

# THE EUROSYSTEM

THE CENTRAL BANKING SYSTEM OF THE EURO AREA

target  
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**CCBM2**

**ts**  
TARGET2-SECURITIES

**SEPA**

A SINGLE  
CURRENCY –  
AN INTEGRATED  
MARKET  
INFRASTRUCTURE

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# CCBM2

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Jean-Claude Trichet

## FOREWORD

It is well known that the Eurosystem is responsible for the definition and conduct of the single monetary policy, as well as for maintaining price stability in the euro area. In addition, the Eurosystem has a number of other tasks that are not so apparent to the public but are by no means less relevant. One of these tasks is to foster efficiency and security for all kinds of transfers of funds and securities in Europe.

The importance of payment and securities settlement systems in modern economies has grown considerably over the last two decades due to the very rapid growth in the volume and the value of payments stemming from money, foreign exchange and financial markets. Payment systems have also become more vulnerable because of their ever-increasing reliance on fast evolving electronic data processing and telecommunications technology, as well as their complex interlinked structure.

In addition to payment instruments, systems and infrastructures, which are generally considered an integral part of the Eurosystem's responsibility, the ECB and the national central banks of the euro area have an interest in the field of securities

clearing and settlement systems. This responsibility became even more apparent with the introduction of the euro as the single currency and the subsequent scale and speed of European financial integration. Moreover, the robustness and smooth operation of clearing and settlement infrastructures are indispensable for the stability of the currency, the financial system and the economy in general.

Looking into the future, the further integration of European financial markets cannot make adequate progress without further integration of their clearing and settlement infrastructure. The Eurosystem is very much committed to fostering this process by playing its operational and catalyst role.

I believe that this brochure will promote a better understanding of these roles among all relevant stakeholders and the public at large.

Jean-Claude Trichet

President of the European Central Bank



## INTRODUCTION

The rapid integration of the euro area money markets has been closely related to the establishment of the TARGET<sup>1)</sup> system, the real-time gross settlement (RTGS) system for the euro, which has been operational since the launch of the single currency. Since its inception back in 1999, TARGET has become a benchmark for the processing of euro payments in terms of speed, reliability, opening times and service level. It has also contributed to the integration of financial markets in Europe by providing its users with a common payment and settlement infrastructure.

During the preparations for monetary union, the Eurosystem was concerned by the lack of a market solution for moving eligible collateral for central bank operations from one country to another and so set up a mechanism called the Correspondent Central Banking Model (CCBM). This mechanism was introduced as a medium-term solution until an alternative is created by the market.

With the euro and infrastructure to transfer funds and collateral at the interbank level in place, a Single Euro Payments Area (SEPA) represents another major step towards closer European integration. Introducing a

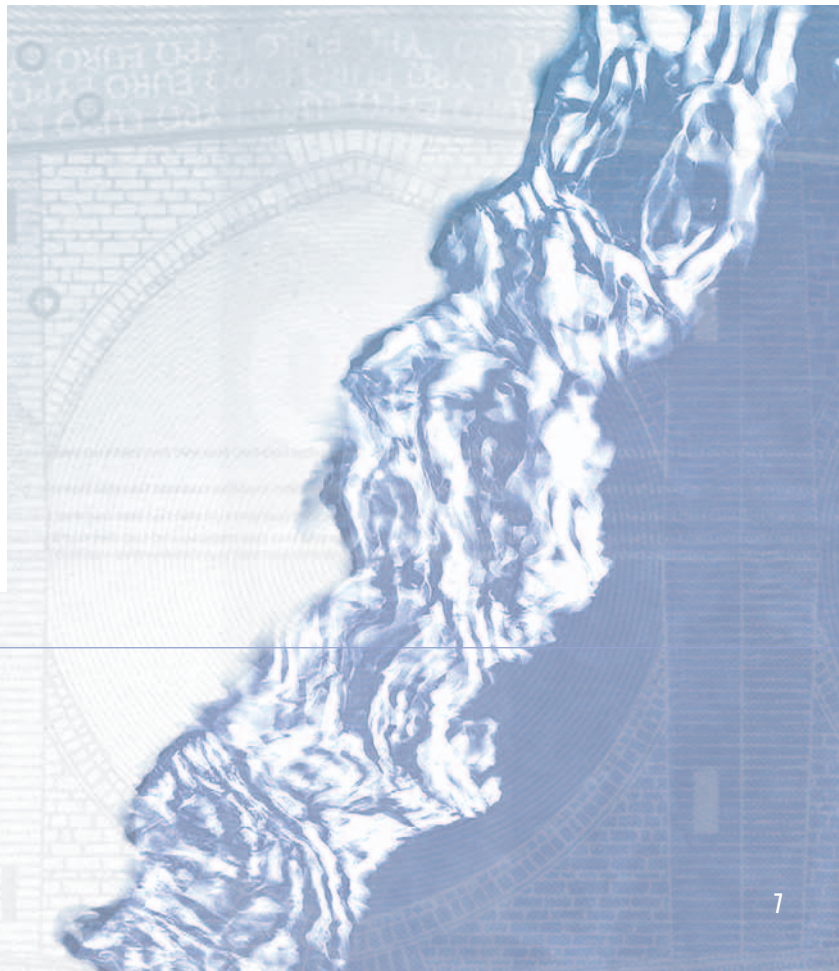
euro area retail payment market means that all euro payments will become “domestic” and that citizens will be able to make non-cash euro payments to any receiver in the euro area using a single account and a single set of payment instruments. This challenging project was taken up by the banking industry in 2002, with the Eurosystem acting as the catalyst to ensure the development of the best possible SEPA.

