

V PAYMENT AND SETTLEMENT SYSTEMS

Interbank payment and settlement system

Development of the payment and settlement systems used in Estonia

On May 19, a **new cross-border payment and settlement system TARGET2-Eesti** started to operate, enabling clients of banks linked to the system settle fast and secure euro payments in the European Union. TARGET2-Eesti is a part of TARGET2, which is a second generation of TARGET.¹

TARGET was composed of the real-time gross settlement (RTGS) systems of national central banks and an interlinking system. TARGET2 is a payment and settlement system that is based on a single shared platform and provides a harmonised set of services. The system is decentralised in legal and operational terms. TARGET2-Eesti offers its clients, that is credit institutions, an effective, fast and

safe infrastructure for settling cross-border euro payments.

For the system participants, transition from TARGET to TARGET2 entails up-to-date tools for liquidity management, including liquidity pooling within a banking group, reservation of liquidity and management of payment flows. Since most of the banks in Estonia have joined TARGET2-Eesti², many local bank customers now have an alternative to settle express payments in euro. Payments via TARGET2 are settled fast, safe and in central bank money. Moreover, TARGET2 allows commercial banks to lower the charges for cross-border express euro payments.

Thus, since May 19 Eesti Pank is managing three interbank settlement systems instead of two: the Settlement System of Ordinary Payments (ESTA) for domestic payments, the Real-Time Gross Settlement System of Ordinary Payments (EP RTGS) for domestic payments, and the Real-Time Gross Settlement System (TARGET2-Eesti) for domestic and cross-border payments.

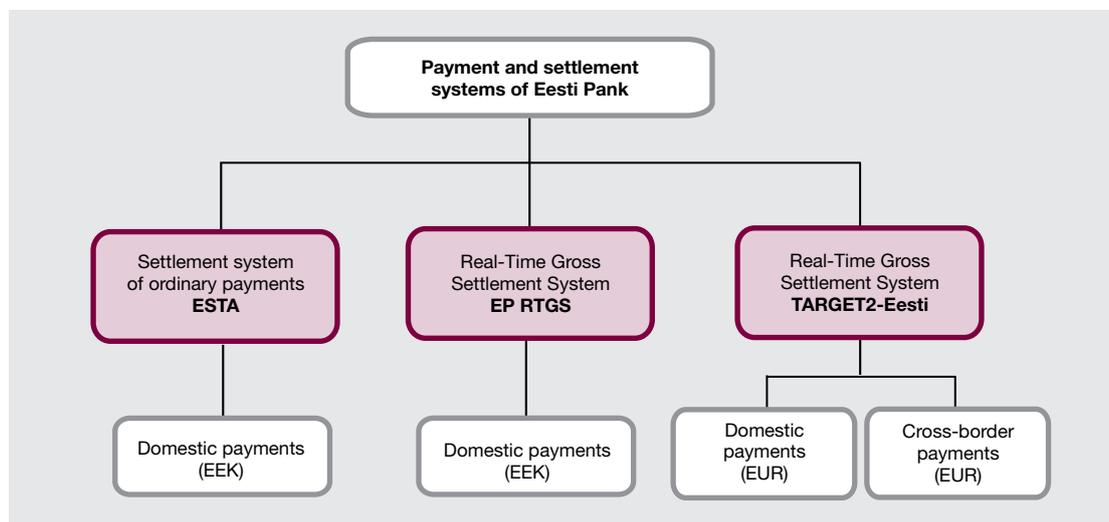


Figure 1. Payment and settlement systems managed by Eesti Pank

¹ Trans-European Automated Real-Time Gross Settlement Express Transfer system. Eesti Pank has been participating in the euro area payment system TARGET since November 20, 2006 when the Real-Time Gross Settlement System of Eesti Pank (EP RTGS) was connected with the Trans-European Real-Time Gross Settlement Express Transfer system (TARGET).

² In addition to Eesti Pank, also Hansapank, SEB Pank, Sampo Pank, Nordea Bank Estonia, Eesti Krediidipank, SBM Pank and Tallinna Äripank have introduced the new system.

ment System (EP RTGS) and TARGET2-Eesti (see Figure 1).

The **cross-border retail payment market** has also gone through some important developments in 2008. For example, under the leadership of the European Payments Council (EPC), Estonian banks have been preparing to join the **Single Euro Payments Area (SEPA)**. The future goal of SEPA is to harmonise and guarantee an easy settlement of both domestic and cross-border euro payments. This would simplify financial matters, strengthen the European internal market and competition as well as enhance efficiency. As of January 28, 2008 several Estonian commercial banks are providing the service of trans-European retail payments in compliance with the SEPA standards.

