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The Publication about the Swiss Payment Traffic Systems

14

Switzerland Coined the Term RTGS

- Clearing Systems Efficiency?
- euroSIC: Currently no EBA-Step 1 Participation

EDITORIAL

Dear Reader,

As of this writing on June 10, 2002, it is exactly 15 years to the day that the Swiss franc clearing system SIC started its operation. More specifically, it was the fully computerized Telekurs SIC system replacing the old, partially manually operated SIC. But who can still remember «B.C.» – Before Computerization? Who remembers that after several years the completed, «new» SIC still couldn't be started up for another entire year? That's how long it took just for all the rigorous certification testing. Only then was it started up. Somehow that doesn't seem to fit in with our times. Maybe SIC's fathers hadn't yet heard about the Time to Market concept, and knew nothing about the fact that it really isn't the big fish eating the small fry, but rather that the faster one gets the slower one in the end. For that matter, they probably never even considered that a payback period shouldn't ever exceed 24 months (not years!). Nonetheless, SIC turned itself into a success story of the finest order – and continues to write history. And if we look around the Telekurs Group, we quickly realize that there are a host of other endurance performers: The Telekurs Financial value data system is still going strong after its recent 25th anniversary. The old faithful Investdata system was operated for exactly as many years. Then there is DTA and LSV, celebrating the same anniversaries. The ATM is still being centrally monitored after 24 years, for over 17 years ec-direct cards are a preferred payment method at gas stations and for 14 years at a number of ever increasing cash registers across the country. Each one of these anniversaries represents a remarkable success story. And then there are those products showing all the potential of becoming one in the future. There is CASH, introduced six years ago, or euroSIC, now up and running for four years and going strong. As you can surmise, I am out to promote endurance. Like any good athlete knows, it takes more than sheer speed to succeed on the field. You can't lose your breath if you want to make it for the long haul. Maybe some day some management expert will develop a new theory based on that philosophy. He or she will go to great lengths to explain to the reader that, in order to really succeed in today's world of hectic pace and continuous change it takes more than speed, agility and assertiveness: it takes endurance.

Endurance is one of the true marks of Telekurs.



*Dr. Georg Kramer,
Chief Executive Officer, Telekurs Holding AG*

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Stephan Zimmermann: «Switzerland Coined the Term RTGS»

At the end of May, Stephan Zimmermann, Head of Operations at UBS AG, turned over his mandate as President of the board of directors of Swiss Interbank Clearing AG to Bruno Pfister of Credit Suisse. As President of the board of directors of Telekurs Holding AG he continues to contribute his knowledge and experience to the joint venture. ClearIT had the opportunity to interview Mr. Stephan Zimmermann shortly after the transition.

ClearIT: Mr. Zimmermann, the development of Swiss Interbank Clearing has been significantly impacted by your vision over the past six years. Today SIC is one of the world's strongest RTGS systems – any reflections?

Stephan Zimmermann: I will remember this time as a very positive experience. It was extremely satisfying to purposefully approach the relevant topics affecting the Swiss payment traffic together with a team of dedicated, professional and pragmatic managers and board of directors. There are three points I especially want to focus on:

- With SIC Switzerland has literally coined the term RTGS long before it became a characteristic feature for all modern clearing systems.
- The cooperation between the Swiss National Bank and the commercial banks, regardless of their respective sizes, is exemplary and various economic models can be realized in a short amount of time.

• The economies of scale work, which means that SIC has indeed proven remarkably effective both for small and large amounts. The SIC system is a global cost leader – and will remain one in future years.

Especially the second point remains a very positive memory. To make changes to their RTGS system CHIPS, the USA require up to 11/2 years. In Switzerland all we need is an AM meeting with all the parties, including the SNB, sitting at the same table. The decisions are noted right then and there. This is very unique indeed.

ClearIT: What does the future for SIC look like?

Stephan Zimmermann: Clearing systems are no exception – they have to undergo continued adaptation to the economic changes. The most crucial adaptations for our clearing system are addressed with SIC³ and some have already been implemented. remoteGate, multi-currency capability, DTA renewal, as well as the continued opening of the system, such as in the cross border area, are good examples of SIC adaptations.