Both TARGET and the CCBM have been a success. TARGET is the market's preferred system for large-value payments in euro and even the world's largest payment system for a single currency in terms of the value of transactions processed. Likewise, the CCBM is the major channel for the cross-border use of collateral. However, both systems have suffered as a consequence of their decentralised set-up, which was based on the principle of minimum harmonisation. In terms of efficiency, they are considered sub-optimal by the market as they do not fully exploit the advantages of the single currency. The Eurosystem has therefore taken steps towards enhancing both TARGET and the CCBM.

1) Trans-European Automated Real-time Gross settlement Express Transfer

TARGET2 will go live on 19 November 2007 and will have completely replaced the current decentralised technical infrastructure by 19 May 2008. The CCBM2 project, which will provide a single set of procedures for all eligible collateral used on both a domestic and a cross-border basis, was launched in March 2007.

Integrating the securities market infrastructure is crucial for Europe. To this end, in July 2006, the Governing Council of the ECB took the decision to evaluate the creation of an integrated solution for the processing of securities and cash settlements on a single platform, which is referred to as TARGET2-Securities (T2S). Since then, the T2S project has progressed rapidly and has now entered the user requirements' phase after the Governing Council of the ECB concluded on 8 March 2007 that the new service is feasible and beneficial for the market. T2S will make an important contribution to financial integration and the creation of a single financial market, and will shape post-trading in Europe for many years to come.



# TARGET2: A SINGLE RTGS PLATFORM

## From TARGET to TARGET2

With € 2.3 trillion settled every day, TARGET is one of the three largest wholesale payment systems in the world, alongside Fedwire in the United States and Continuous Linked Settlement (CLS), the international system for settling foreign exchange transactions.

TARGET began operations on 4 January 1999 at the same time as the launch of the euro. Since then, TARGET has provided a real-time payment processing service with intraday finality to almost all credit institutions in the European Union (EU). Moreover, TARGET serves the monetary policy needs of the Eurosystem and promotes the integration of the euro money market as well as the harmonisation

of business practices in the EU. With its special focus on large-value payments related to interbank operations, TARGET helps to reduce systemic risk.

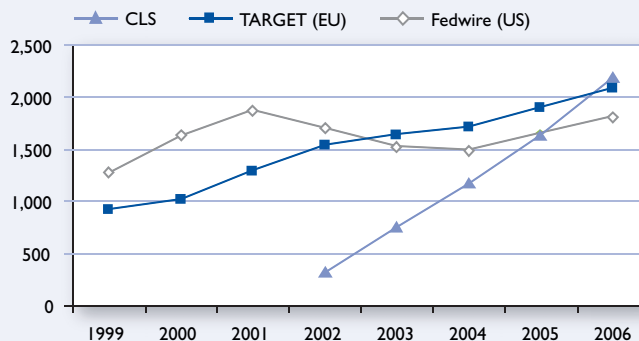
Despite its achievements, TARGET has a number of shortcomings that stem from its heterogeneous technical design. In view of this, and because of developments such as the further enlargement of the euro area, the Eurosystem decided to build the second generation of TARGET, TARGET2, in order to better meet user needs by:

- providing a harmonised service level with a harmonised pricing scheme;
- ensuring cost efficiency; and
- preparing for future developments, including the enlargement of the EU and the euro area.

A real-time gross settlement system (RTGS) is a payment system in which processing and settlement take place in real time (continuously) rather than in batch processing mode. It enables transactions to be settled with immediate finality. Gross settlement means that each transfer is settled individually rather than on a net basis. TARGET is an example of a real-time gross settlement system.

## The three biggest systems in the world

(value traffic comparison, daily averages in EUR billions)





## Harmonised service level

The Eurosystem has developed the features and services of TARGET2 in close cooperation with TARGET users.

Three Eurosystem central banks – the Banca d’Italia, the Banque de France and the Deutsche Bundesbank – jointly provide the single technical infrastructure, the Single Shared Platform (SSP) of TARGET2 and operate it on behalf of the Eurosystem.

