



EUROPEAN CENTRAL BANK

EUROSYSTEM

FIFTH PROGRESS REPORT ON TARGET2

On 22 June 2007, the Eurosystem published the “Fourth progress report on TARGET2”. The report provided details of the remaining pricing and financing issues, as well as of the fine-tuning of some previous decisions, and included the final version of the General Functional Specifications (GFS) on TARGET2. In addition, the report described the progress made with regard to testing and migration activities.

The overall project is very close to completion. Since publication of the last progress report, the Eurosystem has made significant progress in finalising the new TARGET system. Testing and migration activities are at an advanced stage of completion.

On Monday, 19 November 2007, TARGET2 will go live with the connection of the first migration group (Germany, Cyprus, Latvia, Lithuania, Luxemburg, Malta, Austria and Slovenia). The Eurosystem is currently making the final preparations for the imminent connection. Activities for the connection of the two subsequent migration groups (on 18 February and 19 May 2008) are progressing as planned, after which all national central banks and TARGET users will have migrated to TARGET2.

The purpose of the “Fifth progress report on TARGET2” is to update market participants on the Eurosystem’s recent decisions concerning remaining operational issues (Section 1). The report also includes the “Information guide for TARGET2 users” and the “Information guide to TARGET2 pricing”, and describes the communication events envisaged around the go-live date of the new system (Section 2).

I OPERATIONAL ISSUES

I.1 ACCEPTANCE OF THE SINGLE SHARED PLATFORM

The acceptance of the Single Shared Platform (SSP) consists in verifying its compliance with the agreed specifications (General Functional Specifications (GFS) and User Detailed Functional Specifications (UDFS)). This task was mostly carried out between February and April 2007. Overall, the Eurosystem considered that both the general reliability of the SSP and the limited criticality of the outstanding bugs enabled the timely start of user tests on 2 May 2007. In parallel with the user tests, the Eurosystem is performing further acceptance tests, for instance when new technical releases or corrective patches are implemented by the Providing CBs (the Deutsche Bundesbank, the Banque de France and the Banca d’Italia). Between May and October six releases were installed, which helped to reduce further the number of outstanding bugs. The remaining bugs do not prevent the users from completing their certification on time. Of particular note is that the core RTGS settlement function has always been very stable and highly available since the beginning of the tests. More serious were the problems experienced with the Information and Control Module (ICM) and delays in system end-of-day processing. To address these difficulties, the Providing CBs drew up an action plan that had already been partly implemented and helped to improve the situation considerably. Further improvements are expected before the go-live date.

As part of the acceptance tests, two complementary activities are worth mentioning:

- (i) The Providing CBs carried out performance and failover tests on the future production environment in the presence of representatives from the NCBs in September. The outcome of the tests showed positive results and helped build the users' confidence that the performance indicator requirements can be fulfilled;
- (ii) The Eurosystem Central Banks completed the acceptance tests on the Customer-Related Services System (CRSS) for the elements already delivered by the Providing CBs. The system showed a high degree of reliability and only a small number of incidents were reported, some of which have already been corrected.

An action plan will be agreed for all outstanding bugs and their correction will be carefully monitored by the Eurosystem.

1.2 USER TESTING ACTIVITIES

Tests involving TARGET2 users started on schedule on 2 May with the participants of the first migration group. For those of the second and third migration groups, testing activities started progressively between the beginning of July and the end of August, in accordance with the agreed plan.

TARGET2 test procedures for users are following the same approach in all banking communities. First, tests are organised at institution level, where each participant has to demonstrate its ability to connect and to properly interact with the SSP (i.e. connectivity and interoperability tests). Second, multilateral tests are carried out at the level of the whole national banking community, and subsequently with all TARGET users, both migrated and non migrated (i.e. country and business day tests).

Participants in migration group 1 smoothly completed their connectivity and interoperability tests. Only a very limited number of non-critical institutions faced delays, with progress being closely monitored by the Eurosystem. Country tests followed during the months of July and August, also giving positive results. Between 31 August and 2 November, banking communities are scheduled to run business day tests, covering both normal and contingency situations.

Connectivity and interoperability tests are still ongoing in the other migration groups and their progress is regularly scrutinised by the Eurosystem. Country tests started on 6 October in the case of the second migration group and are due to start on 17 January in the case of the third.

To date, all banking communities are on schedule with their preparations for TARGET2 and there are no elements indicating that the migration plans have to be changed.

1.3 CHANGEOVER WEEKENDS

The three changeover weekends for the three migration groups were carefully planned by the Eurosystem in view of the criticality of this project phase. A framework covering technical, operational and organisational aspects was approved by the Eurosystem and relevant elements were communicated to market participants in July. The framework will facilitate the coordination of the actions that have to be carried out both over the changeover weekends and the preceding weeks.

The tests involving TARGET2 users also presented the opportunity to test the organisation of changeover weekends, with very positive results. In particular, a fully fledged "rehearsal" of the first changeover weekend took place with all NCBs on Saturday, 29 September/Sunday, 30 September.

I.4 OPTIONS FOR REMOTE PARTICIPATION IN SECURITIES SETTLEMENT SYSTEMS

From an oversight, business and liquidity perspective, the ancillary systems (ASs) are very important counterparts of TARGET2. In 2005 the UDFS set out the detailed description of functionalities available to ASs, and the third progress report finalised the pricing scheme for ASs in November 2006. However, there is still a need to clarify the arrangements available for remote participation in Securities Settlement Systems (SSSs) i.e. how to enable a bank to participate in several ASs using one single account in TARGET2. The issue emerged because of the different types of SSS models (“integrated” and “interfaced”) and is particularly important for multi-country banks that wish to settle their branches’ transactions related to a foreign AS on the account of the head office. The principle that banks should be able to settle the cash position stemming from any AS on any RTGS account in TARGET2, irrespective of its location, was an important user requirement for TARGET2.

