT 102) will no longer be possible in TARGET2.

The RTGS<sup>plus</sup> system can process multiple customer payments. However, this option has not been used by any RTGS<sup>plus</sup> participant.

- The participants will be given the opportunity – following bilateral consultation – to debit the account of another direct participant in TARGET2 using direct debit (MT 204).

The settlement of such interbank collections is not offered by RTGS<sup>plus</sup> and TARGET.

- Payments can be submitted up to five business days in advance. This is not possible in RTGS<sup>plus</sup> and TARGET.
- As is the case with corresponding banking, all payments throughout Europe will be addressed directly to the receiving credit institutions in future (use of SWIFTNet FIN Y copy).

This procedure applies only to domestic payments in RTGS<sup>plus</sup> today. By contrast, cross-border TARGET payments submitted must be sent to a separate TARGET address; the foreign beneficiary bank will be specified only inside the payment message.

## 2. Liquidity management

- Like RTGS<sup>plus</sup>, TARGET2 has bilateral and multilateral limits. In contrast to today's situation, limits can now be defined throughout Europe. Liquidity management is therefore possible now not only for German credit institutions but also for all TARGET2 participants (as things now stand, around 1,000 banks are likely to be direct participants).
- Liquidity can be reserved for the settlement of priority transactions (highly urgent and urgent) (eg €X million for urgent payments). Liquidity can likewise be reserved in RTGS<sup>plus</sup>, albeit only for settling so-called express payments and only "indirectly" (ie this reservation is de facto the "residual" between total liquidity and the liquidity available for limit payments).
- TARGET2 will offer standardised interfaces to ancillary systems – eg securities settlement and retail payment systems. In theory, a TARGET2 participant can then take part in all ancillary systems in the EU with its RTGS account. Today, bookings arising in the Bundesbank's electronic retail payment system (RPS) as well as the financial settlement of securities transactions of Clearstream and Eurex are made via the Bundesbank's home accounting (not via RTGS<sup>plus</sup>). Clearstream and Eurex will probably shift the financial settlement of securities transactions to TARGET2 once operations go live. Financial settlement of securities transactions will then no longer be booked through Bundesbank accounts, but rather directly through the TARGET2 participants' RTGS accounts. By contrast, balances from the RPS will continue to be booked through participants' Bundesbank accounts to start with. A move to TARGET2 is also planned for these in the medium term.
- TARGET2 participants can also put liquidity aside for the settlement of ancillary systems, but in particular, for the night-time processing of securities settlement systems (dedicated liquidity). For this purpose, liquidity is transferred to a separate sub-account. Today, a similar function is available only for the overnight processing of Clearstream securities transactions; the relevant amounts are blocked on the participant's Bundesbank account.

- By operating TARGET2 on a central platform, the individual TARGET2 participant can also be shown the payments that are intended for him but cannot yet be booked on the RTGS account of the sending foreign credit institution.

Owing to the decentralised design of TARGET, it is not possible to provide transparency of the queues of incoming cross-border TARGET payments from abroad in the current environment.

- TARGET2 will also enable liquidity pooling. Two variants are offered – virtual account and consolidated information.

In the case of a virtual account, the available liquidity of all members of the group of accounts is pooled in one liquidity pool during the day. Each account holder within a group of accounts thus has the possibility of making payments through his own account up to the total level of intraday liquidity available to the account group. However, a virtual account can only include euro-area accounts.

Consolidated information only entails summarized information for these grouped accounts. Consolidated information can also include RTGS accounts from out countries.

RTGS<sup>plus</sup> provides no opportunity to group accounts or to pool liquidity.

### **3. Technical infrastructure of the Information and Control Module**

- The TARGET2 Information and Control Module is exclusively SWIFT-based both in respect of the products and the network that are used. The Virtual Private Network (Deutsche Telekom), which is used for the Information and Control System of RTGS<sup>plus</sup>, will no longer be provided in TARGET2 (not even for a transition period).

Please note the following points during preparation for migration.

#### Retention of the existing dual account structure for RTGS<sup>plus</sup> participants

Even though TARGET2 will also enable liquidity to be kept in the RTGS system overnight and credit lines to be linked to the RTGS account, the Bundesbank will initially retain the account structure which has been tried and operated in the context of RTGS<sup>plus</sup>. Each direct German TARGET2 participant will therefore continue to maintain a home account with the Bundesbank, in which his liquidity will be kept "overnight". The use of standing facilities as well as monetary policy operations will also be settled via this home account at the Bundesbank.

#### Medium-term closure of the customer access mechanism for banks

The Bundesbank will concentrate individual payments in TARGET2. It will therefore shut down access to the customer access mechanism for credit institutions no later than four years after the start of the Bundesbank's participation in TARGET2. These credit institutions must then either become direct TARGET2 participants or use another credit institution as a "settlement agent". The need to have access to SWIFT is not likely to be an obstacle, even for smaller institutions to have direct access.

#### Migration of the settlement of ancillary systems

In the case of the settlement of ancillary systems (eg securities settlement and retail payment systems), it has been decided by the ESCB that the financial settlement will have to take place in TARGET2 after a transition period of up to four years. In the case of internationally-oriented systems (eg Clearstream), it is expected that these will be migrated to TARGET2 once the migration period expires (May 2008) or shortly thereafter.