The SSP of TARGET2 introduces a uniform wholesale payment infrastructure. In TARGET2, all banks in the EU – irrespective of where they are located – are offered the same high-quality services, functionality and interfaces, as well as a single price structure. This means that banks operate under similar conditions across Europe, thus promoting further efficiency and integration in the related financial markets.

TARGET2 also provides a harmonised set of settlement services in central bank money for all kinds of ancillary systems, such as retail payment systems, money market systems, clearing houses and securities settlement systems. The main advantage of TARGET2 for such ancillary systems is that

they are able to access any account on the SSP via a standardised interface. In essence, the settlement of ancillary systems in TARGET2 provides participants with liquidity optimisation opportunities.

The new functionalities of TARGET2 enable multi-country banks to consolidate their internal processes, such as treasury and back office functions, and to integrate their euro liquidity management more successfully. For example, participants are able to group some of their accounts and to pool the available intraday liquidity for the benefit of all members of the group if the legal requirements are fulfilled. In addition, TARGET2 users have uniform access to comprehensive online information and easy-to-use liquidity control measures.

As with TARGET, the business relationship with a participant continues to be dealt with exclusively by the central bank providing the account of the participant.

Although TARGET2 is legally set up as a multitude of systems under national law, the conditions applicable to TARGET2 users are (almost) completely harmonised.

# TARGET2: A SINGLE RTGS PLATFORM

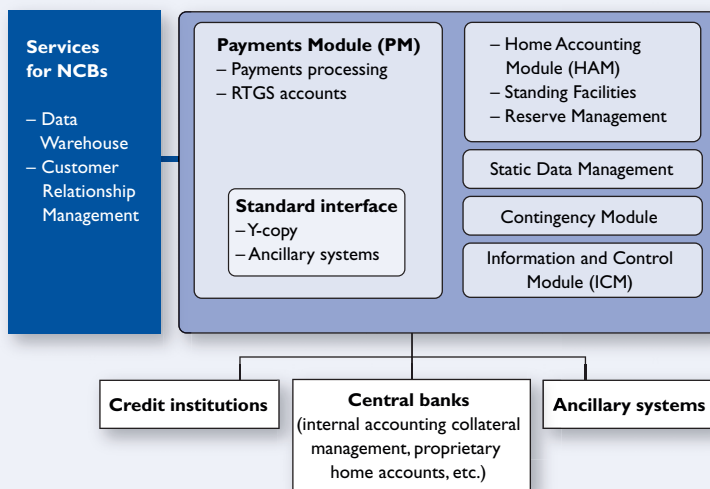
## System structure

A modular approach has been taken for setting up the SSP of TARGET2 (see chart below). Every module in the SSP is closely related to a specific service (e.g. the Payments Module for the processing of payments). Some of the modules (Home Accounting, Standing Facilities and Reserve Management) can be used by the individual central banks on an optional basis. Central banks that do not use these modules offer

the respective services via proprietary applications in their domestic technical environments.

SWIFT standards and services will be used (FIN, InterAct, FileAct and Browse) to enable standardised communication between the TARGET2 system and its participants.

## Structure of the SSP



## Participation

All countries in the euro area are covered by TARGET. Other EU countries may join TARGET on a voluntary basis.

A number of options are available to participants in terms of access to TARGET2, including direct and indirect participation, “addressable BICs”<sup>1)</sup> and “multi-addressee access”.

The criteria for direct participation in TARGET2 are broadly the same as in the TARGET system. Direct participants hold an RTGS account in the Payments Module of the SSP with access to real-time information and control features. Direct participants are responsible for all payments sent or received on their account by any TARGET2 entity (i.e. indirect participants, addressable BICs and multi-addressee access entities) registered through them.

Indirect participation implies that payment orders are always sent to/received from the system via a direct participant. Payments are settled in the direct participant’s account on the SSP. Indirect participants are listed in the TARGET2 directory. Only supervised credit institutions established within the European Economic Area (EEA) can become indirect participants.

Another category of access is that of addressable BICs. Any direct participant’s correspondent or branch that holds a BIC is eligible to be listed in the TARGET2 directory, irrespective of its place of establishment. Similarly to indirect participants, addressable BICs send and receive payment orders to/from the system via a direct participant, and their payments are settled in the account of the direct participant on the SSP.

Finally, multi-addressee access in TARGET2 enables direct participants to authorise branches and other credit institutions belonging to their group to channel payments through the direct participant’s main account without its involvement. This offers a direct participant’s affiliate banks or a group of banks efficient features for liquidity management and payments business. The payments are settled in the account of the direct participant.

1) In order to ensure the correct identification of parties in automated systems, SWIFT developed the Bank Identifier Code (BIC). This is a unique address which, in telecommunication messages, identifies precisely the financial institutions involved in financial transactions.

# TARGET2: A SINGLE RTGS PLATFORM

## Migration

The migration to TARGET2 has been arranged in “country groups”, allowing TARGET users to migrate to TARGET2 in different waves and on different pre-defined dates. Each wave consists of a group of national central banks and their respective TARGET user communities. The number of migration groups is limited to four.

