



EUROPEAN CENTRAL BANK



Cross-border payments in TARGET

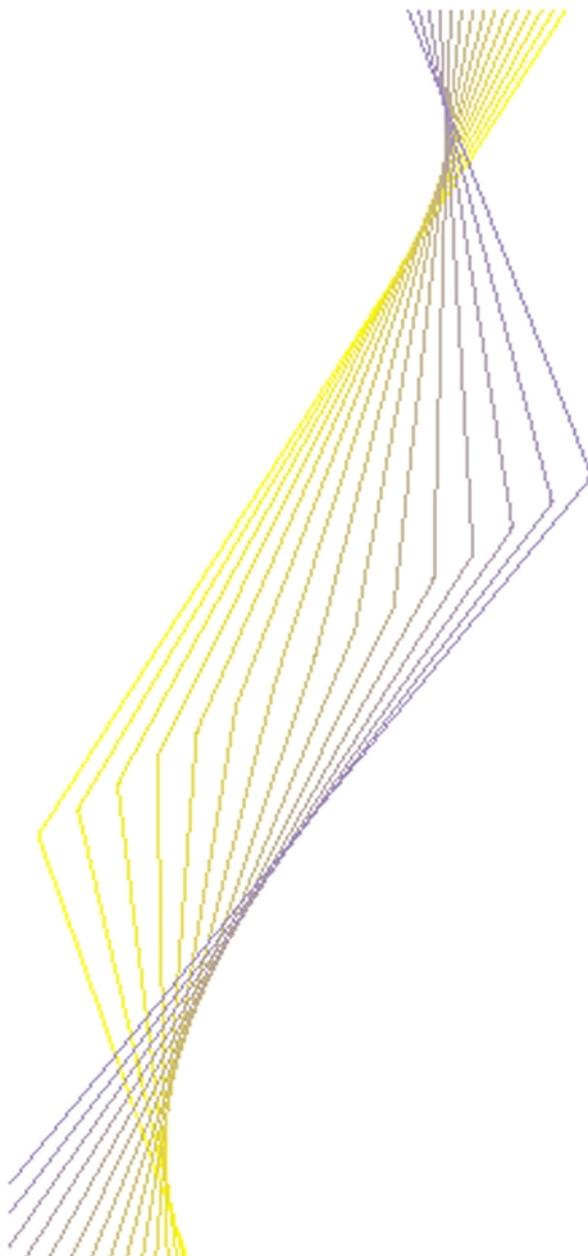
A users' survey

November 1999





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ISBN 92-9181-053-3

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1 Introduction

The Governing Council of the European Central Bank (ECB) decided to conduct a survey on the cross-border payment service offered by TARGET, as perceived by its users. The main findings of this survey are presented in this report, which is mainly of a qualitative nature. Input was obtained by means of a questionnaire addressed to the Banking Federation of the European Union (FBE), the European Group of Co-operative Banks, the European Group of Savings Banks, the Heathrow Group and the national TARGET User Groups. This report is also based on feedback from individual institutions collected during meetings, seminars, etc. up to the end of September 1999. In particular, a meeting with market participants on TARGET and large-value payment systems, held at the ECB on 24 September 1999, provided valuable input. Further information was received by means of monitoring the system and performance measurements made by the national central banks (NCBs) and the ECB over recent months of TARGET operations.

The Governing Council of the ECB decided to publish this report in return for the banking sector's co-operation with this survey.

2 Key information on TARGET

TARGET was created with a view to meeting three main objectives:

- to provide a safe and reliable mechanism for the settlement of cross-border payments;
- to increase the efficiency of intra-EU cross-border payments; and, most importantly,
- to serve the needs of the Eurosystem's monetary policy.

It is accessible by some 34,000 banks, including branches and subsidiaries throughout the EU. The number and value of cross-border TARGET payments increased rapidly from 4 January 1999 onwards and reached a stable level of around 30,000 transactions a day and a value of around EUR 350 billion. Cross-border payments in TARGET have now become an integral and stable part of euro treasury management, representing 27% in value and 10% in volume of all (domestic and cross-border) payments in euro processed through large-value euro payment systems.¹ The average value of individual payments processed via TARGET in September 1999 was EUR 11.5 million compared with EUR 4.7 million for those processed via PNS, EUR 3.1 million for EAF and EUR 2.3 for Euro 1.

¹ Figures for September 1999.

This would seem to confirm that TARGET is fulfilling its objective of supporting monetary policy and money market operations and is being used overwhelmingly for high-value interbank payments, as intended.

3 Banks' perception of the TARGET service²

TARGET is recognised as the de facto standard for making large-value cross-border payments in euro. It has also had a significant impact on the way banks, both large and small, conduct their payments business in the euro area. Furthermore, banks perceive TARGET not as a central bank utility, which they are obliged to use, but as a service offered to them which can add value and reduce the risks involved in their operations. The message from banks is that this service-oriented approach of TARGET should be further enhanced, e.g. by regular meetings with the banking industry at the European level.

