

Consultation on TARGET2 – European Banking Industry Response

24 April 2003

INTRODUCTION

This paper constitutes the official response of the Target Working Group to the European Central Bank's "Public Consultation on TARGET2: Principles and Structure" issued on 16 December 2002.

The Consultation calls for the views of interested parties in two areas:

- first, on "the best ways to implement the approach chosen for TARGET2";
- second, "users are invited to provide their business requirements for TARGET2 in terms of interfaces and communication standards as well as functionality and services."

We wish to highlight that for the latter, the Target Working Group has already sent to the ECB in November 2002 a comprehensive document, called "**TARGET2 User Requirements**" which outlines the principal requirements of the banks with regard to the new generation of the Target service.

These user requirements, although written prior to the consultation, remain valid in their entirety today and constitute *de facto* the response from our group to this part of the Consultation as they already cover to a very large extent the issues addressed there and in particular, the business, the services, the interfaces and pricing. To complement our original user requirements document we now add an appendix which drills down in more detail on some issues brought forward in the consultation.

This response represents the views of the European Banking Industry and is made also on behalf of the European Payments Council (EPC).

GENERAL COMMENTS

1. *Single System*

The banks consider TARGET2 as a **single system**, from both a flow management and an account management point of view, i.e. a **harmonised and integrated system, independent from the number of platforms that in the end will coexist**.

The European Banking Industry considers that the TARGET2 approach, as presented in the Consultation document, does not entirely respond to the original User Requirements document and its appendix. The European Banking Industry believes that the requirements laid down in this document would be better served and more easily met in a single system which is **totally integrated**.

Once the core services are identified and the architecture specified, the least costly way to implement the new system should be pursued.

2. **Functional Harmonisation and Liquidity Management**

In its introduction, the Consultation mentions the present “heterogeneous technical design” of TARGET as a source of problems for users, who expect “a more harmonised service”. The European Banking Industry wishes to highlight that the present **heterogeneity** of TARGET is not limited to technical features, but also to business functions such as liquidity management.

Needless to say the entry of the accession countries expected in a few years will further complicate the liquidity management issue in a heterogeneous system. The future service should be fully harmonised also from a business and functional point of view, on top of technical or operational harmonisation.

In the presence of a decentralised business infrastructure where business relationships are the responsibility of individual central banks and also in the case of a single shareable platform, cash management facilities will be required. It should, for example be possible for a multi-country bank to appoint one central bank master (cash and collateral) account. More details are given in the appendix to the User Requirements document.

3. **Time Schedule and Milestones**

Clarity is sought with respect to the **timing** of the project which is uncertain. The timeframes mentioned in the consultation paper are not always clear. More visibility is needed on the project timeframe and migration plan in order to enable participants to prepare themselves.

A clear implementation plan should be drawn up very soon. Users want the shortest convergence period possible. The European Banking Industry suggests designing the implementation steps, never losing sight of the final objective of a single European-wide platform. In this way it will be possible to reach the result faster and with real control of the costs.

Banks will need to understand what changes they will need to accommodate in their own internal systems for the migration and be given adequate time to plan and effect any changes. This implies comprehensive and early information on the timing of the introduction of any change.

4. **Availability of Core Services**

All the core functionalities already identified by the TWG in the User Requirement document and its appendix, should be in place right from the beginning of TARGET2 as they are key to efficient liquidity management and in order to avoid any regression of functionalities particularly for intraday liquidity management purposes.

Users want the core services available as soon as possible and the European Banking Industry considers the general timeframes indicated in the consultation document as too long.

There should be no transitional period. It would be a nightmare to manage different systems from an operations and payment capacity point of view.

If a step-wise move to the new system is necessary, it has to be fully co-ordinated with the users at each step of the development process, as indicated in § 4.3 of the User Requirement paper and in point 4 of the consultation document.

5. *Strategic Direction*

It is difficult for market participants to grasp the actual scope of the consultation and the real impact of the users on the process. A clearer identification of the topics that should be regarded as already settled by the Governing Council and those that are not would have been appreciated.

The Eurosystem may wish to consider this remark for any further consultation on TARGET2. The open-endedness on some points raises concerns about the length, and hence the cost, of the process of convergence towards consensus on concrete solutions.

