



Official launch of the TARGET2 project for the Luxembourg banking community at the BCL

On 24 November 2005, Mr. Yves Mersch, Governor of the Banque centrale du Luxembourg, had invited representatives of the management of the local banking community to a presentation of TARGET2.

TARGET2, the successor of the present TARGET system is a major project of the Eurosystem in the area of large-value payments. The Governing Council of the ECB launched this project back in October 2002, when it decided to technically consolidate the present TARGET system.

In July 2003, Banca d'Italia, Banque de France and Deutsche Bundesbank offered to jointly build and operate the future common payment platform. End 2003, the Eurosystem central banks had expressed their willingness to join the single sharable platform (SSP).

After an extensive public consultation, the Governing Council of the ECB approved the 22 July 2004 the final version of the General Functional Specifications (GFS) of the future TARGET2 system.

At present, the Eurosystem is finalising the User Detailed Functional Specifications (UDFS). UDFS are composed of four books: book 1 (Core Services), book 2 (Optional Services), book 3 (Additional Information for Central Banks) and book 4 (XML messages). Final versions of book 1 and book 2 were published on 30 November 2005. Minor changes may still occur in the published versions of book 3 and book 4. Concerning the Information and Control Module (ICM), provisional versions of User Handbook I (for credit institutions and ancillary systems) and of User Handbook II (for central banks) are also available.

Main features of TARGET2

The core of the TARGET2 system, the mandatory Payment Module (PM) and some optional modules for National Central Banks (NCBs), will be run on a single technical platform, the SSP. Although the technical infrastructure used for operating the aforementioned services will be centralised, the business relations between the central banks and the participating banks and ancillary systems will remain decentralised, i.e. managed at a national level. Each NCB will thus keep the responsibility for the opening and closing of accounts, the monitoring of activities, the delivery of help desk services, the provision of intraday credit for its participants in TARGET2.





Interfaces to the PM will be standardised. Following an explicit request by the European banking industry, the communication network used by TARGET2 will be SWIFT.

TARGET2 will not only be used for the settlement of payments by some 1,000 directly participating credit institutions. It will become the central settlement engine for most ancillary systems, be they payment or securities settlement systems. It will enable participants to use one single TARGET2 account for the settlement of their transactions in any of the connected ancillary systems. In addition a dedicated night-time window is being arranged to enable the safe settlement of ancillary systems' night-time clearing batches.

Participants in TARGET2 can profit from a set of advanced liquidity management features and thereby optimise the use of their available liquidity, through credit limits, timed payments, reservation of liquidity, etc.

Consolidated Information and Intraday liquidity pooling

For the management of intraday liquidity the SSP offers, besides features available on the level of individual accounts, the possibility to retrieve aggregated information on the liquidity available for a pre-agreed group of accounts (Consolidated Information). This feature offered to all banks, including non-euro area banks, will enable them to obtain an online view of the liquidity situation in each of the linked accounts. Each group of accounts will designate one manager. Payment transactions are booked on the single account against liquidity available on that account, but the manager of the group can initiate liquidity transfers between the accounts of the group and hence use the available liquidity in the group more efficiently.

Euro area banks can also choose to have different accounts aggregated in a Virtual Account. While payment transactions continue to be booked on the individual account, the reference for the liquidity check will be the aggregated amount shown by the Virtual Account, i.e. the balances and the available credit lines of all the accounts that have been grouped. Here again the involved participants have to designate one manager. At the end of the day, the manager of the group will level out the balances on the accounts of the group.

Resilience of TARGET2

To ensure maximum security and resilience, the architecture of the SSP's payment and accounting services is based on a "2 regions x 2 sites" principle. The operations are run alternatively in two different regions (Germany and Italy) with in each of them a back-up site. The system and the application software are updated in the two regions by asynchronous remote copy. Rotation between regions is fully transparent for participants. The SSP is fully compliant with the TARGET Security Requirements and Controls established by the Eurosystem.

A third region (France) is dedicated to the provision of services available to NCBs and hosts data warehousing and customer relationship management functions.

TARGET2 governance

The governance for TARGET2 is organized in three levels. Level 1, the Governing Council of the ECB, will be the ultimate decision making body. Level 2, composed of representatives of participating NCBs, will be the functional owner of the system and level 3, comprising the three providing central banks (Banca d'Italia, Banque de France and Deutsche Bundesbank) will be the technical operators of the new system.