Operation of the settlement systems managed by Eesti Pank

The number of payments settled through the **EP RTGS system** has not changed over the past year: an average of 174 payments per day were made at the end of the first quarter of 2008, which is as much as at the same time in the previous year

(see Figure 2). However, the structure of express payments has changed. The primary change was a 41% decrease in cross-border TARGET payments. Until March 31, 2007 an average of 55 express euro payments per day were settled mainly via Sampo Pank on a rolling year basis and Estonian clients daily received about 5 payments. A year later bank customers did not initiate any TARGET payments and 25 customer payments were received via TARGET. In response to a decrease in TARGET payments, the number of domestic customer payments processed via the EP RTGS has grown, accounting for 65% of all RTGS payments.

The average turnover of payments settled through the EP RTGS grew by 85% and reached an average of 6.3 billion kroons per day. The turnovers of foreign currency purchase and sale transactions and the collateral transactions of ESTA have grown the most, comprising 45% and 30% of the total turnover, respectively.

The rise in the number of payments settled through the **Settlement System of Ordinary Payments (ESTA)** continued at the same pace (13%), reaching

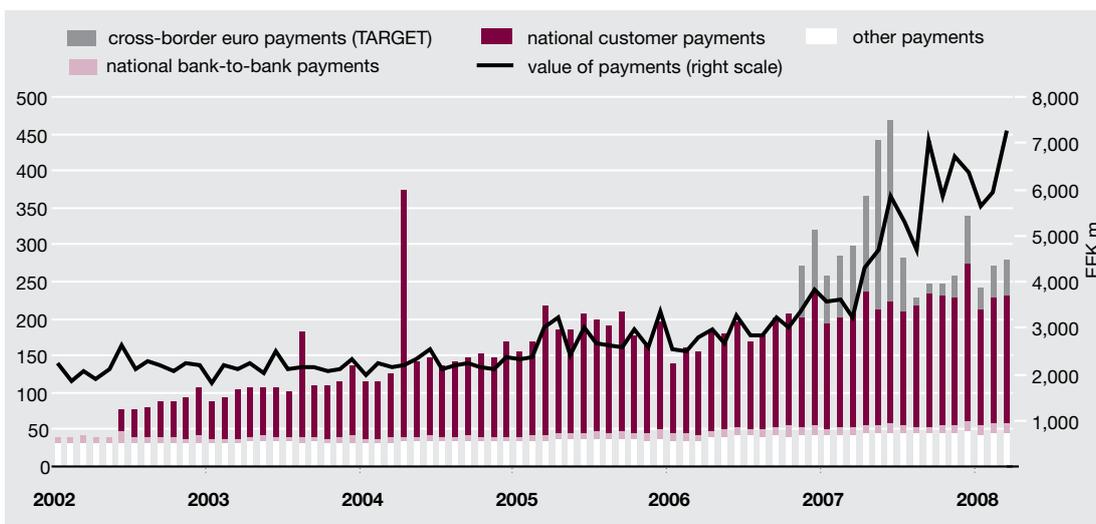


Figure 2. Average number of payments processed per day in the EP RTGS and their average daily value per month

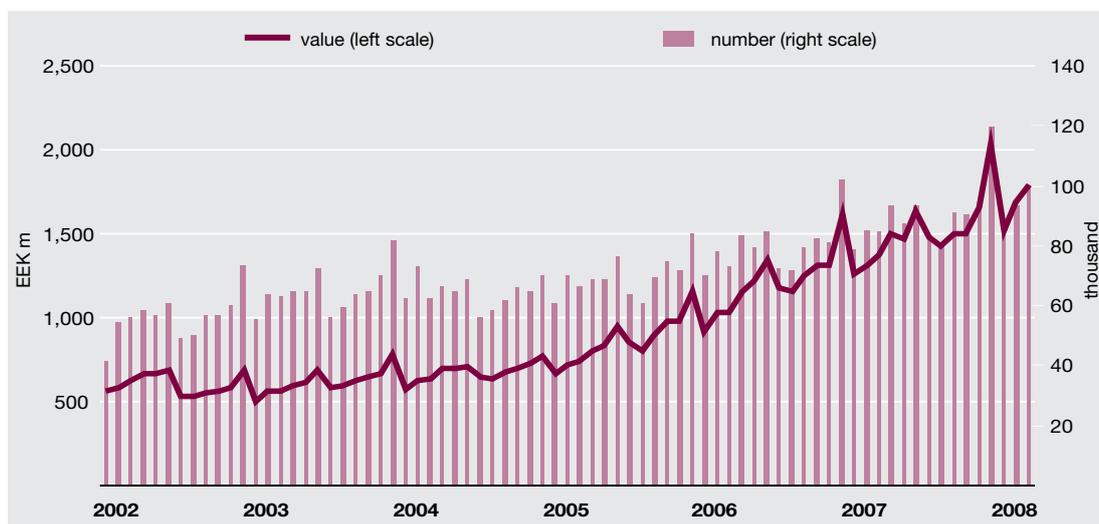


Figure 3. Number of payments processed per day in the ESTA and their average daily value per month

an average of 97,000 payments per day with the year (see Figure 3).

