

TARGET 2 User Requirements
Prepared by the TARGET Working Group
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Introduction

The reform of the current TARGET system aims at providing a response to developments in the international environment, in the integration of European financial markets, in technology, and to participants' requirements.

This note focuses primarily on the participants' core requirements in the framework of the definition of the future TARGET2 specifications. In order to contribute to this debate, many banking communities have provided their individual needs and expectations which they wish to communicate to the Eurosystem. Views were collected from front desk treasurers, liquidity and risk managers and from payment processing managers.

The TARGET Working Group has selected those aspects which are deemed most important for improving TARGET as a whole, classified in (1) technical issues, (2) services and functionalities, (3) SLA and (4) general issues.

The TARGET Working Group did not intend to discuss policy issues or the set-up of the system in terms of centralised or decentralised architecture, because it is understood that this choice falls under the competence of the Governing Council of the ECB. Banks are neutral with respect to the architecture of TARGET2 on the basis that it should not adversely impact them, as TARGET should be considered as a single system.

The TARGET Working Group has taken into account as far as possible all potential evolutions in markets, practices and participation expected within the next years. The TARGET Working Group would welcome further discussion with the ECB on these high-level requirements and stands ready to provide concrete details on these needs at a later stage.

1. Technical issues

1.1 Harmonisation of interfaces and of communication standards

Differences from country to country in the interfaces to the TARGET system create additional costs and organisational complexities to banks accessing the system. Banks are therefore in need of identical interfaces.

Furthermore, the harmonisation of communication standards, message formats (e.g. SWIFT) and internationally recognised banking technology (e.g. SWIFTnet) would reduce costs, favour interoperability, provide a level playing field and simplify connection of new members. This is particularly important in view of the enlargement with new EU countries. This harmonisation should apply equally to "national" and cross-border payments.

The use of the current SWIFT message standards should be enforced for all TARGET2 payments. This means that messages addressed to TARGET should be identical

whatever National Central Bank (NCB) is used and should be subject to strict validation with due certification of the participant¹.

There is also a need to harmonise the criteria and mechanisms for the automatic routing of payments to all addressable beneficiaries. Harmonisation across countries would enhance Straight-Through Processing (STP) and the efficiency of the system².

1.2 Maintenance and upgrades

Maintenance and upgrading of software and hardware should take place in a synchronised manner with SWIFT standards releases and consider the requirements of banks in building a Single Euro Payments Area (SEPA).

2. Functionalities and services

TARGET2 should have broadly defined core services which shall be common to all RTGS systems. Any additional services offered by national central banks must be fully compatible with the core service and not adversely impact it.

2.1 Liquidity management

Liquidity management is the individual responsibility of TARGET participants and should always remain in their full control. Providing consolidated liquidity optimisation and saving mechanisms according to individual needs is key to active management by the participants themselves. Flexible system options and settings should be put in place to meet, upon their request, the individual needs of banks in this regard as well as in the use of collateral.

Liquidity management should be facilitated for intraday operations so that a bank is able to view its available liquidity irrespective of where it is held in the TARGET system and is able to use such liquidity anywhere in the system.

Banks need full visibility on their payment capacity at all times. The distinction between domestic and cross-border markets as far as liquidity is concerned does not exist anymore. Liquidity in euro is a pan-European concept.

Real-time account visibility, comprehensive queue management and gridlock resolution facilities

It is important that the system provides real-time account visibility as well as a queuing mechanism which guarantees full visibility of queued incoming payments and the possibility of actively managing queued outgoing payments. Gridlock resolution

¹ Certification is to ensure that the participant meets all requisite technical and operational procedures.

² At present, there are discrepancies in the handling of payments sent to indirect participants via intermediaries/agent banks (e.g. in some countries they are rejected if the intermediary is not specified, while that field is not mandatory).

mechanisms such as circles processing and liquidity saving mechanisms such as bilateral and multilateral offsetting of payments would usefully complement queuing and decrease the potential for systemic risk. The TARGET Working Group considers it essential that these functions should be offered as core services at European level.

Payment capacity and access to existing liquidity

TARGET2 should also offer the possibility to reserve liquidity for specific payments at the request of the participant. Liquidity reserves should be left to individual banks' choice and be flexible enough to be adapted to unexpected changes in liquidity conditions or other unforeseen events during the operating day.

Settlement of ancillary systems in TARGET2

Banks also consider that an attempt should be made to optimise settlement (mechanisms and timing) of ancillary systems within TARGET2 throughout the EU. The extreme variety of settlement times is an obstacle to efficient liquidity management and create a potential for operational risk.

