

## TARGET2 – a single Europe for individual payments as well

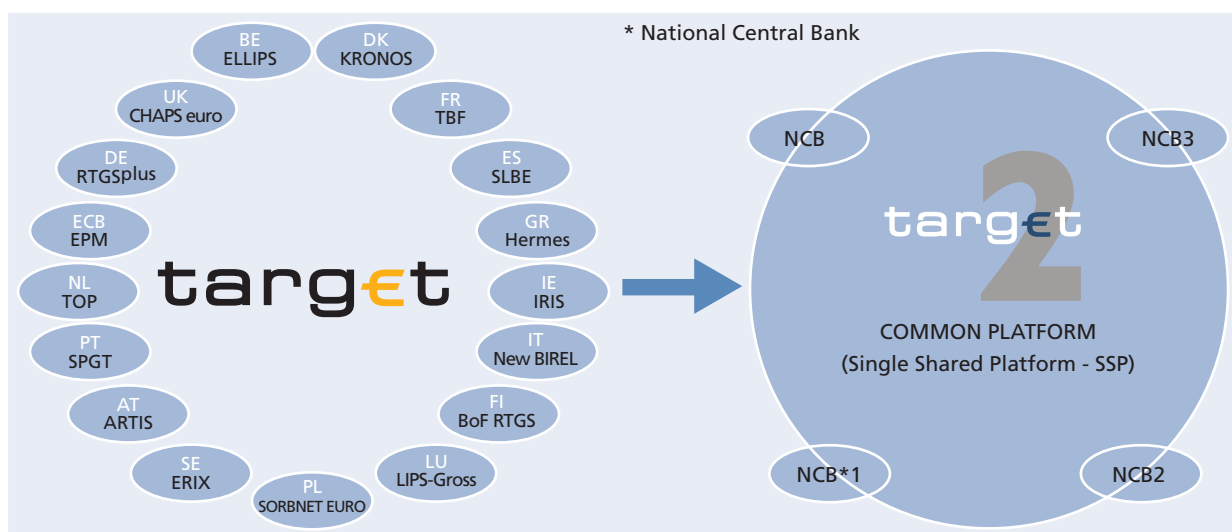
### TARGET2 – the reasons behind the development

In October 2002, the Eurosystem began work on a new TARGET2 system. Although the TARGET system in place since 1999 has proven to be a very successful payment system with the highest turnover in Europe, certain structural drawbacks have become evident. In particular, the decentralised structure – TARGET is comprised of 17 individual systems – and the principle of “minimum harmonisation” appeared in the longer run to be less advantageous in terms of performance, costs and stability. Furthermore, the European banking industry had made it clear that, given the planned Single Euro Payments Area, in future it would prefer a single

TARGET2 platform with largely standardized features and technical interfaces, which would enable an efficient pan-European liquidity management.

### TARGET2 – a cooperation project

From the start of the TARGET2 debate, the Deutsche Bundesbank has consistently supported the idea of a single shared platform. This led to in-depth discussions with the Banca d'Italia and the Banque de France. The upshot of these talks was that in July 2003 all three central banks decided to submit a common offer to the ESCB to develop and operate the TARGET2 Single Shared Platform (SSP).



On 16 December 2004 the ECB Governing Council mandated the three central banks to develop and operate the SSP.

All the central banks in the Eurosystem as well as Poland and Denmark will use the SSP. Some new Member States central banks will only join TARGET2 when they introduce the euro as the common currency. This means that in future there will only be one common technical platform in TARGET2.

### TARGET2 – the conceptual design

Overall, the new TARGET2 system has the following objectives:

- Meeting the user requirements of the European banking industry.
- Compliance with the neutrality principle. The new system may not lead to competitive distortions between the individual countries or market infrastructures.
- Safeguarding the principle of decentralisation within the ESCB. The participating central banks will retain responsibility for conducting business with their customers.
- High degree of flexibility through a modular approach in order to accommodate the various interests of the participating national central banks.
- High level of standardisation.
- Benchmark-setting contingency provisions.

### TARGET2 – the advantages for the participants

In addition to the high level of service already provided in RTGS<sup>plus</sup> and TARGET, TARGET2 offers

- additional liquidity management opportunities (reservation of liquidity, liquidity pooling),
- the application of Europe-wide limits,
- direct addressing irrespective of whether domestic or cross-border payments are involved,
- the processing of "interbank" direct debits (MT 204),
- the possibility of submitting payments "in advance",
- the settlement of ancillary systems (eg securities settlement systems, retail payment systems and individual payment systems) in the common platform; the main advantage being that each ancillary system in TARGET2 has access to every central bank account in Europe,
- better queue transparency (for cross-border payments, too),
- a larger settlement volume (greater liquidity savings) and
- standardised functions, services, technical interfaces and prices across all TARGET2 countries.

### TARGET2 – the pricing scheme

In TARGET2, the distinction between national and cross-border EU payments will cease to exist. In future, there will only be one common pricing scheme for the core service, which aims to meet two main objectives. First, it should ensure broad access to the system, which means that it should not discourage smaller institutions from direct

participation. Second, the pricing scheme should be attractive to the major market players, who account for a very large share of the current TARGET1 transactions and who, in particular, process urgent commercial payments. The processing of these payments in RTGS mode contributes to financial stability in the euro area and allows cost-recovery at a reasonable price.

Following discussions with users, the Governing Council of the ECB decided on the following pricing scheme on 20 July 2006. The participants may choose between two options. Option A charges a small monthly fixed fee of 100 euro plus a flat rate of 0.80 euro per transaction. Option B charges a monthly fixed fee of 1,250 euro as well as a volume-based degressive fee ranging from 0.60 to 0.125 euro per transaction. The point at which option B becomes more attractive is when 5,750 transactions or more are carried out per month.

