



EUROPEAN CENTRAL BANK

## SECOND PROGRESS REPORT ON TARGET2

On 8 February 2005, the Eurosystem published the first progress report on TARGET2. The report focused on issues related to the TARGET2 service, establishing a general framework for the pricing of the core service, describing the migration strategy for TARGET2 and giving a preliminary indication of the overall project planning for TARGET2.

This second progress report starts by providing further information on the planned start date of the single shared platform (SSP) for TARGET2 and the corresponding dates for the different migration windows. The second chapter provides information on the pricing strategies for the TARGET2 core service, the liquidity pooling service and ancillary system settlement. The last chapter provides details of the operational day for TARGET2, including the night-time settlement window for ancillary systems, and describes the ongoing work related to contingency arrangements.

### 1. PROJECT PLANNING

On 17 June 2005, the Governing Council of the ECB communicated to the market that the period of extensive user consultation had concluded and that the go-live date for the first migration window will be during the second half of 2007. The timeframe ensures that all comments made by the various participants are taken into account and that banks have enough time to prepare for the testing of TARGET2. Having now completed a comprehensive assessment of the TARGET2 planning arrangements, the Governing Council has decided to set **19 November 2007** as the go-live date for TARGET2.

Key to remaining within the timeframe envisaged is the finalisation of the User Detailed Functional Specifications (UDFS). An interim version was published on the TARGET2 website at the end of August 2005. This version, which was prepared with the close collaboration of the TARGET user community, is considered a stable and sufficient basis for the development of the central banks' and TARGET users' information systems. After settling all remaining issues, it is planned that the final UDFS will be available at the end of November 2005.

## 2. TESTING AND MIGRATION

### 2.1 Migration

The Eurosystem has agreed to split the migration into four waves (with the last wave being reserved for contingency purposes only) and has decided on the composition of the migration groups. The exact dates of each migration wave are as follows: 19 November 2007, 18 February 2008, 19 May 2008 and 15 September 2008 (in the event that the contingency window has to be activated).

**Table 1 Composition of migration groups and changeover dates**

<b>Group 1</b>	<b>Group 2</b>	<b>Group 3</b>	<b>Group 4</b>
<b>19 Nov. 2007</b>	<b>18 Feb. 2008</b>	<b>19 May 2008</b>	<b>15 Sep. 2008</b>
Austria	Belgium	Denmark	<i>Reserved for contingency</i>
Cyprus	Finland	Estonia	
Germany	France	ECB	
Latvia	Ireland	Greece	
Lithuania	Netherlands	Italy	
Luxembourg	Portugal	Poland	
Malta	Spain	United Kingdom	
Slovenia			

In May 2005, the Eurosystem published the national migration profiles, which describe the situation on the days the central banks will migrate to the SSP. The migration profiles provide an overview of the usage of the different modules (including the optional modules), information on the type of business settled in each module, and a list of the ancillary systems that intend to settle in the Payments Module of the SSP from the date their home central bank joins the SSP, including the envisaged settlement procedure.

### 2.2 Testing

Testing will be carried out with TARGET2 users according to migration waves. For each wave, tests will be split into different streams, for example, at institution level, at the level of national banking communities and at European level. While users belonging to the first migration group will be working to a tight timeframe (five months starting in May 2007), those in subsequent migration groups will have several months more to complete their tests. A more detailed description of planning and organisational aspects for user testing activities can be found on the TARGET2 and the central banks' websites.

### 3. PRICING OF TARGET2 SERVICES

#### 3.1 Single price structure for the TARGET2 core service

##### 3.1.1 Pricing scheme

The pricing scheme for the TARGET2 core service 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 should be attractive to the major market players, who account for a very large share of the current TARGET1 transactions. The processing of these payments in RTGS mode contributes to financial stability in the euro area and allows cost-recovery at a reasonable price.

Based on the forecasts of costs and volumes associated with TARGET2 (i.e. 81.2 million transactions in 2007), a number of pricing proposals have been calculated and assessed against the defined policy objectives.

The Governing Council presents a pricing scheme which will be finally decided upon after discussion with the banking community. More information would be given in the next progress report on TARGET2.

In the pricing proposal, the participants may choose between i) a small monthly fee of EUR 100 plus a flat rate of EUR 0.80 (Option A) and ii) a monthly fee of EUR 1,250 plus a volume-based degressive fee ranging from EUR 0.60 to EUR 0.20 (Option B). The monthly fee is a fixed amount payable by each participant. The point at which Option B becomes more attractive is when 5,750 transactions are carried out per month.