Prioritisation of payments

Participants should be allowed to actively manage their payment queues by having the possibility of attaching different priorities to payments according to their urgency and by changing the priorities as long as the payments are queued and not processed. Banks believe that this core service should be offered with either centralised or decentralised queues.

Availability of collateral and bridges with Securities Settlement Systems

The mobilisation of collateral on a cross-border basis to obtain intraday liquidity in TARGET should be enhanced via a more efficient management of links between securities clearing and settlement systems on the one hand and between the cash settlement and securities settlement systems on the other in order to allow real-time transfers in central bank money.

TARGET2 should keep the possibility of delegations of central bank money to securities systems which will guarantee liquidity savings and the fluid operation of the system.

2.2 Information management

Better visibility is needed in many regards:

Information on system breakdowns

Banks deem it essential that the TARGET Service Provider supplies accurate, timely, reliable and dynamic information whenever a problem arises. They have identified the following requirements:

- i) Timely communication of TARGET2 problems
- ii) Estimate, whenever possible, when normal service will be resumed

iii) Immediate provision of information about slowdown or stop processing together with the measures taken by the TARGET Service Provider to limit the impact of the incident.

All this information should be transmitted through harmonised communication standards and channels between the TARGET Service Provider and banks.

TIS-System status

The information provided by TIS should give bank treasurers a good indication of the nature and seriousness of the problem, accompanied by a reasonable estimate on downtime and expected recovery. If the nature of the problem is unknown to the TARGET Service Provider and therefore no estimate can be given, the regular hourly update should be displayed with the latest status of the problem. Should new information become available during that period, the TARGET Service Provider is requested to display immediately an intermediate message.

This approach will help banks to take a sensible decision on how to route their payments. Moreover, the TARGET Service Provider is invited to communicate to banks whenever it plans to use its contingency channels.

Push and pull information

Banks have identified the need for a proper balance between push and pull approaches to receiving information, while taking into account both volume and degree of criticality of payments. This is particularly important for the status of waiting queues, real-time position reports and cash management.

Other information

The TARGET service provider is invited to provide statistics on daily flows and enhance its payments directory to reflect which participants can be reached directly or indirectly. This enhanced directory should offer to participants optimal tools for automatic routing to all addressable beneficiary credit institutions. There should also be a possibility for individual requests for information (e.g. reports on payments issued and received) and for information of a general nature.

2.3 Business continuity

Back-up

TARGET2 should have state-of-the-art business continuity and contingency arrangements that are proportionate to participant needs. It should ensure a level of back-up appropriate to guarantee equal service at all times as the primary site, even in case of a total loss of a primary site and/or personnel within. The back-up facilities should make it possible to cope with the treatment of both hardware and software problems. The infrastructure should permit the resumption of operations at a distant site, in both technical and functional terms, within the time limit set in the service level agreement.

Business continuity measures should be harmonized for TARGET as a whole. A maximum recovery time of 2 hours for vital components should be agreed and enforced for the whole system.

Contingency

Contingency measures, i.e. when the normal, fully automated back-up solutions either have been exhausted or cannot be invoked, or during the time needed to switch to secondary sites, should be standardised and transparent. Current contingency arrangements do not meet the banking profession's needs for volume and speed. This is specifically the case for the number of critical payments which can be processed by each RTGS system in one hour when TARGET is operating in contingency mode. The present number is too low. Contingency capacity must be enhanced. The contingency plan should be set up in full cooperation with the users of the system and be embedded in the service level agreement.

Liquidity transfers between TARGET participants and transfers to/from ancillary systems (e.g. EBA, CLS) are of course of high priority. However, it should be noted that also some commercial payments are critical to the smooth functioning of payment systems during the day. These payments cannot be identified automatically within the current TARGET configuration.

Commercial banks and central banks are therefore in need to indicate which commercial payments are considered time-critical when the system operates in contingency mode.

Moreover, fully transparent and common contingency and incident management procedures must be in place and known to all users. A decision making procedure, escalation plan and timing schedule for contingency management, together with a crisis management plan should be defined and communicated. In the light of the events of 11 September 2001, banks increasingly see the need for crisis management, including a back-up of vital components and required human resources and utilities to operate the system.

3. Service Level Agreement

3.1 Performance and availability

TARGET2 should result in a marked improvement in performance over the current system through service level agreements governing the relations between the system's service provider and its users, the credit institutions (level of service, contingency, compensation, etc). The TARGET Service Provider should commit to a minimum availability ratio during normal opening hours.

