

WGT2/2010/180-rev annex



Consultation on a possible strategy for ISO20022

-Terms of reference-

Introduction

ISO 20022 has been at the core of discussions in the financial industry for the past few years, as it aims to increase the efficiency and the interoperability of financial institutions, market infrastructures and end users.

TARGET2 already makes use of XML messages for its Ancillary Systems Interface (ASI) and its Information and Control Module (ICM), using formats that are very close to ISO20022. While this puts TARGET2 in a relatively advanced position vis-à-vis other LVPS, the continuous technical evolution, the close linkage of TARGET2 to other Eurosystem projects and the latest developments on SEPA called for a broader and longer term reflection on ISO20022. The Eurosystem is therefore considering a strategy to facilitate and encourage wider usage of ISO20022 in TARGET2, which could eventually create synergies for all stakeholders and contribute to higher efficiency of the industry.

Making TARGET2 compliant with this new set of standards would definitely have a long-term effect on the scope of the system and may trigger technical and operational changes going beyond the normal cycle of a yearly release. For this reason the Eurosystem, acting as operator of TARGET2, would like to receive feedback from its participants with the aim of developing a strategy that brings benefits to all stakeholders.

A three step strategy for TARGET2

The Eurosystem has considered a three-step strategy for increasing the compliance of TARGET2 with ISO20022, the implementation of which would be spread over several yearly releases.

1st step: Implementation of ISO20022 XML messages for customer payments in TARGET2

Notwithstanding its nature as a large-value payment system, in practice a large share of traffic in TARGET2 is composed of customer payments (more than 60% on average). This pattern is seen, to a greater or lesser extent, in all national communities since the launch of TARGET in 1999 and has even increased in recent years. This confirms that there is a market demand for the settlement of customer payments in real time in TARGET2. It should be underscored that the volume of customer payments in TARGET2 remains marginal compared to the overall retail traffic in the EU (less than 0.5%), and that the prices charged for a transaction in TARGET2 are significantly higher than the ACHs fees (between 100 and 300 times higher).

If the EU regulation on a SEPA migration end date is approved, more than 50% of the transactions processed in TARGET2 would fall into its perimeter¹. In order to continue supporting the business case of customer payments in TARGET2, the Eurosystem is naturally considering implementing XML capabilities by introducing support for the FItoFICustomerCreditTransfer² message in TARGET2 (pacs008.001.01). This development would be planned for the end of 2012 (SSP release 6.0) and would form the first step of the TARGET2 strategy for ISO20022.

The introduction of XML credit transfers would aim at allowing participants to continue settling their urgent customer payments in TARGET2 without however affecting the main positioning of TARGET2 as large value payment system.

The Eurosystem is suggesting applying the following principles/requirements to that development:

- Subject to the final wording of the EU Regulation on a SEPA migration end date i) all credit institutions participating in TARGET2 may have to be able to receive customer transactions in the new XML format and ii) all customer transactions where both the originating and the beneficiary banks are located in a SEPA country should be remitted to TARGET2 using the new XML format³. For these reasons no flag or conversion mechanism would be foreseen.
- It is also proposed to implement the PaymentReturn message in TARGET2 (i.e. pacs.004.001.01). Upon request, it may also be considered whether to implement further messages e.g. Interbank recall of a Credit Transfer. However the development of FItoFICustomerDirectDebit – pacs003.001.01 in TARGET2 is not being considered, as customer direct debit is not a primary business case in TARGET2.
- The system would still accept customer payments using MT103(+) for payments falling outside of the perimeter of SEPA e.g. when either the originating or the beneficiary bank is not located in a SEPA country (subject to the final wording of the EU Regulation on a SEPA migration end date).

¹ It is expected that the regulation will apply to all customer payments, including single commercial payments processed by large-value payment systems.

² The FItoFICustomerCreditTransfer message is the standard on which is based the SEPA Credit Transfer scheme (SCT) developed by the EPC.

³ Pending the decision on a possible regulation for a SEPA migration end date.

- Individual XML credit transfer transactions would be submitted by the participants via SWIFTNet InterAct. From a technical viewpoint the settlement of XML transactions would follow the logic of the Y-Copy services with a full copy of the message being sent to the platform, as it is currently the case for FIN payment traffic.
- Indication of the Distinguished Names (DN) of the participants should be included in the TARGET2 Directory. In this respect, two possibilities are envisaged: either the TARGET2 directory is amended to include information on the DN or a supplementary directory including all DNs is created.
- This development would not affect the other FIN messages currently used in TARGET2. In particular MT202(COV), notification or reporting messages (MT900/910/940/950) would continue to be processed as today.
- For the time being the Eurosystem intends applying the TARGET2 core pricing to the XML credit transfers. No price differentiation would be foreseen between XML credit transfers and payments using other standards like MT103 or MT202.

Feedback from participants on any of the items listed above would be highly appreciated as well as any further suggestions on the processing of XML credit transfers in TARGET2. It should be noted however that the proposed principles/requirements are still pending the decision on a possible EU Regulation on a SEPA migration end date. Some adjustments may be needed to take into account the final wording of the regulation.