Several issues related to TARGET have proved to be less problematic than many banks believed before the start of Stage Three of Economic and Monetary Union (EMU). The banks have not contested the TARGET pricing policy, for instance. However, it was underlined that due to the – compared with other systems – somewhat higher TARGET transaction fees, banks also expect a higher service level. Execution times for TARGET payments as well as the long operating hours seem to be in line with the banks' needs and expectations.

The existing shortfalls can be grouped into four main categories: TARGET availability, information on TARGET operations, liquidity management and business practices, and harmonisation of the end-to-end service provided by TARGET.

Availability

Having accepted the fact that there was some disruption to the availability of certain RTGS systems participating in or connected to TARGET during the early days of operation, banks now expect significant improvements in the short term. The participants are also concerned about the backup and contingency arrangements, which have not sufficiently met their expectations on the occasions when TARGET components have malfunctioned.

² See also the annex for more detailed information.

Information on TARGET operations

Banks require timely and accurate information on the status of TARGET, especially in the event that one of its components malfunctions. Some larger banks, especially those connected to more than one RTGS system, would welcome a single source of information coming directly from the ECB.

Liquidity management and business practices

One issue which goes beyond TARGET is related to the co-existence of several large-value payment systems in euro. At the beginning of Stage Three, new systems were implemented in parallel with the “old” processing channels. These systems first had to show stability and reliability before banks could make their decisions on the kind of channel to use for specific payments. This situation complicated the process of liquidity management in euro, especially at the beginning of 1999 when the banks experienced some teething problems.

In 1998 banks had already drawn up some business practice guidelines for the future TARGET service, but it became clear in January 1999 that this was, in practice, insufficient. In particular, compliance with such guidelines was not easy to achieve given the many national differences. In September 1999 the FBE published guidelines on liquidity management which cover all euro payments made through TARGET as well as any other euro payment systems. These guidelines are particularly focused on the regime for late payments.

Harmonisation of the end-to-end service provided by TARGET

Banks now expect the NCBs and the ECB to harmonise their systems in such a way that users will not experience differences between the various RTGS systems when processing payments. The requests range from an identical message format for all RTGS interfaces, instead of the current heterogeneous domestic ones, to a uniform service with all the features of a centralised system. In particular, some banks expect TARGET as a whole to provide them with the same services that certain NCBs provide as part of their RTGS service (e.g. debit/credit statements, queue visibility, gridlock resolution, etc.).

4 Comments and follow-up by the Eurosystem³

The Eurosystem has acknowledged the need for an ongoing dialogue with the TARGET users. Meetings are held at the national level as well as at the European level. This includes dealing with day-to-day issues (cross-border payment practices, standards, business practices, and liquidity management) and communication with the banks on future trends in the payment systems industry.

TARGET availability

The improvement of TARGET availability, which is not yet satisfactory for all components of the system, is being given the highest priority. The issue is being actively addressed and monitored closely by the NCBs and the ECB. Furthermore, additional contingency measures will soon be implemented, which will enable TARGET to process a number of critical payments. The Eurosystem is aware of the fact that the increased dependence on TARGET as well as the development of more demanding business needs (e.g. DVP, PVP and global risk management), which rely on real-time processes, are generating a need for considerable improvements in TARGET availability.

Information on TARGET operations

Several NCBs have recently improved their communication channels with their banks. However, further possibilities for swifter and more consistent information in the event of problems in TARGET, intended to assist banks in their decision-making, are at present under consideration. The issues of forwarding the debit/credit time stamp to the credit institutions and of regular communication of TARGET Interlinking performance statistics are also on the agenda of the Eurosystem.

Liquidity management and business practices

Between 11 and 29 January 1999 an extended service window was offered in TARGET to support banks in overcoming the teething problems related to liquidity management in the new euro environment. With regard to the subject of best business practices, there is a need for increased dialogue within the European banking industry to promote the harmonisation of the still very different business cultures. The Eurosystem takes an active interest in industry initiatives and, in particular, welcomes the FBE Guidelines on Liquidity Management published in September 1999. However, from the Eurosystem's point of view more emphasis should be placed on the preferential routing of very large-value payments to RTGS systems.

³ See also the annex for more detailed information.

Harmonisation of the end-to-end service provided by TARGET

TARGET is based on 15 national RTGS systems and the ECB payment mechanism (EPM). Some of these systems had been in existence for a long time, while others had only just started operations when the euro was launched. In order to minimise the time and cost incurred by central banks and credit institutions when setting up the system, TARGET was based on a number of minimum common performance features rather than on a common design for all of the participating RTGS systems. Providing a level playing-field for all banks by harmonising the service and information offered by the different systems constitutes an ongoing item on the agenda of the Eurosystem.