Of course Postfinance plays a very important role, too. Postfinance is a SIC system participant no different than any of the others. Participation as a shareholder in Swiss Interbank Clearing AG is currently being discussed. One of the main deciding factors for future development is the full integration of all market participants.

This is simply mandatory for feasibility and acceptance reasons.

Of course staying true to the mission and the purpose of the SIC system is always a determining issue for future developments: To provide the Swiss financial market with an efficient, inexpensive and secure clearing system. No more, no less.

ClearIT: The European payment landscape is in the midst of several changes with the introduction of the cash euro and the new clearing systems RTGS^{plus} and Step 2. Which development potentials do you envision for euroSIC?

Stephan Zimmermann: The first thing to mention here is that euroSIC isn't actually a competitor to RTGS^{plus} or Step 2. This would be a very lopsided perception. However, euroSIC and the SECB Swiss Euro Clearing Bank GmbH are well established in the market and are providing Swiss financial institutions a reasonably priced option for their euro payments with swisseuroGate. The transaction volume increase for this year makes me feel optimistic for the future.

Looking down the road, I don't believe that Europe will need 15 clearing systems. A homogenous market will only require one good clearing system. But it's probably safe to predict that even in a distant future there will be more than one system.

ClearIT: During our last interview two years ago (ClearIT No. 6) you mentioned that the appropriate networking, tapping into the European

Stephan Zimmermann has worked at UBS AG, formerly the Swiss Bank Corporation, since his commercial apprenticeship. For 13 years after receiving his Masters in Business Information Technology he managed the processing centers in London, Singapore, and Frankfurt as Operations Manager. Stephan Zimmermann has been in top management since 1996. Currently he is in charge of Operations and is a member of the UBS AG Group Managing Board. In addition, he is the president of the board of Telekurs Holding AG as well as a board member of CHIPCo (US Clearing House), SIS SEGAINTERSETTLE AG, SWIFT and SWX the Swiss stock exchange.

development and a further opening of the SIC system are the major challenges. According to your opinion, how far has this integration progressed?

Stephan Zimmermann: Today, any bank worldwide can participate in SIC so long as they meet the admission criteria. The technical requirements are already met with remoteGate and the generic system platform. The further opening of the system is becoming increasingly important in order to facilitate access to globally active financial institutions.

Direct participation is of particular interest to those financial institutions who wish to benefit from the advantages of the Swiss Value Chain, such as the delivery versus payment process for securities transactions.

As far as the development within the euro zone is concerned, we are only just at the beginning. With euroSIC a platform has been created providing the Swiss banks not only with an elegant, simple way to settle euro payments within Switzerland, but also access for payments within the euro zone. At the same time, it created a

new way for EU banks to transfer euros to Switzerland.

ClearIT: As the former board president of Swiss Interbank Clearing you were interested in reasonably priced systems and in a high payment volume, as the person in charge of UBS, on the other hand, you are having your banks' cross-border payments in euro processed via proprietary access to the German clearing system and not via euroSIC. How would you explain these differing perspectives?

Stephan Zimmermann: UBS is one of the most important financial institutions in securities and commercial banking. The question whether direct access to a system is or isn't a requirement hinges in part on the institution's individual risk of the commitment in a particular currency. If a bank considers direct liquidity steering in specific currencies a necessity, the resulting consequence dictates direct access to the appropriate markets. That's why the UBS is a self clearer in euro as well as in other significant currencies, such as the dollar or the yen.

The above notwithstanding, UBS has, right from the start, supported and taken part in the vision of the cooperative core of the Swiss financial market and significantly contributed to the development and implementation of euroSIC. This, knowing all along that UBS would only be able to effectively use certain parts.

ClearIT: Large, global projects like Continuous Linked Settlement System or WATCH were realized either with tremendous delay or not at all. Are these indicators that the financial world is indeed not yet ready for world encompassing cooperation?