The Eurosystem has defined tools to facilitate the migration to TARGET2, e.g. the National Migration Profiles and Ancillary System Profiles, operational workshops, registration and changeover procedures.

### Composition of the migration groups

Group 1	Group 2	Group 3	Group 4
19 November 2007	18 February 2008	19 May 2008	15 September 2008
Austria	Belgium	Denmark	
Cyprus	Finland	Estonia	
Germany	France	ECB	
Latvia	Ireland	Greece	Reserved
Lithuania	Netherlands	Italy	for
Luxembourg	Portugal	Poland	contingency
Malta	Spain		purposes
Slovenia			

TARGET users are allocated to the first three groups according to the central bank with whom they maintain their business relationship, while the fourth group is held in reserve as a contingency measure. The total migration period is limited to six months (or ten months if the fourth group is used).

More detailed information on TARGET2 can be found in the “Information guide for credit institutions using TARGET2” and in the latest “TARGET Annual Report”. All relevant documents can be downloaded from the ECB’s website at <http://www.ecb.int/paym/target/target2>.

Information on TARGET2 is also provided on the websites of the national central banks.





# TARGET2-SECURITIES: A CENTRAL SETTLEMENT HUB FOR THE EURO

## **Fragmented securities settlement infrastructure in Europe**

Despite the single currency, the European securities settlement market remains highly fragmented. Owing to, among other things, the large number of settlement systems, EU cross-border settlement costs are much higher than domestic ones and those in the United States. At the same time, demand for an integrated European settlement infrastructure is increasing. For example, cross-border collateral for Eurosystem credit operations exceeded domestic collateral in 2006.

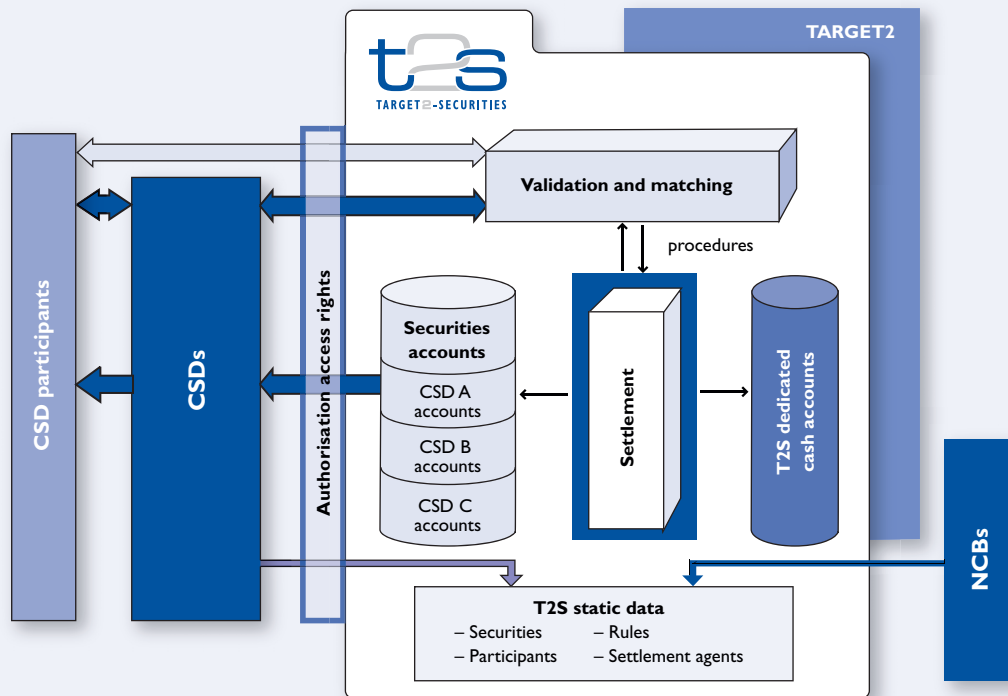
## **A single platform for the whole of Europe**

TARGET2-Securities (T2S) is a Eurosystem proposal to overcome the current fragmentation of the settlement infrastructure. It is a technical platform for the central securities depositories (CSDs), providing a single harmonised venue where all EU assets can be exchanged for euro with standardised communications protocols. It eliminates the financial exposure in cross-CSD settlement through central bank money settlement, increases the efficiency of collateral management and provides position takers with the ability to optimise their financing across all EU assets in euro. With T2S, the cross-border settlement of today will become the domestic settlement of tomorrow.

T2S is a technical settlement platform and therefore CSDs will preserve legal relations with their customers, including custody and notary functions.