2nd step: Interconnection with TARGET2 Securities

The go-live of T2S, now scheduled for September 2014, should be considered from a TARGET2 viewpoint, not only because TARGET2 itself will have to cater for its connection with T2S but also for the impact the connection may have on its participants. In line with the requirement of the T2S Programme Board that T2S should be based exclusively on ISO20022, it is proposed that TARGET2 implements an interface with T2S using ISO20022 standards. Undoubtedly, such a development would create opportunities and synergies for the wider usage of ISO20022 in TARGET2.

In this context the coexistence of new/legacy standards is seen as a key issue and several approaches are considered:

- *Option 1* The participant interface of TARGET2 (i.e. ICM) could be left unchanged, including the features⁴ required for proper treasury/liquidity management with T2S. This option would have the advantage of limiting the adaptation costs on the TARGET2 users' side without however solving the issue of coexistence of standards, as the T2S participants' interface will be based on ISO20022 for both their cash and securities business.

⁴ This would encompass for instance the orders to push liquidity from TARGET2 to T2S or the notification of inward flows from T2S to TARGET2.

- *Option 2* The ICM could be enhanced so that the features required for proper treasury/liquidity management with T2S are developed in accordance with ISO20022 standards. For banks, moving to ISO20022 for cash management & treasury operations may theoretically create synergies with the migration already on its way on the securities side. With one single set of standards they may be in a position to manage not only their cash business (between TARGET2 and T2S) but also the securities side.
- *Option 3* The ICM could be enhanced in order to provide participants with supporting / converting tools allowing them to properly manage their liquidity on both the TARGET2 and T2S side from one single interface using similar standards as today.
- *Option 4* The ICM could be enhanced with a combination of option 2 and option 3.

Beyond the infrastructure-to-infrastructure interface, the Eurosystem is also keen on providing the users with tools that can facilitate their global liquidity management and allow them to reap all the benefits brought by T2S. Assuming that the banks would prefer to manage their liquidity via a single interface, the Eurosystem already identified some possible tools to enable the users to manage their DCA on T2S via the TARGET2 interface.

- (i). The first tool would be the consolidation of the balances of DCA and RTGS accounts on the ICM, thus giving the overall liquidity position of the bank in one single screen without having to access T2S.
- (ii). The second one is the possibility to pull back liquidity from the DCA to the RTGS via the ICM, thus allowing banks to shift liquidity back and forth without having to upload any instruction on the T2S side.

A preliminary technical analysis confirmed the feasibility of the above-listed features. Moreover TARGET2 may provide its participants with liquidity forecasts through the ICM (subject to authorisation granted by the respective CSDs) or end-of-day account statements for their DCAs. If supported by the banks, these liquidity management tools could be offered as optional services in the context of option 3 and option 4.

The Eurosystem is willing to establish a dialogue with participants to collect their feedback and possible concerns on the issue of coexistence of standards stemming from the connection of T2S to TARGET2. In this context participants are invited to indicate which of the 4 options they would prefer. In the event that they support options 3 or 4, they are also invited to clarify which integrated liquidity management features would be worth considering in the enhancement of the ICM.

3rd step: possible further compliance

Assuming that TARGET2 would increase its ISO20022 compliance for customer payments (with the implementation of XML standards) and for cash management & treasury transactions (with an enhanced TARGET2 interface with T2S), the question naturally comes as to whether this compliance should encompass the other activities of TARGET2 in order to eventually reach 100% compliance with

ISO20022. In a nutshell the other activities which would still be using legacy standards, are the reporting messaging (MT900 debit advice, MT910 credit advice, MT940/950 account statements), interbank credit transfers (MT202) and more marginally direct debits (MT204).

On the one hand these messages are well established and extensively used by banks and removing them from TARGET2 would represent substantial costs for participants. Furthermore it is acknowledged that, even if FIN standards were removed from TARGET2, they would still have to be maintained in banks' local systems to carry out correspondent banking business with the rest of the world.

On the other hand the Eurosystem is willing to promote the usage of ISO20022 standards as much as possible as a means to increase the efficiency of the banking industry in line with the Lisbon strategy. In particular banks that are willing to use the new standards more widely should be offered that possibility in a major market infrastructure like TARGET2.

Consequently the Eurosystem envisages a flexible coexistence of legacy and ISO20022 standards in the coming years rather than a forced migration. This means that the above-listed messages would remain in TARGET2 until it is confirmed that a majority of users do not require them any longer. In the meantime however the Eurosystem stands ready to consider the implementation of specific new message types if and when the market demand arises, to support participants that would prefer a faster move to ISO20022 standards. The feedback of participants on their own migration plans would therefore be welcome in order to clarify these possible steps towards a further compliance with ISO20022 in TARGET2.

The Eurosystem invites all TARGET2 users to provide their comments / feedback on the present document. The National Central Banks will collect the replies of the TARGET National User Groups at the latest by 9th November 2010. In parallel the European Central Bank will collect the views of the TARGET Working Group.

It is already expected that further consultations will be carried out on each of the steps forming the strategy in the context of the regular consultations on TARGET2 yearly releases.