Stephan Zimmermann: These two projects cannot be compared. The reasons behind the problems differ greatly. In the final analysis, WATCH was economically not feasible. That's why not enough members could be committed who would have provided the necessary payment volume.

CLS is a different case. There are few things more complex than a global infrastructure. With CLS, features typical of global projects are clearly evident. They follow existing and developing markets and as a result almost always take longer and end up being significantly more expensive than originally anticipated. In addition, there have been many changes in personnel – almost none of the original developers are still involved. While this is the norm with global projects, it doesn't make the situation any easier. CLS is also rather demanding in its content: to always have liquidity available at the appropriate locations 24/7 requires global bookkeeping – a rather considerable challenge in and of itself.

But to make it in the market place involves another deciding factor altogether: The primary CLS mission concerns eliminating the fulfillment risks, the so-called Herstatt risk in response to the request by



Stephan Zimmermann
Photo: UBS

the regulators. So long as there is no fine for non-processing of settlement risks, there is no pressure to actually use CLS and cheaper solutions are still being researched.

CLS will ultimately be introduced and will be successful. However, we will only learn to truly appreciate this new global payment system in a few years.

ClearIT: For some time now SWIFT has been trying to reposition itself in the market with the introduction of new products. The limited acceptance of e-paymentsPlus seems to indicate that this might have been a step in the wrong direction. Which direction is SWIFT pursuing?

Stephan Zimmermann: During the lifetime of any company, changing market tendencies have to be anticipated with product R & D, even though it is unpredictable what the market will actually do.

And nobody got past the Internet bubble – SWIFT wasn't immune either. Now that the bubble has burst, other challenges are demanding attention.

SWIFT's greatest strength and also its core business remains messaging: the transmission of financial transactions between banks over the world's safest network. This main responsibility will be continually perfected.

The entire financial industry is participating in SWIFT. This quite naturally predisposes SWIFT to be the perfect institution to push global standardization within the financial transaction industry. New standards are implemented according to new insights and perceptions. The standardization within the securities area is picking up speed. However, existing message types won't necessarily be adapted

to new trends or technologies without noticeable added values, especially when considering that each innovation also requires system modifications for each participating bank. That's why there isn't yet an MT103 in XML format.

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Clearing Systems Efficiency

Opinions differ about the best way to make a clearing system efficient. SIC, the Swiss franc clearing system is considered efficient.

Christian Schwinghammer explains the different approaches.

Nowadays, the efficiency of clearing system settlement mechanisms is improved predominantly in one of two ways: By either resolving or avoiding system

gridlocks or by reducing excessive liquidity.

Both strategies are used in a series of liquidity-saving elements of systems such as the German RTGS^{plus}, the British NewCHAPS or the Australian RITS. In these clearing systems offsetting is continually activated both bi- and multilaterally. The SIC system has been using a bilateral offsetting process since the end of 2001.

In general, clearing systems work best when sufficient liquidity is available. The higher the liquidity, the lower the risk for gridlock, and the more efficient the system.

The Cost Question

Preparing liquidity reserves affects costs as much as the delayed settlement due to gridlock. At least in Europe the cost for liquidity is currently relatively low. As a

direct consequence many banks have not specifically developed their liquidity management.

This means that a system operator may not have very high demands of the appropriate know-how of many of its participants. A customer friendly system design would take this into consideration.

It is established that a more flexible liquidity approach, such as by providing free intraday credits, will result in significant savings. Beyond that, the splitting of very large payments is recognized as one of the most effective ways to prevent gridlocks. An efficient clearing system does not require extensive, liquidity saving mathematical algorithms be implemented.

Disciplined behavior on the part of the system participants, preventative measures by the system manager, and appropriate price structuring are certainly suitable to support payments being settled efficiently as well as reasonably priced.

Gridlock

Caused by insufficient coverage. All system participants are unable to process pending payments.

The Situation in Switzerland

The willingness of the SIC participants to split payments of over 100 million CHF into several smaller chunks is an important prerequisite to successfully reduce the liquidity requirements of the clearing system. The risk of gridlocks occurring in SIC is indeed very small.