**T2S places securities and cash accounts on a single platform**



# TARGET2-SECURITIES: A CENTRAL SETTLEMENT HUB FOR THE EURO

## **Integration and economies of scale: prerequisites for approaching the highest levels of efficiency in Europe**

### **T2S entails a number of important benefits:**

- cross-border settlement within the system will become as efficient as domestic settlement;
- dynamic effects of trading volumes and liquidity due to increased competition in trading, better pricing of securities and unencumbered access to settlement will cause higher trading volumes which in turn will lead to lower T2S unit processing costs;
- increased market liquidity and access to a wider investor base will lead to a lower cost of capital for issuers;
- lower cost of portfolio diversification and an increased market liquidity will lead to a better return for investors;
- reduction of intermediaries' back-office costs through economies of scope;
- further savings from reduced fail rates due to simplified processing;
- pooling the liquidity of a pan-European settlement system as well as integrating securities and central bank money on a single platform (the so-called integrated model) increase both efficiency and stability;
- the neutrality of the ECB as a supranational organisation with a clear commitment to financial integration and no economic self-interest ensures that a truly Europe-wide settlement infrastructure can be built for the benefit of the users.

Consequently, T2S will offer a genuine chance to approach the lowest levels in cost of capital in the world. Moreover, this will lead to growth in the capital market and therefore to an increase in overall productivity and economic growth.



## Close cooperation with the market

T2S will be based on the TARGET2 (T2) concepts and will hence facilitate liquidity management and provide the same levels of availability, resilience, recovery time and security as T2. It will take advantage of the Eurosystem's infrastructure to provide an efficient solution for CSDs and their users. The close links between T2S and T2 will provide enhanced liquidity management mechanisms. The existing operational structures and support organisation, telecommunications infrastructure, business continuity and disaster recovery arrangements will be re-used to the maximum extent possible.

“T2S on T2” must be understood as an open concept that should not impose constraints on the users' requirements. When designing T2S, any re-use of the T2 solutions will always be subject to these solutions' meeting the needs of T2S users. Four national central banks (the Deutsche Bundesbank, the Banco de España, the Banque de France and the Banca d'Italia) are ready to develop and operate T2S.

T2S will be built in close cooperation with the market. Since the first announcement of the project in July 2006, the market has been involved in the project in various ways. These include:

- official market consultations;
- meetings with all the stakeholders, including the banks and CSDs;
- the close involvement of CSDs and banks in the governance of the current phase, in particular in the Advisory Group and the Technical Groups;
- a dedicated project team comprising experts with CSD and market participant backgrounds.

## The way forward

The pre-project phase ended in March 2007 when the Governing Council of the ECB decided that the project was feasible and should progress into the next phase. Detailed user requirements are to be defined in the Technical Groups, assisted by project teams within the ECB and the four national central banks, by early 2008. The start of operations is foreseen for 2013.



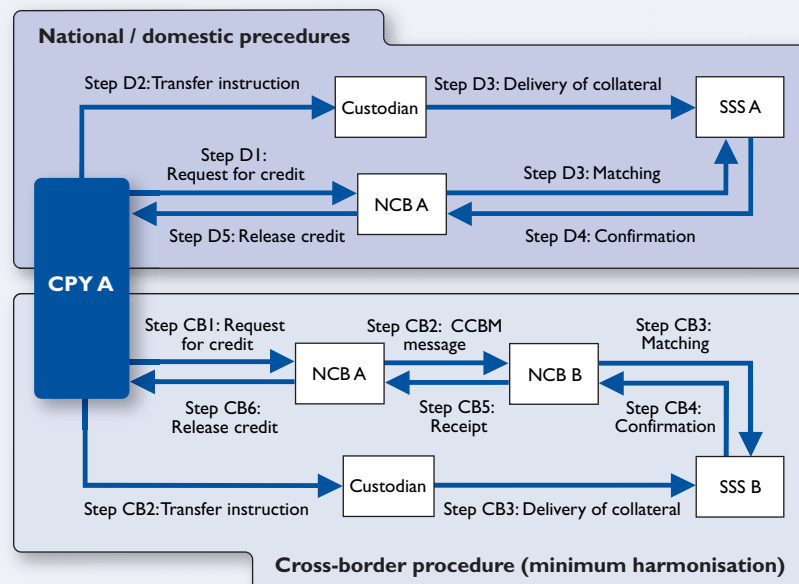
# CCBM2: TOWARDS A CONSOLIDATED MANAGEMENT OF COLLATERAL

## From CCBM to CCBM2

With the introduction of the euro, there emerged a need for a mechanism enabling the cross-border use of collateral for the Eurosystem's monetary policy operations and TARGET intraday credit operations. In the absence of market alternatives, the Eurosystem implemented the Correspondent Central Banking Model (CCBM) as a medium-term solution. Eurosystem counterparties can only obtain credit from the central bank in the country

in which they are located by collateralising eligible assets. With the CCBM, counterparties can obtain credit from the central bank in their country (the home central bank – HCB) on the basis of collateral issued in other countries and transferred to another Eurosystem central bank (the correspondent central bank – CCB). The CCB holds the collateral on behalf of the HCB granting the credit to the counterparty.<sup>1)</sup>

### The current framework for the delivery of collateral



1) For more details, see <http://www.ecb.int/pub/pdf/other/ccbm2006en.pdf>



Notwithstanding the existence of links between central securities depositories (CSDs), the CCBM remains the major channel for the cross-border use of collateral for Eurosystem credit operations: in 2006, 79% of cross-border operations were channelled via the CCBM, while the share of collateral transferred via links amounted to 21%.