<b>Option A</b>	<u>(periodical fee plus transaction fee)</u>		EUR
Flat rate			0.80
<b>Fixed fee</b>	Monthly		100
<b>Option B</b>	<u>(periodical fee plus transaction fee)</u>		
<b>Fixed fee</b>	Monthly		1,250
	<b>Monthly Transactions</b>		
<b>Band</b>	<b>From</b>	<b>To</b>	<b>Price</b>
1	1	10,000	0.60
2	10,001	25,000	0.50
3	25,001	50,000	0.40
4	Above 50,000		0.20

This pricing scheme meets the objective of broad access by providing an option based on a small monthly fee plus a flat-rate transaction fee. In addition, it is attractive to larger participants because the volume-based degressive tariff rewards higher volumes with a low price and entails a marginal fee of EUR 0.20 for major users.

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

The single price for transfers made using TARGET2 will apply to transactions both within and between participating EU Member States. Central banks will pay the same price for the TARGET2 core service as other direct participants.

### **3.1.2 Date of implementation of the single price structure**

Since the migration to TARGET2 takes place in different waves, the SSP and the still to be migrated TARGET1 platforms will co-exist during the migration phase. The Eurosystem has examined the issue of how to price the TARGET2 service during the migration period, with the aim of ensuring equal treatment of central banks and other users to the greatest possible extent.

After an extensive analysis, the Governing Council decided that all central banks, irrespective of their individual migration dates, should apply the TARGET2 prices as from the moment when the third country window joins the SSP, i.e. 19 May 2008. This solution means that all market participants across the Eurosystem will receive the benefit of the TARGET2 price at the same time and it ensures a level playing-field for migrated and still to be migrated countries (both for users and central banks).

## **3.2 Pricing of core services priced separately**

### **3.2.1 Intraday liquidity pooling**

The intraday liquidity pooling feature by means of a virtual account (VA) will be provided for accounts held by euro area banks with euro area central banks. Consolidated account information (CAI) will be provided to all banks that choose to use this feature, including non-euro area banks. Both the VA and CAI services will be priced separately from the TARGET2 core service on the basis of a fixed fee for each account in a group of accounts.

Given the allocation of costs between the CAI and the VA functionality, and based on the feedback received from TARGET users, the Eurosystem estimates that there could be approximately 100 accounts using exclusively the CAI feature and 100 accounts using, additionally, the VA feature. The annual fixed fee for each account in a group of accounts would amount to EUR 2,900 if only the CAI is used, and EUR 6,800 if the VA functionality were additionally used.

It should be noted that the boundaries (i.e. the types of participants allowed) ensuring the legal soundness of the virtual account option still need to be defined.

### **3.2.2 Ancillary system settlement**

Ancillary systems are those systems in which payments or securities are exchanged and/or cleared while the ensuing monetary obligations are settled in TARGET. It is estimated that approximately 50 ancillary systems will connect to the SSP between 2007 and 2011. According to the specifications, ancillary systems will have several possibilities to interact with TARGET2. They will be able to choose to settle their transactions via the payment interface, the ancillary systems interface or, during a four-year

transition period, via the proprietary home accounts. The settlement of an ancillary system requires, in general, specific additional services to be provided by the relevant central bank (e.g. a central bank might need to monitor thoroughly the settlement process of an ancillary system or to provide additional support during contingency). It is justified to charge the ancillary system for such “extra” services in the form of a fixed fee in addition to a transaction fee (for the transactions resulting from the ancillary system settlement processes), irrespective of where and how the ancillary systems settle their transactions. The fixed fee still needs to be defined and will be charged to each system on the basis of common parameters reflecting the costs incurred by the Eurosystem (e.g. for monitoring, contingency or support).

It should be noted that the decision of the Governing Council to price the payments through home accounts at a higher level than the TARGET2 price would also apply to transactions of ancillary systems settled on a proprietary home accounting application.

### **3.3 Pricing of optional modules**

The Governing Council has decided that, for the time being, there will be no harmonisation of the pricing policies applicable to the SSP optional modules (the home accounting module<sup>1</sup>, standing facilities and reserve management) vis-à-vis end-users.

## **4. OTHER ISSUES**

### **4.1 Night-time settlement**

Unlike the current operational day for TARGET, TARGET2 will start the new business day in the evening of the previous day. The night-time window<sup>2</sup> will be available from 7.30 p.m. to 6.45 a.m. the next day, with a technical maintenance period of 3 hours between 10 p.m. and 1 a.m. It will facilitate the night-time settlement of the different ancillary systems in central bank money with finality and will also support cross-system settlement during the night. Night-time settlement will have no impact on users, since there will be adequate technical/operational tools available (in TARGET2 and ancillary systems) in order to run the night-time settlement smoothly without involving banks’ liquidity managers.