Due to the close cooperation between the Swiss National Bank as the system manager with the participating banks, as well as to the efficient price structuring of the SIC systems 80 % of all the payments are already submitted. By 2 pm 80 % of the volume and 99 % of the number of transactions are already settled (see table).

Switzerland's financial market – and with it the SIC participants – is identified by

the unique situation that two large participants lead the clearing system by transaction volume. That's the reason the offsetting algorithm for the resolution of gridlocks introduced in December 2001 is adequate even though it only works on a bilateral basis.

The comparatively small additional benefit presumably gained by a multilateral algorithm would hardly justify the effort. The marginal utility achieved by additional and more complex algorithms for gridlock resolutions also appears insignificant.

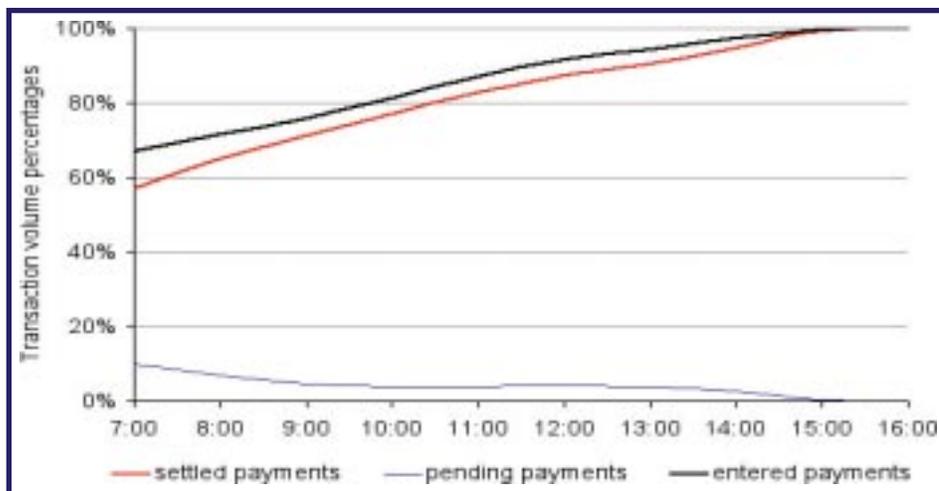
Additionally, simulation results indicate that the liquidity saving algorithms are most efficient in systems with comparatively few transactions.

However, transaction-wise SIC is one of the strongest RTGS systems worldwide, with enough new transactions and therefore enough new liquidity continually being added.

Fortunately, Swiss Interbank Clearing is in a position where the implementation of complex, liquidity saving algorithms for the SIC system is not a necessity for some time, particularly due to the fact that the fundamental aspects such as the submission patterns of individual participants and the cooperation between system participants and system manager are well structured in Switzerland.