Despite the success of the CCBM, market participants identified some drawbacks to this procedure, namely the varying degree of automation between central banks, the difference between the domestic and cross-border procedures and the resulting lack of standardisation (e.g. the use of various communication protocols, different legal techniques for collateralisation). Furthermore, the increase in cross-border use, which rose from around 10% in 1999 to 50.15% in 2006, emphasised the need for reconsidering the existing arrangement.

Against this background, the Eurosystem decided on 8 March 2007 to review the current collateral management handling procedures<sup>2)</sup> and create the CCBM2 (Collateral Central Bank Management).

2) See Press Release [http://www.ecb.int/press/pr/date/2007/html/pr070308\\_2.en.html](http://www.ecb.int/press/pr/date/2007/html/pr070308_2.en.html)

# CCBM2: TOWARDS A CONSOLIDATED MANAGEMENT OF COLLATERAL

## **CCBM2:**

### **A harmonised solution for collateral management within the Eurosystem**

The aim of the CCBM2 is to substantially increase the efficiency of Eurosystem central banks' collateral management and to address the drawbacks identified by market participants to the extent they fall within the central banks' remit.

The scope of the CCBM2 will go beyond that of the current CCBM, which is restricted to cross-border use only, in that it will provide for a single set of procedures for all eligible collateral (both securities and non-marketable assets) used both on a domestic and cross-border basis.

Contrary to the CCBM, the new system will provide a harmonised level of service based on SWIFT communication protocols, thus facilitating interaction between the Eurosystem central banks and their counterparties.

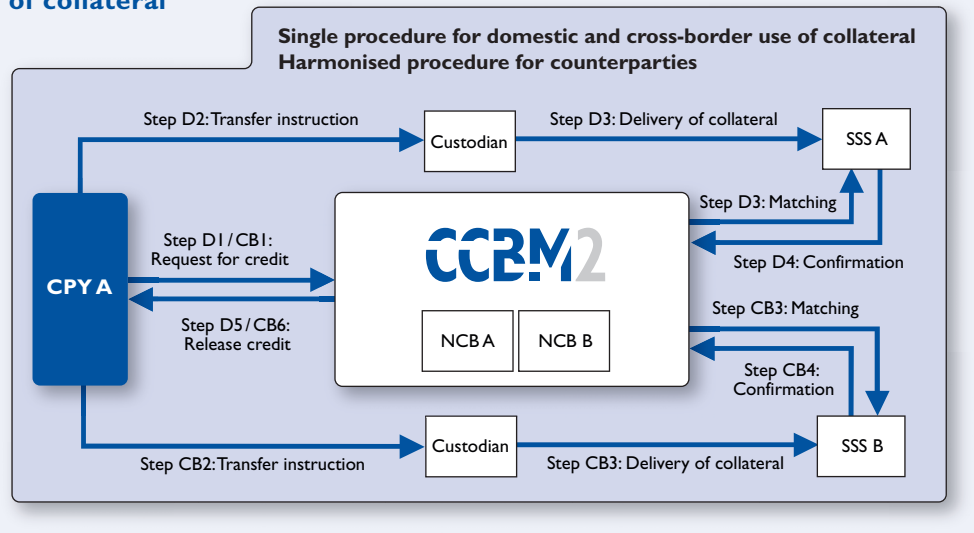
Furthermore, the CCBM2 will be fully compatible with TARGET2 and T2S, in particular with the communication interfaces of both these platforms and the settlement procedures of T2S for the delivery of securities.

The CCBM2 will be an IT platform for the management of Eurosystem credit operations operating on a straight-through processing (STP) basis, enabling central banks to rationalise their internal organisation while preserving the decentralised account relations with counterparties. It will be based on existing central bank collateral management systems, such as the Euro Collateral Management System (ECMS) platform shared by Nationale Bank van België/Banque Nationale de Belgique and De Nederlandsche Bank.

It will be based on a voluntary participation and modular approach, with modules for securities, credit claims and the collateral management interface/TARGET2 interface.

Finally, it is worth noting that links between CSDs will continue to remain an alternative for the cross-border use of collateral.

## CCBM2 – Single procedure for domestic and cross-border use of collateral



### CCBM2 development

In order to maximise the synergies with the T2S project, the Eurosystem decided to launch both projects in parallel. On the one hand, the CCBM2 could benefit from the envisaged T2S platform in terms of the settlement services and, on the other, T2S could make use of some of the CCBM2 services in terms of self-collateralisation.