6. *Compliance with Core Principles*

As a general principle, and as already stated in our User Requirement document, users wish that the “**Core Principles for Systemically Important Payments Systems**” be applied to all components of TARGET2, e.g. to multiple platforms if they exist, as well as the observations made in the IMF report on observance of standards and codes in the euro area be considered for all components of TARGET2.

A **clear distinction and strict separation** should be made between the oversight role of the Eurosystem and its operator functions as service provider of TARGET. This requirement is stated in the IMF report.

SECTION 1: GENERAL FEATURES AND STRUCTURE OF TARGET2

7. *Multiple-Platform system:*

Amongst the principles upon which the multiple-platform system will be based, as mentioned in point I of the consultation, “General Features”, the European Banking Industry believes that a first overwhelming principle should be considered: **the ability to meet the needs of the users.**

The requirement is that this multiple-platform system be capable of meeting all the user requirements as listed in our aforementioned User Requirements document and the accompanying new appendix, at the lowest possible running and migration cost and in the least complex manner.

Amongst these needs, intraday liquidity services and flow management as well as central collateral management will certainly not be optimised by the multiple-platform system. Liquidity and collateral management are key priorities to the banks.

As a consequence, the new TARGET architecture should assist the bank treasurer in centralising his/her liquidity management and facilitate the fluidity of central bank money flows.

8. *The expected TARGET2 system*

In a true SEPA environment, users expect the implementation of one single, European-wide platform. The European Banking Industry doubts that the whole efficiency of the system (e.g. cost of the services, development of core and additional functions, flexibility, rules to use the system, increase of the user community) and its effectiveness (service levels, procedures concerning the provision of the services) can be met with a multiple-platform environment. Furthermore, local additional services could still be provided when based on this single platform.

9. *Subsidies*

The European Banking Industry duly takes note and welcomes the fact that subsidies going beyond an acceptable public good factor will be phased out after a period of 4 years and that platforms not meeting the **cost-effectiveness principle** will have to be given up. The European Banking Industry would have welcomed a shorter period than this 4 year period.

10. *Neutrality*

All choices made with reference to the **single shareable platform** must be **neutral** to all users, whatever their location, because each user anywhere in the same playing field should have the same rights to the service. For the choice of the location of the single shareable platform, it is essential to respect the principle of political, geographical and commercial neutrality vis a vis the different financial centres. In other words, in respect to the European financial centres which will join the single shareable platform through their NCBs, the single shareable platform has to be neutral.

This means that the geographical location, brand name, management and operational teams have to comply with this principle.

11. *Data protection*

It is a core principle that the single shareable platform must combine neutrality to users and financial centers whilst at the same time accommodating specific national legal and regulatory requirements e.g. in relation to data protection and privacy. It must of course support core bank needs such as making payments, handling accounts for banks and the standing facilities in accordance with user requirements.

12. *Business Continuity, Capacity and Performance*

Our requirement is to be able to count on a service with **100% availability and full resilience** in case of disaster.

The European Banking Industry regrets that business continuity, as mentioned in the User Requirements document (section 2.3), is not mentioned in the consultation. Users wish to receive a clear specification of the required level of business continuity, back-up and contingency procedures.

Furthermore the overall capacity of the system in terms of volumes and throughput must be sufficient to avoid any deadlocks within the processing of payments-even during peak-hours of the day.

SECTION 2: PERIMETER, BUSINESS, SERVICES AND INTERFACES OF TARGET2

13. *Services* (point 2.3):

Users wish to participate in the decision making process and welcome the statement that “the service level of TARGET2 will be defined in close cooperation with the TARGET user community”. In this respect, we refer once again the Eurosystem to the “TARGET2 User Requirements” document sent to the ECB in November 2002, and to its new appendix. User involvement is especially important for what concerns the initial definition and revision of the list of core services.

14. **Interface with users** (point 2.4 (i)):

The European Banking Industry strongly supports the **single interface** to TARGET2 for all (domestic and cross-border) payments. This single interface should be very clearly defined and not only relate to the “harmonised use of Swift message standards”. It should strive for full standardisation encompassing a much broader scope beyond message formats and it should include procedures, security services, identical validation, single-window entry point for every service of the TARGET2 platform, contingency etc.

Furthermore the “very likeliness” of the “harmonised use of Swift message standards” happening is not acceptable; it **must** happen with total certainty and the standards chosen must remain stable in the medium term.

15. **Settlement of ancillary systems (cash and securities)** (point 2.4 (ii)):

Ancillary systems should be able to settle right from the start of TARGET2 on the single shareable platform. Please refer to the Appendix to the User Requirements for more details.