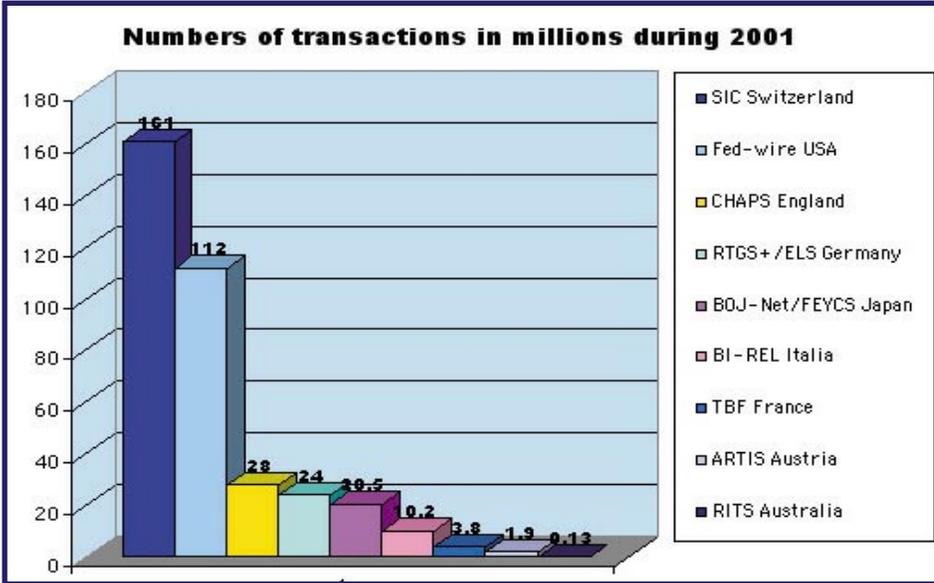
Bilateral Offsetting

It's a simple principle: For each payment not immediately settled, an offsetting payment is sought on the recipient side. The use of these bilateral and simultaneous offsetting results in notably faster payment execution and shortened wait queues.



Submitted, pending and settled payments per day (average during 2001)

Table: D. Heller, Swiss National Bank, January 2002



An overview of SIC and other RTGS systems

This is particularly important because no matter how mathematically refined an algorithm is, it cannot compensate for a participant's oversight.

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BUSINESS & PARTNERS

Postfinance and SIC

Established processes are changed with the full participation by Postfinance in the SIC system. What should banks be on the lookout for?

When in November 2000 Postfinance came online with SIC, it rendered superfluous the Swiss National Bank's (SNB) gate keeping function. The interbank payment traffic between banks and Postfinance has been simplified by as a result. In October 2001, as a second step, Postfinance also introduced the processing of customer payments as A messages.

For the customer payment exchange via SIC the so-called C messages have been used for several years now. These transactions are exchanged by file transfer between Swiss Interbank Clearing and Post-

finance. The C messages are to be used for the time being, however a task force has been organized to develop the specifications for the merging of C into A messages.

The Interbank Team

The Interbank Team was assembled by Postfinance for the internal and organizational processes related to the SIC online access. The team handles all new responsibilities resulting from the SIC access, such as

- the processing of incorrectly submitted SIC entries with control and repair tools,
- the processing of manual fund transfer orders submitted via ZAG-FAX and SWIFT MT200,

- reconciliation or booking of the SIC traffic (settlement account SNB) or
- balancing EFT/POS transactions and DTA input.

The Interbank Team processes research for A and B transactions and operates the hotline for specific inquiries by the banks and by Swiss Interbank Clearing.

Postfinance was able to develop in short order the required know-how while simultaneously developing an efficient network of relationships with the respective bank representatives in large part due to the concentration of multi-faceted assignments encountered by the Interbank Team.



The First Experiences

During these first months we became specifically aware of the following points the banks might want to take note of:

- When returning C11 messages via A11 to PF the reference number from field 33B must be submitted.
- The accurate representation of the account number (e.g. 30-3333-3) is

important for automatic processing of B11 messages benefiting the banks' postal accounts.

- For transfer orders via SWIFT, field 57 should contain the financial institution's own clearing number, not the SNB's number.

The most efficient way to do this is via Yellownet (mask «Transfer into SIC»). These orders are processed automatically.

Postfinance will continually match the online interface capacity as well as the organizational processes to the transaction volume.

At this point the future shift from C to A messages and therefore from file to online interface is almost a given. As soon as the larger institutions are planning that step, Postfinance will be given ample notice in order to have enough time to prepare for the necessary adaptations.

Bulk Payment Traffic

Postfinance is using SIC for interbank business processing (B messages), high value payments and urgent payments. The

bulk payment traffic will still be processed by Postfinance, using their own existing services.

Recently Postfinance has started to offer this new, bulk capable service for the processing of deposit slips to the banks: By using EGA-B (electronic credit advice with image) and EGA-V (electronic credit advice with image) deposit slips are being electronically notified and the current processes are simplified as a result. EGA-B and EGA-V together form a uniform standard for the credit notification, enabling the banks to streamline their subsequent processing, making it more efficient than the traditional paper trail notifications.