In order to integrate the counterparties' needs, the Eurosystem is developing the CCBM2 in close cooperation with market participants. Thus, following the Eurosystem's decision to review the

collateral management handling procedures, an initial market consultation<sup>1)</sup> on the CCBM2 objectives and principles was launched in order to integrate the feedback in the user requirements. On the basis of this first step and after consecutive rounds of consultation, the Eurosystem will prepare detailed user requirements and set up an implementation timetable.

More detailed information on the CCBM2 can be found on the ECB's website at <http://www.ecb.int/paym/coll/coll/ccbm2/html/index.en.html>.

1) See <http://www.ecb.int/ecb/cons/html/t2securities.en.html>

## SEPA: A SINGLE SET OF PAYMENT INSTRUMENTS

The euro area will have one retail payments market and all euro payments will be “domestic”. With one set of payment instruments, citizens will be able to make payments throughout the euro area as quickly and easily as they make national payments today.

In contrast to the three other projects, the Eurosystem is not the main driver of SEPA. However, the Eurosystem considers SEPA an extremely important project for Europe and guides the market with a strong voice to ensure that the new retail payments market will be in the best interests of all European citizens and corporations. SEPA will constitute another main part of the continual European integration and is therefore not a “one-shot operation”. SEPA must continue to evolve and move with cutting-edge technology so that customers’ needs and requirements remain satisfied.

The project is being run by the European Payments Council (EPC), which was established by the European banks in 2002. The EPC is creating the building blocks for SEPA.

### Why SEPA?

Since the introduction of the euro banknotes and coins in 2002, consumers have been able to make cash payments throughout the euro area using a single currency. The aim now is to enable customers to make cashless payments throughout the euro area from a single account under the same basic conditions, regardless of their location.

To facilitate this, all the euro area retail payments markets will become one market – the Single Euro Payments Area (SEPA). In SEPA, all euro payments will be treated as domestic payments and the current differentiation between national and cross-border payments will disappear. This will involve not only the alignment of national practices for the banking industry, but also changes for customers. In SEPA there will be:

- one currency;
- one set of payment instruments – credit transfers, direct debits and card payments;
- one legal framework – based on the Payment Service Directive (see below).

## The SEPA building blocks

Credit transfers, direct debits and card payments are well-known payment instruments that for decades have proved their efficiency and popularity throughout the euro area. Detailed schemes for the new SEPA credit transfers and direct debits are being developed. On this basis, banks will provide products for their customers. For cards, the situation is different, as only high-level principles are being developed. The Eurosystem strongly recommends that a European debit card scheme be set up. This could either be a completely new scheme, an alliance between existing schemes or an expansion of an existing scheme.

The goal is that national paper-based instruments and non-SEPA payment instruments, such as cheques, will gradually be phased out and replaced by the new SEPA instruments.

Changes are needed if the existing infrastructures plan to process the new SEPA payments, as they must be able to send and receive SEPA payments throughout the whole euro area. To achieve this, interoperability allowing the exchange of payment orders between infrastructures is required. The Eurosystem does not expect all current infrastructures to become SEPA-compliant. Consolidation will occur and the number of infrastructures will diminish.

### The EPC has developed two schemes:

1. **SEPA Credit Transfer** – roll-out starts in January 2008
2. **SEPA Direct Debit** – roll-out starts in November 2009 at the latest

The schemes will allow customers to send and receive euro transfers to / from any beneficiary in the euro area. Both schemes will use well-known international standards:

- IBAN (international bank account number),
- BIC (bank identifier code), and
- UNIFI (ISO 20022) XML message standards.

### The EPC has also developed two frameworks:

1. **SEPA Card Payments** – roll-out starts in January 2008  
Cardholders will be able to pay with one card throughout the euro area and there will no longer be cards for national use only. The point-of-sale terminals will be standardised and merchants will be able to accept a wide range of cards with a single terminal.
2. **SEPA clearing and settlement infrastructures** – roll-out starts in January 2008  
By the end of 2010, the infrastructures must be able to reach all euro area banks and process euro payments made with the three SEPA payment instruments. Reachability must be guaranteed either directly or indirectly through intermediary banks or through links between infrastructures.