During the night-time settlement window, liquidity transfers to and from the RTGS account will, in principle, be possible. Participants will be able to choose whether to use this functionality, or to limit the functionality by assigning liquidity to specific mirror accounts or sub-accounts before night-time settlement starts (i.e. no liquidity transfers during the night). Such a solution would keep night settlement simple and predictable for participating banks. Banks may alternatively decide not to participate in night-time settlement.

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<sup>1</sup> However, payments made through home accounts should be priced higher than the normal TARGET2 price (see last progress report of 8 February 2005).

<sup>2</sup> Only model 6 (settlement on dedicated liquidity accounts) of the generic settlement procedures of the SSP’s ancillary systems interface will be offered during the night-time window.

The Governing Council believes that the solution envisaged will generally increase the efficiency of night-time settlement and will favour initiatives such as cross-system delivery versus payment. It should be noted that the Eurosystem might implement restrictions on night-time settlement through operational procedures at a later stage.

**4.2 TARGET2 operational day**

The operational day for TARGET2 has been assessed from a payment systems and accounting perspective. The Eurosystem has additionally ensured that the operational day is in line with Eurosystem monetary policy procedures. Considering the differences between the arrangements for TARGET2 and the current TARGET system (i.e. after the migration there will no longer be any Interlinking), the Eurosystem has agreed on an earlier deadline of 18.15 for requests to standing facilities (15 minutes after TARGET closing time). On the last day of the reserve maintenance period, the deadlines for requests to access standing facilities and for TARGET2 end-of-day procedures will be delayed by 15 minutes to 18.30 and 19.00 respectively.

**Table 1: Operational day for TARGET2**

	<b>Time</b>	<b>Description</b>
<b>Day time</b>	6.45 a.m. – 7 a.m.	Business window to prepare daylight operations.
	7 a.m. – 6 p.m.	Day trade phase.
	5 p.m.	Cut-off for customer payments.
	6 p.m.	Cut-off for bank-to-bank payments.
<b>End of day</b>	6 p.m. + 15 min	General cut-off for the use of standing facilities.
	6 p.m. + 30 min	Cut-off for the use of standing facilities on the last day of the minimum reserve period.
	(shortly after) 6.30 p.m. **	Data to update the accounting system will be available for central banks.
<b>Start of day &amp; night time window for ancillary systems</b>	6.45 p.m. – 7 p.m. **	Start-of-day processing.
	7 p.m. – 7.30 p.m. **	Provisioning of liquidity until start-of-cycle message of ancillary systems.
	7.30 p.m.** – 10 p.m.	Start-of-procedure message to set aside liquidity and ancillary system night-time processing (ancillary system settlement procedure 6).
	10 p.m. – 1 a.m.	Technical maintenance period of three hours. The system is shutdown.
	1 a.m. – 6.45 a.m.	Night-time processing (ancillary system settlement procedure 6).

\*\* 15 minutes later on the last day of the minimum reserve period

**4.3 Contingency procedures**

Work on TARGET2 contingency procedures has started recently and is benefiting from the close cooperation of the European banking industry. The aim of the contingency is to ensure that systemically important business continues in the event a TARGET2 participant (a bank, ancillary system, central bank, SWIFT or the SSP) is faced with a problem. Of course, TARGET2 will ensure a much higher resilience than the current TARGET systems owing to the “two regions – four sites” concept used for the real-time payment components of the SSP. However, the Eurosystem has seen a need also to cater for contingency situations where resilience measures will not help. Accordingly, it has developed a methodology that

involves the following three steps: identification of failure scenarios, the analysis of impacts in terms of payment processing and the drafting of appropriate contingency measures.

Work is progressing on the scenarios that would have to be covered by contingency measures in the event of an SSP failure. The scenarios under investigation are i) software failures affecting both sites, ii) the time needed to perform an inter-region failover, and iii) on a best effort basis, the unavailability of SWIFT. During discussions, the following issues have been identified as critical:

- the number of systemically important payments that would qualify for contingency processing. The higher the number, the more demanding the requirements for the contingency procedures;
- the sources of liquidity for the Contingency Module. As stated in the UDFS, the Contingency Module will start with a zero balance. The processing of contingency payments will therefore require either the activation of the existing payments capacity or additional collateral. There is a common understanding that the liquidity sources in the event of a TARGET2 contingency should be harmonised across the euro area.

The Eurosystem expects to settle these issues by the time of the next progress report.

It should be noted that the discussion of the contingency procedures will not lead to any amendments to the specifications of the Contingency Module in the current version of the UDFS.

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