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SWIFT in Switzerland

Within the financial industry, SWIFT has become a term everyone is familiar with by now. But what is SWIFT's structure? Daniel Wettstein of the Swiss National Bank SNB, and SWIFT Switzerland chairman, offers a fascinating insight into the Swiss User Group of this multinational organization.

The Society for Worldwide Interbank Financial Telecommunication (SWIFT) is the network for processing global banking business. 7'300 participants from 196 countries generate a message volume of up to 7.5 Million transactions per day. Switzerland, with a volume share of 5.5% ranks sixth among the participants, and is currently in a remarkable growth phase, especially in categories three and five – treasury and securities.

But there is more to SWIFT – it is actually a standard. In its attempt to realize straight through processing (STP) the global banking business processing is dependent upon standardized message traffic and a secure network. Thanks to SWIFT the operational risk of the underlying business transactions and – almost as an aside – the costs are lowered.

SWIFT is an open standard that can be used across all banking business transac-

tions and that has caught on in the banking industry internationally. Little by little, the proprietary standards of the various national processing systems are replaced by these standards, and Switzerland is no exception.

They are developed by financial industry experts who are serving within international task forces. Due to its significant transaction volume and high turnover, Switzerland is very well represented and has considerable input affecting criteria and design.

The SWIFT Standards Committee has implemented a new process, fundamentally changing the development of standards with the use of modeling techniques. The newly developed standards are formulated in the XML format (eXtended Markup Language) with the help of computer aided tools.

Strong Representation of Interests

SWIFT is a cooperative organized by

countries. It has been in Switzerland since 1974 in the form of SWIFT Switzerland National Member and User Group with 250 members, submembers and participants.

This organization ensures the representation of interests vis-a-vis SWIFT, within the framework of committee meetings. It primarily develops recommendations for the board papers, determines the admission criteria for Switzerland and processes and supervises the admission of participants.

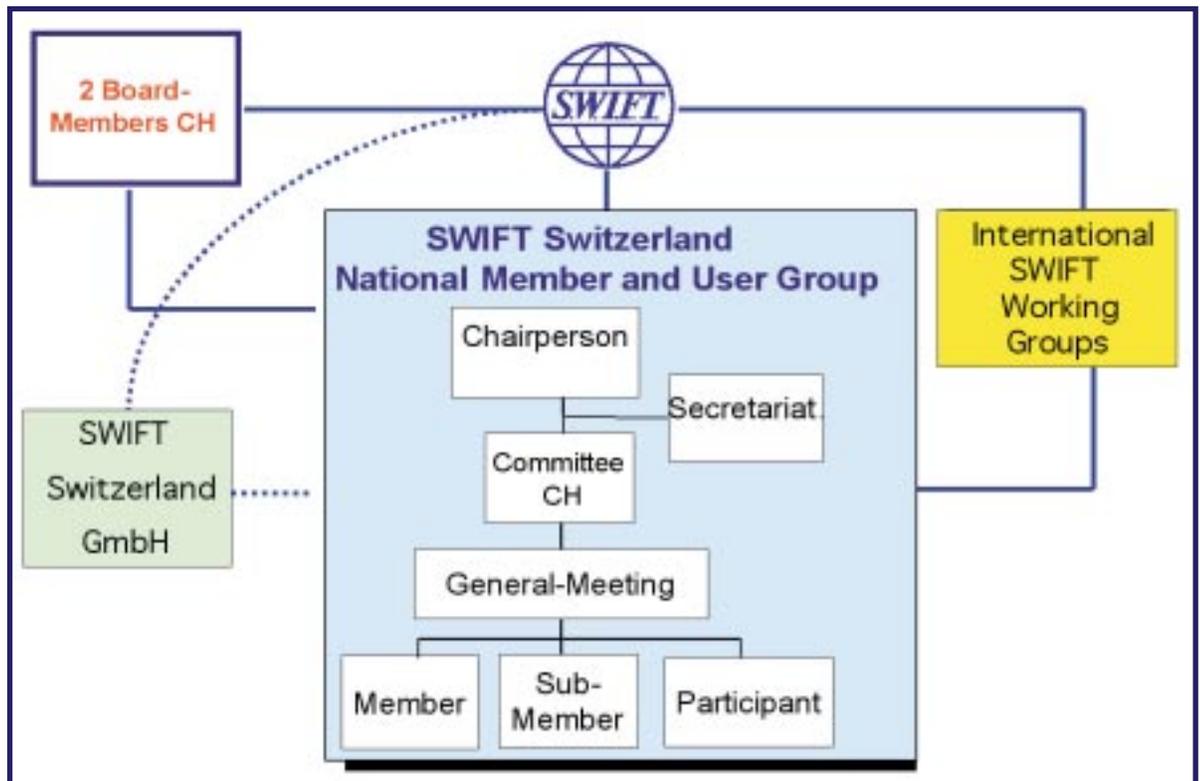
For the purpose of better use of the available resources there is close cooperation with the SKSF (Swiss Commission for Standardization within the Financial Industry). The SKSF with its trade commissions (Payments, Securities, Treasury Products, Trade Finance, Loan Transaction, Data Standards, IT Security, E-Commerce) processes all the standards and opinions for Switzerland, to the degree that they are SWIFT relevant.