TARGET2 project plan

At the level of the Eurosystem, major milestones of the TARGET2 project have been or are in the process of being finalized. Now that the detailed functional specifications are frozen and the providing central banks have started the development of the SSP, NCBs and their participants can launch their national and individual migration programs to TARGET2.

The future TARGET2 milestones consist of:

- internal developments by level 3 until the fourth quarter 2006
- internal testing by level 3 and acceptance testing by level 2 during the first quarter of 2007
- user testing from April to October 2007
- migration to TARGET2 starting in November 2007.

Migration to TARGET2

In order to minimize the risks inherent to the switch from a technically decentralized system to a common infrastructure, the Eurosystem has opted for a phased migration in three waves. The Governing Council of the ECB, in its meeting of 20 October 2005, agreed on the migration dates and the composition of the migration groups as follows:

- Group 1 on **19 November 2007**: Austria, Cyprus, Germany, Latvia, Lithuania, **Luxembourg**, Malta, Slovenia
- Group 2 on 18 February 2008: Belgium, Finland, France, Ireland, The Netherlands, Portugal, Spain
- Group 3 on 19 May 2008: Denmark, the ECB, Estonia, Greece, Italy, Poland.

An additional migration window for contingency purposes was agreed for 15 September 2008.

Pricing issues

Also in their meeting of 20 October 2005, the Governing Council decided on a single price structure for the TARGET2 core services. The pricing scheme aims at ensuring broad access to the system by not discouraging smaller institutions from a direct participation, while at the same time being attractive to major players.

The Governing Council presented a pricing scheme that will be finally decided upon after discussion with the banking community. Participants may choose between the following two options:

- Option A: a monthly flat fee of € 100 plus a single transaction fee of € 0.80 per transaction.
- Option B: a monthly flat fee of € 1,250 plus a transaction fee on a monthly sliding scale with a fee of € 0.60 for the first 10,000 transactions, of € 0.50 for the next 15,000 transactions, of € 0.40 for the next 25,000 transactions and of € 0,20 for any transaction above 50,000.

When assessing the pricing scheme, the Governing Council considered its impact on each country by comparing the average fees per country to the current TARGET average fees. In almost all countries, the average fees under the envisaged pricing scheme are considerably lower than today.

The Luxembourg migration program

In 2004 and 2005, the BCL had organized several more informal meetings to keep the national banking community informed about the progress of the TARGET2 project. In cooperation with its participants, the BCL established the milestones for the migration of the community to TARGET2. For each participant, they consist of:

- the Pre-project phase, comprising the internal agreement to participate and the mandate to the project team

- the Project phase, subdivided in

- Start of the project (definition of user requirements, budget agreements, signing of functional specifications)
- SWIFT registration (for the test environment, to CUG and SWIFT-Net browse registration are foreseen in July 2006 and for the live service in January 2007)
- Internal preparation (internal developments and testing should be finalized before April 2007)
- Legal documentation
- User testing from April to October 2007 including certification of the test results in August 2007 and tests in the live environment in early September 2007
- Going live: the migration date for Luxembourg is 19 November 2007.

While addressing the banks on 24 November 2005, Mr. Mersch emphasized that any delay in the Luxembourg migration will put high additional financial burden on the TARGET participants. If not ready on time, Luxembourg will be relegated to the fourth window that is migrating 10 months later. As a consequence, the community would have to finance their present LIPS-Gross system until that time. In addition, the present system would require costly adaptations to connect to the SSP during the migration phase. Therefore, Mr. Mersch urged the banks to proceed with their internal projects and he underlined that the community cannot afford to wait for latecomers.



NEWSLETTER

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Useful links and contacts

Further information about TARGET2 is available at the websites of the Banque centrale du Luxembourg at

http://www.bcl.lu/fr/systemes_paiement/gros_montant/index.html

and http://worf/en/payment_systems/large_value_payments/index.html

and the European Central Bank at

<http://www.ecb.int/paym/target/target2/html/index.en.html>

The first progress report on TARGET2 is available under

<http://www.ecb.int/pub/pdf/other/target2progressreport200502en.pdf>

while the second report is found under

<http://www.ecb.int/pub/pdf/other/target2progressreport200510en.pdf>

To access information restricted to interested banks, please contact the Payment Systems Department of the BCL, who will provide you with a user name and a password.

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