Synopsis of banks' perception of TARGET and the Eurosystem's comments

Banks' perception of TARGET	Eurosystem's comments
1 Business framework	
In general, the framework defined by the NCBs/ECB for TARGET operations has been well received.	
1.1 Accessibility of the TARGET service	
<p>From its first day of operation, TARGET was considered to be a widely available service and its capacity, as such, was appreciated and made use of by some institutions immediately. Feedback from small and medium-sized banks indicates that this change in the cross-border payment environment is highly appreciated, as it has reduced their dependence on intermediaries, such as correspondents.</p> <p>The "TARGET Directory", which lists the credit institutions that can be "accessed" via TARGET and indicates which credit institutions are direct participants in RTGS systems, is regarded by many banks as a rather static tool which is not compatible with the real-time nature of TARGET.</p> <p>Furthermore, since TARGET does away with the need for banks to maintain reciprocal relations, yet does not provide the same facilities offered by standard correspondent banking service providers, there have been a number of requests for TARGET to support a wider range of services and, in particular, certain functions relating to enquiries and requests for charges.</p>	<p>The aim was to provide TARGET services to RTGS participants on a non-discriminatory basis: the services of TARGET should be available to any credit institution which is a direct RTGS participant in TARGET, regardless of its size or location.</p> <p>Possible solutions for the provision of certain functions, such as enquiries and requests for charges, are currently under consideration.</p>
1.2 Operating hours and calendar of TARGET operating days	
The long operating hours – from 7 a.m. to 6 p.m. – are rarely mentioned as a criterion in the service.	The extended service window offered from 11 to 29 January 1999 was perceived as useful at the time by

<p>In principle the same is true for the calendar of TARGET operating days.</p>	<p>some banks, but no there was no request to pursue this beyond end-January and the return to scheduled operating hours went smoothly.</p> <p>Following a request from the European banking industry, the Governing Council of the ECB decided to have four more TARGET closing days in addition to Christmas Day and New Year's Day for the year 2000, (Good Friday, Easter Monday, 1 May and 26 December), as the constraints involved in providing a service on days when a large number of countries participating in TARGET have a public holiday are severe.</p>
<p>1.3 TARGET pricing policy</p>	
<p>In general, the banks do not contest the pricing policy for the TARGET system. They are willing to accept a higher transaction cost than for other systems, but expect a higher level of service.</p>	<p>The banks' comments on the price of TARGET indicate more about the expected service than about the price as such.</p>
<p>1.4 Speed of payment execution</p>	
<p>Some banks say that their expectations are fully met under normal circumstances, and very much appreciate this aspect of TARGET service, which is something of a turnaround compared with previous practices.</p>	<p>Very few banks have conducted any meaningful assessments on this subject, and therefore their feedback often seems to be based on impressions related to their general view of TARGET, rather than on facts.</p> <p>The TARGET Interlinking element of processing in the cycle was measured by the NCBs and the ECB on a specific business day and showed that the normal processing time required for a payment is between 1.5 and 6 minutes. This clearly indicates that under normal circumstances, the market requirements are being met. However, banks' evaluation of the performance of TARGET is based on the "end-to-end" service which includes many factors outside TARGET's control (liquidity management, processing times of intermediaries, etc.).</p>

1.5 Intraday liquidity	
<p>The banks have not, in general, reported any problems related to access to intraday liquidity.</p> <p>Views on the use of the correspondent central banking model (CCBM) are mixed, and often depend on the countries involved. It is generally viewed as positive that such a service exists, but the practicalities (e.g. hours of operation, delays) are sometimes viewed negatively.</p>	<p>In TARGET liquidity is very flexible to manage and it is available at a low cost, since minimum reserves, which credit institutions are required to hold with their central bank, are available for settlement purposes during the day. In addition, the Eurosystem provides unlimited intraday credit free-of-charge. Central bank credit has to be fully collateralised, but the range of eligible collateral is very wide. Assets eligible for monetary policy purposes are also eligible for intraday credit. The overnight lending and deposit facilities also allow for “last minute” reactions to unexpected liquidity situations.</p> <p>In order to facilitate the cross-border use of collateral, the Eurosystem has implemented the correspondent central banking model (CCBM), which allows participants to obtain credit from their home central bank against collateral held in another country. In addition, a large number of links established between securities settlement systems have also been approved to facilitate the cross-border use of collateral. Finally, the opportunity cost of collateralisation of the Eurosystem’s credit operations is further reduced because of easy substitution of collateral.</p>
2 Availability	
<p>Banks consider TARGET as a mechanism, at least, for the (cross-border) settlement of contractual obligations in central bank money. Therefore, it is vital for them that TARGET is available under all circumstances.</p> <p>The banks acknowledge that given the complexity of the system, the implementation of the TARGET service in the decentralised RTGS environment was conducted in a professional manner and they accepted the “teething problems” which arose during the first two months of operations. However, certain banks felt</p>	<p>TARGET availability is monitored and reviewed on a daily basis as well as on a periodical basis. Backup and contingency plans have been tested for all TARGET components. However, in practice, the nature of the problems which have arisen during live operations (hardware failures, system software errors, etc.) has sometimes prevented the backup procedures from being used and, as a result, a few long service interruptions have occurred. Furthermore, it has always been clearly indicated that contingency plans</p>