Performance indicators need to be defined and monitored. These indicators should include the percentage of time the system is available when needed and the average and maximum time required to process payments. Users should be made aware of the agreed service level and the respective responsibilities as well as of a common definition of force majeure.

3.2 Responsibility of the TARGET service provider and compensation scheme

Banks consider it essential that a fully-fledged compensation scheme is included in the features of TARGET2. This compensation scheme should be based on market criteria and include reimbursements, also in cases of damage due to intraday delays in processing or interruptions in services.

4. General issues

4.1 Purpose and Competition

The purpose of TARGET2 is to settle payments which require intraday finality and timely settlement. It should not be the purpose of the TARGET Service Provider to seek competition between TARGET2 and private payment systems, especially not in the field of retail payments. TARGET2 is intended to process monetary policy operations and should therefore primarily focus on high-value and/or critical payments.

In this respect, banks consider that TARGET2 should not process mass payments as they, in addition to single retail payments, will be handled by a pan-European ACH which is well underway thanks to the initiative of the banking industry. However, it should be possible to route any individual transfer through TARGET2 with no constraint on the amount of the payment, irrespective of its origin (money-market-related or commercial payment). This is particularly important for smaller banks.

The banking industry believes that the choice of the settlement channel should be left to the strategic decision of each individual bank and should not be constrained by limitations in the system.

Pricing and economic viability

It is in the logic of a single euro payment area that the same services should be priced the same way wherever they are originated and regardless of the architecture of TARGET2. This being said, pricing has to remain low and transparent to all users and is expected not to be subsidised for reasons of economic viability or competition.

One digressive price structure applied to single operations for all participants is advisable in function of the banks' volume of activity. The future system should sustain long-term economic equilibrium, and provide users with the economies of scale resulting from both increases in volume and technological innovations.

Participation

All credit institutions, be they small or big, are potential users of TARGET2 and therefore the customers of central banks in this regard. The participation scheme should continue to provide for fair and open access, both direct and indirect if participation evolves towards a tiered structure.

4.2 Compliance to Core Principles

For reasons of reliability and credibility, TARGET2 is expected to fully comply with the BIS CPSS report on Core Principles for Systemically Important Payment Systems.

4.3 Migration

The timing of the process of bringing the new system into operation is expected to be fully coordinated with the market. A global project calendar is expected to be made public and adhered to, after due consultation with the users. This calendar and process should be drawn up in taking into account legacy systems, local practices and the different levels of maturity of the different players.

4.4 End of day procedures

The decision to delay TARGET2 closing time should not be taken at 17:30 only, as is presently the case, but preferably as soon as possible. One hour should always be kept between customer cut-off time and closing time in order to allow direct participants to make their end-of-day liquidity arrangements.

This should also be the case when closing time is delayed due to a problem in the system.

Standing facilities must remain available after the extended closing time. TARGET2 should either be open as a whole or closed as a whole in all circumstances. Any delay in TARGET2 closing time should impact all participants equally.

4.5 Holiday calendar

The TARGET holiday calendar should serve as a common and global reference for the processing of euro payments with no local exceptions.

4.6 Governance and relationship with customers

Credit institutions will be the effective users of the TARGET2 system and therefore the customers of the service provider (central banks) in this matter.

Governance rules should provide for thorough and continuous consultation with all participants on the day-to-day functioning of the system and its evolution through dedicated national and pan-European structures.

A clear rule book governing the relations between the system and the participants needs to be established.

Furthermore, TARGET2 should be supportive of market practices and rules of conduct agreed by participants when making payments in euro.

Conclusion

Banks want a more homogeneous and efficient TARGET2 system. Day-to-day operations in TARGET have revealed a number of areas in which improvements are necessary.

Banks wish to benefit from improved liquidity management, information management, business continuity and performance for the processing of their payments. Core services should be offered at a lower and harmonised price.

Banks wish to be consulted systematically on any changes, be they to the system, its rules or its procedures (i.e. long-term calendar). Continuous consultation with the users of the system is critical to ensure that:

- the system is coherent with market practices;
- the system is harmonised from a technical point of view (identical technical interfaces, communication standards, message formats, internationally accepted banking technology);
- the principle of a level playing field is respected;
- the level of service provided by the system is commensurate with the needs of its clients and of the market;
- the impacts of technical and functional changes are properly perceived.