SECTION 3: GOVERNANCE, FINANCING AND PRICING ISSUES

16. **Governance**

The users are pleased to note that the **3 levels of Governance** acknowledge the existence of a “Single Euro Payment Area” and do not make a distinction between “domestic” and “cross-border” TARGET-related issues. The users will welcome clarification of how the governance of the single shareable platform will work. Transparency is needed in this regard.

The multi-level governance structure should not hinder an **efficient decision-making process, especially in case of contingency**. A precise set of rules with regard to the operation of the system, and in particular clear procedures in case of problem, is required and must be made available to all users.

17. **Organisation**

The **organisational set up** of the service provider must be compatible with the service level agreement and contingency requirements.

The rotation system for the technical operator of the single shareable platform as proposed in section 3.3, is impractical and should be excluded, as rotation of service may lead to variations in service level / reliability which would be unacceptable.

On the other hand, the statement in this same section 3.3 that *“the operation of the platform could be outsourced to a separate legal entity, either privately owned or jointly owned by the central banks which join the shareable platform”* raises some concerns relating to the actual control by the central banks of such an outsourced platform and the role of the users in that context. In the case of outsourcing, the European Banking Industry believes that all risks and responsibilities as well as full control should be retained by the Eurosystem.

18. Role of Users

The role of users is considered by the European Banking Industry to be of the utmost importance in every step of the decision making process.

The European Banking Industry has taken note that users will be associated in the decision-making process at all levels of Governance, including level 1 (“In the decision making process at the different level of governance, the **close involvement of the system users** is a crucial aspect”). This user involvement goes very much in the direction indicated in the TWG user requirements.

Whilst there is already great disparity in the size and activity of the users, this will be greatly widened when the EU increases to 25 members. It is essential that the consultation process be effective. However, a weighting criterion based on volumes and values shall not prevent the needs of smaller participants to be taken into consideration. This is in line with the open access to the system that is – and will continue to be – one of the basic features of TARGET2.

One particular area of concern is the role the users will have in the single shareable platform, as well as that of the Eurosystem.

The European Banking Industry would like to stress that all users – independently of whether they will access the single shareable platform or an individual one – should be on the same footing, both in terms of services and in terms of the consultation process.

19. Pricing

The European Banking Industry requires **full transparency** in the fixing of pricing, on the cost methodology, as well as in the identification of the benchmark system. Additional services, which can be priced separately, must therefore be clearly identified. We do not consider timed payments in an RTGS system as being additional services: they should not be priced separately.

The influence of the public good factor on cost recovery and hence pricing should also be made transparent to users.

The European Banking Industry takes note of the “*Single TARGET - wide price structure*” for the core service, for all (domestic and cross-border) payments. This “*same price*” will be based on a “*benchmark RTGS system*”. This statement raises some questions: will it be fixed once and for all? What if another RTGS system becomes more cost-efficient?

Taking into account strong economies of scale effects, this benchmark system would ideally be the one which would carry all TARGET traffic because in the case of 15 different co-existing platforms, even the most cost-efficient one would not be a credible benchmark compared to a single platform. Users expect from the Eurosystem a clear definition of the benchmark RTGS System, once the core service has been clearly defined.

SECTION 4: FURTHER STEPS IN THE ESTABLISHMENT OF TARGET2

We have already mentioned in our general remarks the lack of clarity with regard to the timing of the project. No date is mentioned for the start of TARGET2 or for its full implementation, only planned somewhat vaguely in "*the second half of this decade*".

During the project phase, the Eurosystem should prepare a specification book to answer the user requirements. Users should have the opportunity to check if those specifications meet their requirements and then only after agreement on these specifications, start the building phase. Only such a method can avoid impairing the quality of the end product.

It is stated that "*credit institutions will have to adjust to the interface and functionality of the shareable platform*": this implies costs which banks wish to minimize! So banks should be involved in the specifications and the horizon of implementation should be decided together.

CONCLUSION

When banks are cooperating to build the Single Euro Payment Area and a single pan-European ACH, PE-ACH, they naturally expect from the ESCB a similar integrated RTGS system with a single European-wide platform and a precise timetable for implementation. The TARGET Working Group, as the voice of the banking industry, looks forward to staying in close contact with the Eurosystem for the definition of the specifications of TARGET2.