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In addition, SWIFT Switzerland also focuses on specific problems like the SWIFTNet FIN migration. A task force is supporting the preparations for the network change with all SWIFT participants and the IT providers. There have already been three road shows with around 400 participants. Additionally, SWIFT provides the participants with special support teams.

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Organigramm SWIFT

euroSIC: Currently No EBA Step 1 Participation

Time and again euroSIC participants ask how they can process payments crediting Step 1 participants. Horst Sander and Christian Schwinghammer explore these options and explain why euroSIC will not become a Step 1 member for the time being.

The SECB Swiss Euro Clearing Bank and Swiss Interbank Clearing as system manager and euroSIC system operator continue to perceive a lack of incentives to join the Euro Banking Association (EBA) payment system «Step 1» for small payments.

Longer Clearing Times

The euroSIC system is a true RTGS system, operating on the basis of instant finality with coverage. As a result, the creditor immediately has irrevocable access to any and all settled amounts in their accounts. The euroSIC clearing day ends at 6:45 pm on the settlement date which permits full advantage of the attractive TARGET cut-off times.

The cut-off time for end-of-day processing for Step 1, on the other hand, is an early 9:30 am on the settlement day, leaving a very limited amount of time to benefit from the TARGET cut-off times. This in and of itself speaks against a euroSIC participation in Step 1.

The Step 1 funding process can last from 10:30 am until 4:00 pm. Therefore, payment instructions by Step 1 members crediting euroSIC participants – while received by SECB by 9:30 am on the value date – can only be executed after 4:00 pm, once the cover payment from the

Step 1 settlement bank has been received.

Compare that with a bank choosing the swisseuroGate path: Payments can be submitted until either 4:15 pm (customer payments) or 5:15 pm (bank to bank payments) and still be settled the same day.

Step 1 Has its Price

SECB and Swiss Interbank Clearing are constantly striving to optimize the euroSIC system's cost structure. The tangible results of this policy are continually passed on to the participants in the form of low transaction fees and set pricing.

One of the significant reasons against access to Step 1 is the additional costs resulting from such participation. This includes transaction costs, the installation and operating costs for a Step 1 work station plus the EBA joining and annual Step 1 membership fees.

Add to this the Step 1 settlement bank fees – a requirement for processing and cover payments and with that an additional correspondence bank with a corresponding administrative effort for reconciliation and distribution.

Another segment of the EBA clearing system worth exploring is the liquidity steering: It, too, would generate additional operational costs and requires tremendous additional effort and expenditure according to SECB's evaluations.

All these costs would have to be passed on to the euroSIC participants, breaking swisseuroGate's low-cost pricing structure. The same holds true for the expenses

Back in November 2000 the trade organization Euro Banking Association (EBA) launched its new low value payment system «Step 1». Currently there are about 180 banks participating in the EBA clearing system.