The Eurosystem implemented this user requirement and confirms that it will be possible to settle the cash position of any AS on any RTGS account. The assessment of possible options was based on the business and functional scope of TARGET2, as well as on the principles of level playing-field and decentralised access to credit facilities.

The Eurosystem evaluated various proposals for remote participation in SSSs and favoured the option whereby NCBs “passively” support foreign SSS models (integrated or interfaced). This solution would keep the current legal relationships between the SSSs and their “home” NCB untouched, but would facilitate the remote access to foreign SSSs by virtue of additional legal agreements/guarantees between the central banks concerned.

In the integrated model, the remote participant can transfer liquidity from its TARGET2 account to the cash account on the SSS integrated

platform (and vice versa). As this cash account is legally owned by the “home” CB of the SSS, the remote participant in the SSS would need a separate agreement with the “home” CB of the SSS concerning cash accounts on the SSS platform. In the case of the interfaced model, liquidity can be made available at the request of the remote participant by shifting liquidity from its TARGET2 account (at any CB) to its sub-account dedicated to the settlement of a specific SSS and opened in the books of the same CB. In addition, NCBs have worked out the necessary internal arrangements so that the “home” CB of the SSS remains the single legal contact point for the SSS.

The above technical provisions would not make “remote” auto-collateralisation possible. In general, the Eurosystem worked with the hypothesis that auto-collateralisation practices would remain in their current domestic set-up in TARGET2, possibly until TARGET2 Securities goes live.

2 COMMUNICATION ISSUES

2.1 INFORMATION GUIDE FOR TARGET2 USERS

The “Information guide for TARGET2 users” (Attachment 1) aims to provide banks and ASs using TARGET2 with a standard set of information in order to give their operators a better understanding of the overall functioning of the system and enable them to make use of it as efficiently as possible. It answers the most frequently asked questions relating to TARGET2 and tries, in particular, to give users a clear understanding of those features that are common and those that are specific to each country. Additional documentation on country-specific features can be found on the websites of the respective national central banks. The information guide is intended purely to provide information on the current TARGET2 system. The contents of the document confer no legal rights on participants/operations or any other person or entity.

The information guide informs users about the operational procedures of TARGET2 in normal and, more especially, abnormal situations. It reflects discussions held with users (banks and ASs) by the Eurosystem, following on from the opportunity given to users to provide comments on the draft information guide.

2.2 INFORMATION GUIDE FOR TARGET2 PRICING

The “Information guide to TARGET2 pricing” (Attachment 2) provides TARGET2 users with a comprehensive overview of the pricing schemes related to TARGET2 (core services, liquidity pooling and AS services) and a detailed reference to the billing principles for the various types of transactions, as well as the entities to be invoiced. The content of the guide builds on the decisions communicated in the previous progress reports.

The “Information guide to TARGET2 pricing” will be published on the TARGET2 website and regularly updated, as required. It will serve as reference documentation on pricing and billing issues, but does not confer any legal rights on operations or entities.

2.3 TARGET2 COMPENSATION CLAIM FORM

Appendix II of Annex II of the TARGET2 Guideline adopted by the Governing Council on 26 April 2007 (ECB/2007/2) deals with the TARGET2 compensation scheme and provides, inter alia, that “*a claim for compensation shall be submitted on the claim form available on the website of the [insert name of CB] in English...*” and that “*if the assessment entails a compensation offer, the participants concerned shall, within four weeks of the communication of such offer, either accept or reject it, in respect of each payment or payment order comprised within each claim, by signing a standard letter of acceptance (in the form available on the website of the [insert name of CB])*”. In view of this, a single form (Attachment 3), combining the claim form and a standard letter of acceptance, was prepared by the Eurosystem for publication before the start of operations of

TARGET2. This form would enable TARGET2 participants to submit claims for compensation and to accept any offer that is made under the compensation scheme.

2.4 COMMUNICATION EVENTS AROUND THE GO-LIVE DATE OF TARGET2

The Eurosystem has discussed possible ways to mark the go-live date of TARGET2. In that respect, the Eurosystem considered and accepted a proposal by the Providing CBs to host a Eurosystem event in Rome, Frankfurt and Paris.

On the morning of Monday, 19 November 2007, the Eurosystem will organise the actual inaugural event for the SSP at the premises of the Banca d’Italia with a symbolic “pressing of the green start-button”. Other central banks, particularly those that are migrating on that day, may also organise a national event with their banking community and/or the local press to mark the start of TARGET2 and the migration of their banking community to the SSP.

On 20 November 2007, the Bundesbank will host a Eurosystem press conference in Frankfurt in order to review the first day of operations.

In January 2008, the Banque de France will host a conference in Paris attended by central banks, TARGET2 users and the press to discuss TARGET2 in various work streams (e.g. to assess events around the go-live date and the operation of TARGET2, to discuss and explain any difficulties experienced and how they were/ will be solved, to draw lessons from TARGET2 in the field of European integration, to highlight future enhancements, etc.). It would also be possible to reflect on TARGET2-Securities and CCBM2.

Finally, the Eurosystem will consider organising a TARGET2 end-of-migration event on 19 May 2008 (or shortly afterwards), when the third and final group of central banks is scheduled to migrate to the SSP. More details about this event will be given in due course.

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ISBN 978-92-899-0209-0 (online)