<p>that the improvements were not sufficient because:</p> <ul style="list-style-type: none"> • the euro money market has very quickly become integrated; and • certain features of RTGS systems which have not been harmonised have an impact on the conduct of business, particularly in the event of problems. 	<p>rely on manual processing and that in such circumstances only a very small number of critical payments can be processed. This estimate was based on the assumption that if banks' liquidity were shifted (using manual processing) to an alternative TARGET entry point, they would be able to conduct their operations normally. In practice, very few banks have prepared themselves for working in this way. Nevertheless, the improvement of TARGET availability is being given the highest priority.</p>
<p>3 Information on TARGET operations</p>	
<p>Banks accept that service interruptions will occur from time to time, although all efforts should be made to reduce these events to a minimum. However, they expect to receive accurate and timely information on the status of payments in the failing system, the duration of the incident and other details which would be of help in the decision-making process.</p>	<p>Owing to the differences in the organisational set-up of the NCBs and the different mechanisms used to communicate with RTGS participants (S.W.I.F.T., workstations, etc.), the content of the messages sent out and the time of delivery of the information can vary. As a result, those banks which have several access points to TARGET may occasionally have received slightly different information. Possible improvements in this field are under consideration.</p>
<p>4 Liquidity management</p>	
<p>From early January 1999: i) the size of TARGET (over 34,000 banks, including branches and subsidiaries can be reached via TARGET); ii) the extent of the use of the system (30,000 transactions, between EUR 300 billion and EUR 400 billion per day); iii) the availability of other channels for making payments (correspondent banking; Euro 1, national systems); and iv) the absence of bilateral agreements on the payment flows, led to a strong demand from banks for clear common procedures for the whole market, but also more specifically for TARGET.</p>	<p>Efficient liquidity management in TARGET is the process that should help establish single money market rates throughout the euro area and reduce settlement risk for banks. It is the key to the success of TARGET and the singleness of monetary policy.</p> <p>Although the technical platform provided by TARGET makes this possible, it is only one element in the process. Experience has shown that not all banks have equipped themselves with adequate tools and structures for this process, that the complexity of the euro payments market has increased the tendency to delay position management until the last possible moment and that banks expect TARGET as a whole to provide them with the same services that certain NCBs provide for their RTGS participants (e.g. debit/credit</p>

	<p>statements, queue visibility, gridlock resolution, etc.), which is far more than TARGET was originally asked to offer. Clear domestic and cross-border rules are essential for achieving intrasystem and inter-system management. Nevertheless, banks, particularly those not used to operating in this way, also need to develop active liquidity management procedures.</p>
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5 Harmonisation of the end-to-end service provided by TARGET

<p>Interlinking payments standards are welcomed by the banking industry, which is asking why their implementation was not fully extended to include domestic RTGS systems. The message from the banking sector is clear: the NCBs and the ECB should harmonise their systems in such a way that users do not experience any differences between different RTGS systems when processing payments. The requests for harmonisation go, however, beyond identical message formats. Some banks have asked for a uniform service with all the features of a centralised system (queue visibility, gridlock resolution, etc.).</p>	<p>Standardised message formats are not of value in themselves. In the context of TARGET, they should facilitate real-time cross-border processing by providing standards which facilitate automation. Moreover, TARGET should help to integrate the technically segmented payments markets by establishing the appropriate forward-looking standards and thus promote straight-through processing.</p> <p>During the first few weeks of operation, there were a number of issues raised by banks concerning TARGET message formats and complaints that information was not transferred from one end of the chain to the other. Further investigation indicated that the standards for TARGET were not the issue, but rather that there was an amalgamation of other general problems in the processing of cross-border payments which were unrelated to TARGET, or that the issues were linked to insufficient testing by banks in co-operation with their NCBs. Cross-border rejections of payments dropped to below 1% before the end of the first month and are currently at a level of 0.4%, which may be almost impossible to reduce further.</p> <p>Further harmonisation of the TARGET service level is an ongoing item on the agenda of the Eurosystem in order to provide a level playing-field for all banks.</p>
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