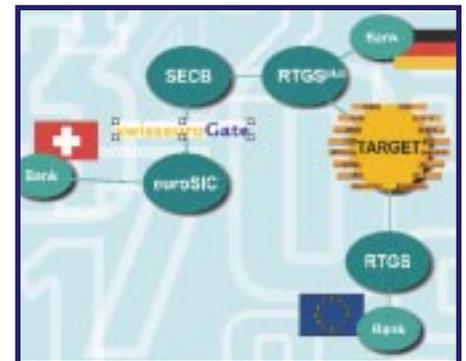
resulting from implementing and maintaining the EBA interface.

swisseuroGate – a True-and-Tried Interface

Today all euroSIC participants can reach any and all financial institutions connected to Step 1 within the EU – via swisseuroGate: Payments from the euroSIC system are routed via SECB and RTGS^{plus} directly to the German Step 1 banks.

All other Step 1 participants throughout the entire EU can be accessed indirectly via TARGET and the connected national RTGS systems (e.g. NewCHAPS in England, BI-REL in Italy or TBF in France).

Going the other direction, payments between the EU and Switzerland can be



swisseuroGate – the fast and least expensive way into the EU.

processed using the same route via swiss-euroGate – just as simply, fast and affordably.

The Bottom Line

A euroSIC access to Step 1 does not offer any benefits to the Swiss banks. Quite the opposite is true: Currently it would be

more expensive for euroSIC participants to route payments for a Step 1 member via EBA clearing than via swisseuroGate. While Step 1 certainly has its place in the market, it still makes sense for SECB and Swiss Interbank Clearing to hold off on obtaining access at this point.

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| Field | Status | Description | Content |
|-------|--------|-----------------------------------|---|
| F20 | M | Transaction Reference Number | k85cmt |
| F23B | M | Bank Operation Code | CRED |
| F32A | M | Value Date, Currency Code, Amount | 010312EUR5000, |
| F50K | M | Ordering Customer | Uhrengrosshandel Buxtehude |
| F57A | O | Account With Institution | BCCOCHFR |
| F59 | M | Beneficiary Customer | /1233-94852 Horlogerie du Joux, Les Brenets |
| F71A | M | Details of Charges | SHA |

Check out our Cross-Border Guide on the Swiss Interbank Clearing website for different payment processing examples, such as how payments are routed correctly to your euroSIC account.

Or determine the fees for individual payments.

You can find a wealth of information on this exclusive feature: Take advantage of our Cross-Border Guide at www.sic.ch

DTA and LSV Updates

Due to the increased use of telebanking services over the past few years, banks are very interested in their customers electronically submitting all payments directly to their financial institutions. More and more banks are now equipped to accept DTA (Data Carrier Exchange) files directly and to subsequently process them within their own payment traffic applications.

During its session in June 2002, the Swiss Interbank Clearing Board of Directors has therefore decided to continue central DTA processing by Swiss Interbank Clearing only until the end of 2005.

The DTA format will continually be maintained and can still be used in future.

A project task force is currently developing a migration and communication concept to be introduced in late summer or early fall.

At that point the customers will be informed by the banks about the new options for submitting orders as well as about new products.

Swiss Interbank Clearing remains the central processing point for LSV (Direct Debit) processing.

Since an increase in transaction volumes is anticipated in LSV over these next years, the current processes will continually be improved and further automated. Additionally, the LSV service will be continually adapted to the new market demands.

These service requirements with the working title «LSVnew» are currently being defined by a taskforce and will be published upon completion.

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From 30-09 To 04-10 Sibos Booth # H263

Swiss Interbank Clearing is participating in Sibos for the third time. After Munich and San Francisco, and after a one-year hiatus, Sibos will be held in Geneva this year.

Together with our booth-partners SIS SEGAINTERSETTLE AG and Telekurs Financial we hope to welcome you in Geneva.

We will be providing information about:

SIC
euroSIC
swisseuroGate
remoteGate

And ...

The ever popular, traditional opening reception will be held Monday evening in conjunction with SWIFT and Swiss Plus.

Don't miss it!



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