Although the average daily turnover of payments in the ESTA increased by 24%, growth slowed owing to a relatively high comparison basis. The average daily turnover amounted to 1.7 billion kroons. The average value of the payments settled through the ESTA reached 17,500 kroons.

Overseer's assessment of payment and settlement systems

There were no such incidents in the operation of the Estonian payment and settlement systems in the past six months that would have threatened the stability of Estonia's financial sector.

Although the functionality and principles of the **systemically important settlement systems** operating in Estonia – the EP RTGS and the ESTA – have been structured so as to minimise the materialisation of potential risks, some failures nevertheless occurred in the past half-year (see Figure 4). The EP RTGS encountered seven serious failures³, which interrupted the system's operation for 2 hours and 31 minutes. The ESTA survived one serious malfunction, which caused an interruption in operability for 45 minutes. The failures did not affect financial stability.

Oversight of TARGET2-Eesti

In overseeing TARGET2-Eesti, Eesti Pank proceeds from the guide on the implementation of the Eurosystem's TARGET2 oversight function⁴ and Eesti Pank's framework for the

³ According to the risk management procedures, a failure is considered serious if the incident involves several system participants or if it entails the application of business continuity or a decrease in the operability of settlement systems.

⁴ European Central Bank (2006).

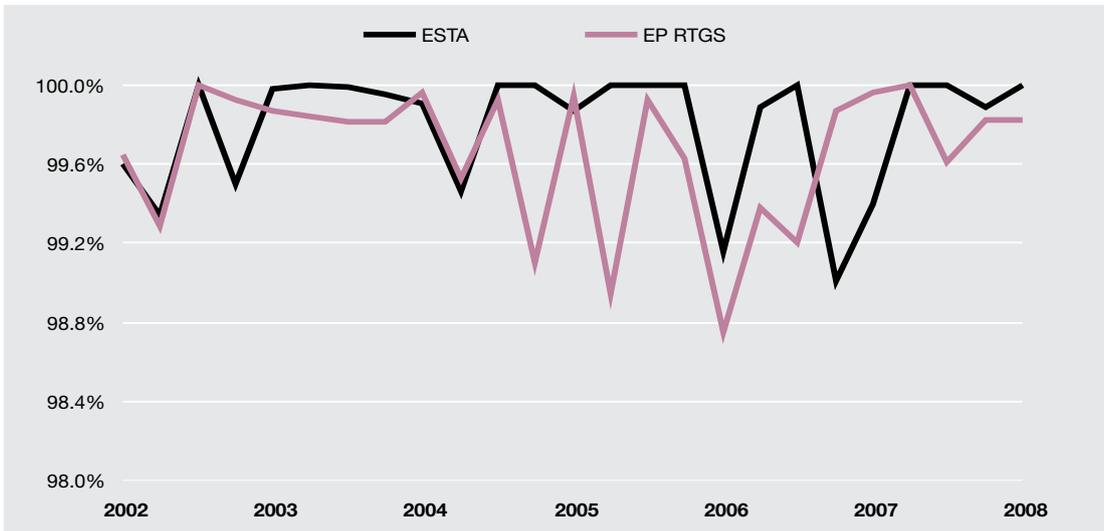


Figure 4. Availability of interbank settlement systems

oversight of payment systems⁵. The assessment of TARGET2 and its subsystems is based on the “Core principles for systemically important payment systems”⁶ by the Bank for International Settlements (BIS) and “Business continuity oversight expectations for systemically important payment systems”⁷ implemented by the Eurosystem.

The responsibility for the oversight of the entire TARGET2 lies with the European System of Central Banks, including the Eurosystem and the central banks outside the Eurosystem that are connected to TARGET2. The leading overseer of the single platform of TARGET2 is the European Central Bank. Owing to the legal and operational decentralisation of the subsystems of TARGET2, the responsibility for overseeing TARGET2-Eesti lies with Eesti Pank.

The oversight of TARGET2 supports its secure and effective operation; the primary purpose of oversight is to minimise systemic risk. To this end,

national central banks assess the compliance of TARGET2 and its subsystems with internationally recognised standards (see above), make recommendations and implement measures to achieve compliance.

According to the overseer of Eesti Pank, the system of TARGET2-Eesti complies with the principles recognised internationally and by the Eurosystem. The probability of the occurrence of systemic risk is reduced by identifying and preventing other potential risks in the settlement system. The legal framework, functional and technical solutions and procedures of TARGET2-Eesti are secure and appropriate. In addition to the legislation of the Republic of Estonia, the legal relationships of TARGET2-Eesti are regulated by the rules of TARGET2-Eesti and the accession contracts concluded between the payment and settlement system participants (between Eesti Pank and the members of the settlement system).

⁵ *Financial Stability Review*, November 2003.

⁶ CPSS, BIS (2001).

⁷ European Central Bank (2006).