OPTION A		
Monthly fixed fee	EUR	100.00
Flat rate	EUR	0.80

OPTION B			
Monthly fixed fee	EUR	1,250.00	
BAND	Monthly Transactions		EUR
	Volume	Cumulative	Price
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	Above 100,000		0.125

## TARGET2 – liquidity pooling

TARGET2 offers two types of liquidity pooling, ie in the form of a virtual account and in the form of consolidated information. Both options are based on the idea of allowing TARGET2 participants to pool their RTGS accounts in a group of accounts.

In the case of a virtual account, the available liquidity of all members of the group of accounts is consolidated in a liquidity pool during the day. Each account holder within a group has thus the possibility of making payments through his own account up to the total level of intraday liquidity available to the group of accounts. Only accounts of participants in the euro area may be included in a virtual account. Responsibility for the management of the individual accounts at the end of the day (eg to fulfil the minimum reserve requirement or to avoid drawing overnight credit) lies with the relevant group of accounts.

In the case of the consolidated information option, only consolidated information is offered to the group of accounts. Processing is still carried out exclusively at the individual account level. The consolidated information is also available to participants from non-euro-area countries.

## TARGET2 – open participation without any size-related access criteria

TARGET2 provides open and competitively neutral access to large-value payments in euro. In principle, credit institutions will be free to choose between direct or indirect participation.

### Direct participation

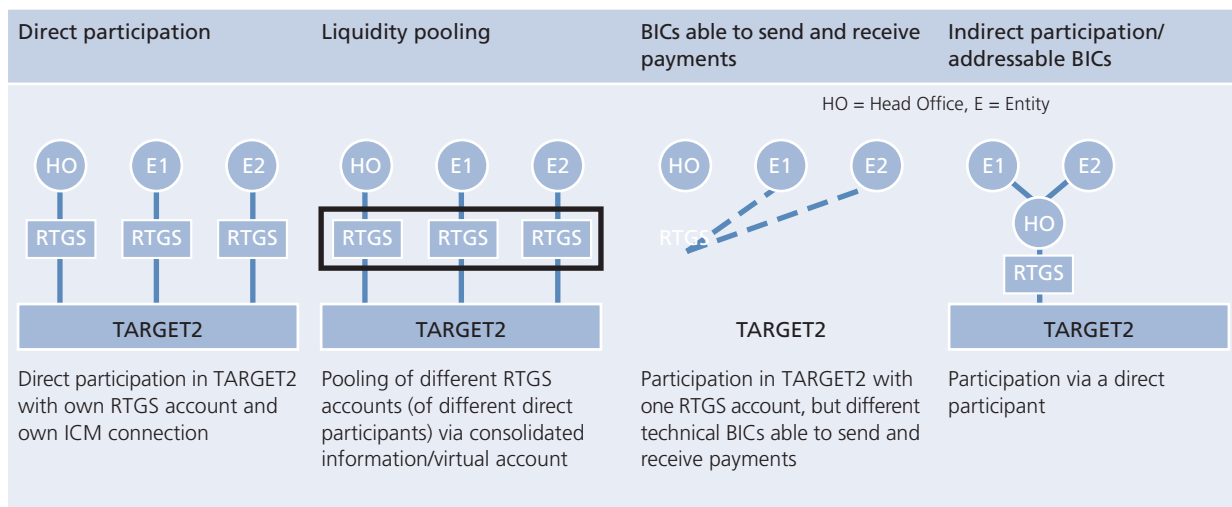
Direct participants must have their own RTGS account and their own Information and Control Module (ICM) connection. Supervised credit institutions established in the European Economic Area (EEA) are allowed to become direct participants. A direct participant may also hold multiple accounts in TARGET2, which have to be assigned to different BICs. On request, single BICs, which are generally used for internal purposes of a participant, may remain unpublished in the TARGET2 routing directory (so-called “unpublished BICs”).

Owing to the liquidity pooling feature, several direct participants may also group their accounts to form a virtual account or they may use the consolidated information feature.

Furthermore, a participant may hold just one RTGS account and may authorise branches and credit institutions belonging to the same group and located in EEA countries with a separate BIC to send and receive payments directly (so-called “technical BICs” or “multi-addressee access”).

### Indirect participation

As a matter of policy, indirect participants settle their TARGET2 payments via a direct participant, which means that they do not have their own RTGS account and are not able to send or receive payments directly. Only credit institutions established in the EEA are allowed to become indirect participants. Indirect participants are recognised by the system operator. They benefit from the protection of the Settlement Finality Directive of the EU (in the countries where such protection has been granted).



#### Addressable BIC

Any branch or correspondent of a direct participant is allowed to be listed as an addressable BIC in the TARGET2 directory, irrespective of its geographical location. From a technical point of view, there is no difference between indirect participants and addressable BICs. Legally, however, addressable BICs only provide routing information in the TARGET2 directory without any further legal consequences.

#### TARGET2 – the migration

The Eurosystem assessed the advantages and disadvantages of a “big bang” migration compared with a phased migration by “country windows”. The simultaneous migration of all TARGET

participants to the single shared platform would create an enormous project risk and would not permit any flexibility in the organisation of the changeover.

For this reason, the Eurosystem opted for a country window approach in which user groups will changeover to the Single Shared Platform on various pre-defined dates. Each group will consist of various central banks and their respective national banking communities. The migration process is expected to be spread over a six-month period, during which both TARGET1 components and the SSP will coexist. The Eurosystem has defined the country windows based on the technical project requirements.

Germany will migrate in the first country window together with Austria, Cyprus, Latvia, Lithuania, Luxembourg, Malta and Slovenia on 19 November 2007.