### The European Commission has developed:

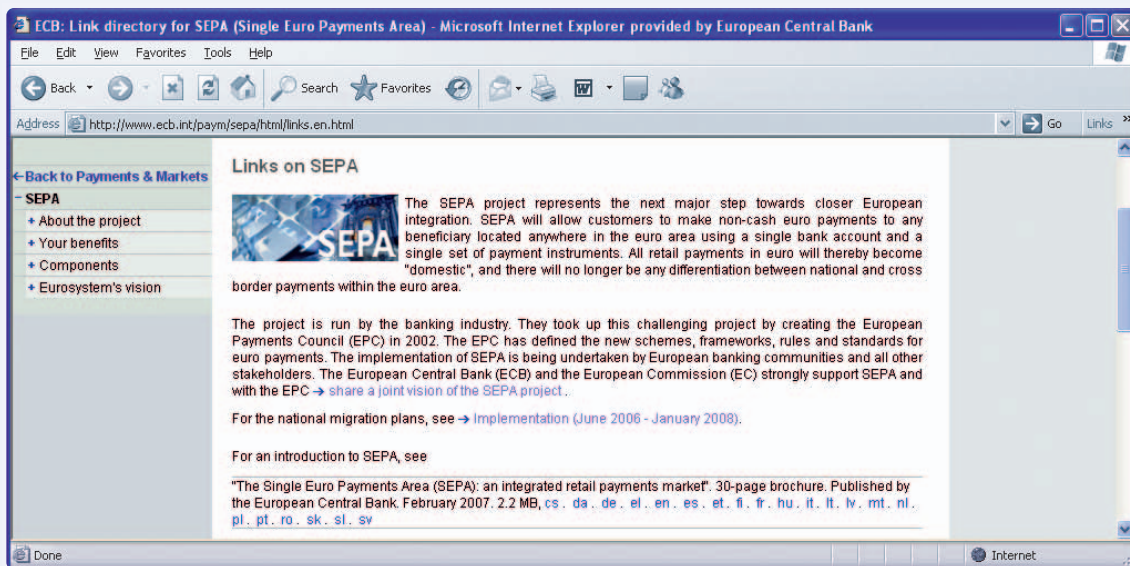
**the Payment Service Directive (PSD)** – to be transposed into national law by 1 November 2009 at the latest. The PSD was approved by the European Parliament and the ECOFIN Council in early 2007. It provides the legal foundation for SEPA, as it protects and reinforces the rights of all payment service users.



# SEPA: A SINGLE SET OF PAYMENT INSTRUMENTS

## The national migration plans

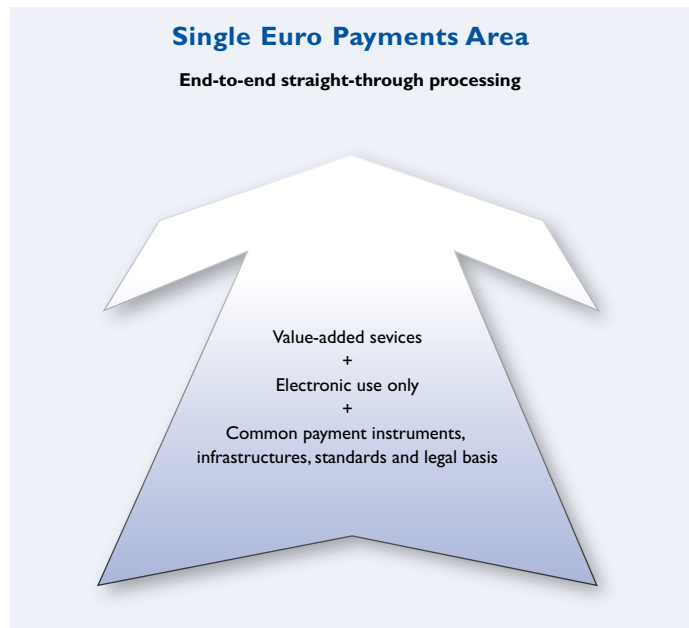
National implementation/migration bodies have been established in each euro area country. They have made national migration plans that are published on the SEPA website at [www.sepa.eu](http://www.sepa.eu).



**Next step –  
customer-to-bank domain**

With the building blocks almost in place, the ground is set for SEPA. To ease the migration and guarantee the user friendliness of the SEPA payments, the focus must be on the customer-to-bank domain. SEPA-wide services linking the customer and the bank should be free to evolve. Such services, which are offered to customers before and after payment, include e-invoicing, e-reconciliation, online payment solutions, etc. When these services are combined with SEPA payments, paper is eliminated from the payment chain and end-to-end STP can be achieved.

The Eurosystem encourages work in this field and welcomes the EPC’s initiative to develop a common online payment service that allows customers to conduct payments with online merchants in a safe and well-known environment (i.e. via their internet banking application). Market initiatives are also trying to align existing e-invoicing solutions and set up SEPA e-invoicing. The Eurosystem strongly supports such initiatives, as they will help SEPA become a success for all stakeholders as well as for the European economy.



**E-invoicing:** bills are sent directly to the payer’s internet banking application. If he/she accepts, an automatic payment instruction is created containing the relevant information on the payer and payee.

**E-reconciliation:** bills are electronically matched with the payment, and the payee’s records are updated automatically.

# IMPRINT

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**PRINTED BY**

Kern & Birner GmbH & CO KG, Frankfurt am Main, Germany

ISBN 978-92-899-0204-5 (print)

ISBN 978-92-899-0205-2 (online)







EUROPEAN CENTRAL BANK

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