

Eesti Pank policy for the operation and oversight of payment systems and for facilitating the payment market

Under the Eesti Pank strategy for 2014–2018, it is part of Eesti Pank's mission to promote a secure and efficiently functioning payment market. The payment market, including the operation of payment systems, is important for the maintenance of economic and financial stability, the implementation of monetary policy and the smooth functioning of currency circulation. The main components of the Estonian payment market are the payment and settlement systems (see [Appendix 1](#)) and payment instruments (see Figure 1).

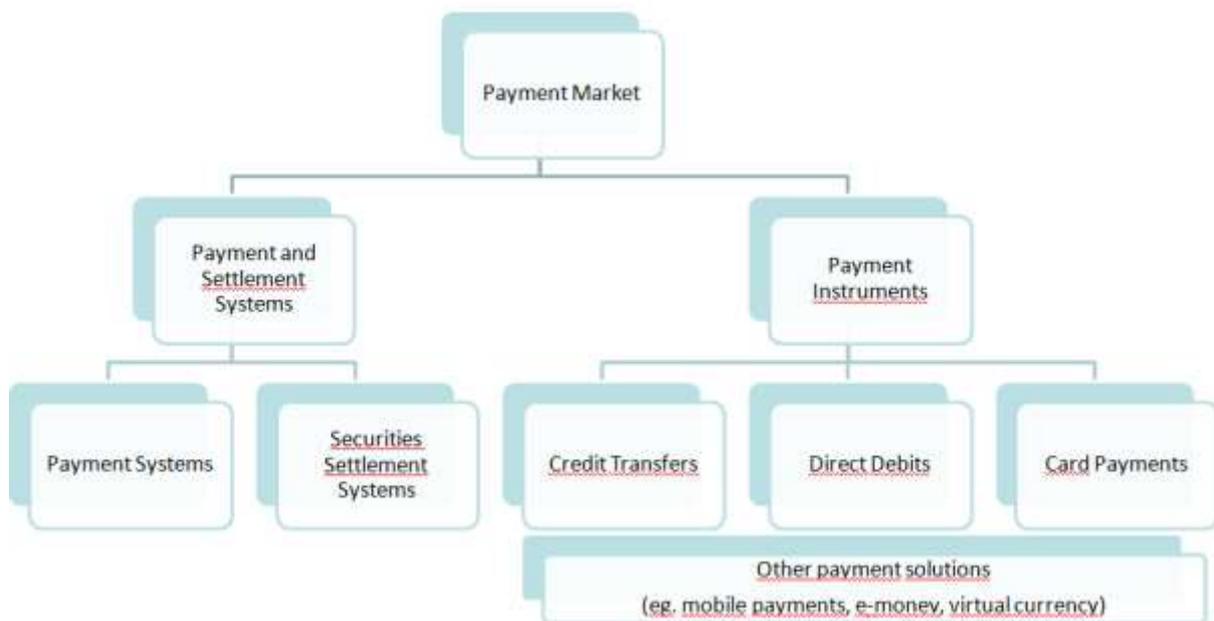


Figure 1. The Estonian payment market

Under § 2 (2)4 of the Eesti Pank Act, Eesti Pank has the following responsibilities for payment systems and the payment market:

- promoting the smooth operation of payment systems
- overseeing payment systems
- facilitating the payment market

To promote the smooth functioning of payment systems, Eesti Pank is the owner, operator and developer of the payment systems it manages.

As overseer of payment systems Eesti Pank assesses and guides the operation and development of payment systems and of related securities settlement systems.

In facilitating the payment market Eesti Pank helps design and implement the market and the policies and legal framework that apply to it.

These responsibilities are undertaken by the Eesti Pank Payment and Settlement Systems Department. In addition to this, **Eesti Pank has the right** under the credit institutions act¹ and the law of obligations act² to **regulate payment systems and the payment market** by setting the rules for the functioning of the payment systems it operates and the requirements for the settlement of payments. In regulating payment systems and the payment market Eesti Pank starts from the needs of providers and users of payment services and European Union legislation on payments. Eesti Pank uses the right to regulate only when it is necessary. If there is no direct need for regulation, Eesti Pank looks firstly to reach agreement between the service providers. Regulation of payment systems and the payment market is done with the support of the Eesti Pank legal services.

This policy document describes how the responsibilities listed above are fulfilled and the principles followed in this. The framework is intended to be followed in conjunction with the applicable legal requirements and does not imply any change to the interpretation of the law. If there is any discrepancy in the terminology used in the framework and the law, the law takes precedence.

¹ Credit Institutions Act § 87 (2), "Payments of credit institutions shall be settled through a payment system pursuant to the procedure established by Eesti Pank"

² Law of Obligations Act § 709 (17), "Eesti Pank may establish more detailed requirements on the maintenance of payment accounts and settlement of payments by credit institutions and other financial institutions"

I. The promotion of the smooth operation of payment systems

Eesti Pank has the right to establish and manage payment systems and to provide additional facilities for settling payments³.

Principles

Eesti Pank promotes the smooth operation of payment systems in accordance with international standards in order to minimise risks (see [Appendix 2](#)) and to ensure that systems are operational and cover their costs.

Eesti Pank needs to ensure the efficient functioning of the real-time settlement of funds, securities and collateral management for the purposes of monetary policy operations.

Tasks

Eesti Pank is the owner and operator of the payment system TARGET2-Eesti and is developing the securities settlement platform TARGET2-Securities. This allows it to offer Estonian banks the operational possibility to participate in the monetary policy operations of the Eurosystem.

1. TARGET2-Eesti is the component system managed by Eesti Pank of the pan-European system TARGET2 and is notified as a designated payment system under the [Settlement Finality Directive \(98/26/EC\)](#). TARGET2-Eesti can handle both domestic and cross-border payments. TARGET2-Eesti is mainly used for payments that are made as part of the monetary policy of the Eurosystem, though the system is also intended for any type of express payment. Payments are made in real time and one by one. Settlement is made in central bank money in accounts opened in Eesti Pank.
2. TARGET2-Securities is a multi-currency platform for securities settlement⁴. TARGET2-Securities is linked to TARGET2 as the cash leg of the securities transaction is settled using central bank money.

Eesti Pank provides the CCBM⁵ for settling collateral in the monetary policy operations of the Eurosystem.

Eesti Pank also provides account management services and payment settlement services for its contractual clients and executes the orders arising from transactions concluded on behalf of Eesti Pank.

³ Eesti Pank Act § 14 on the authority Eesti Pank

“Given the competence of the European Central Bank and of the European System of Central Banks, the Bank of Estonia, in order to perform its duties, is authorised to:

...

2) make and accept deposits;

...

5) process payment instructions and clear payments;

...”

⁴ The platform will be launched in July 2015. The Estonian Central Securities Depository signed a framework agreement with Eesti Pank to join the platform in July 2012, and it will join in February 2017

⁵ Correspondent Central Banking Model

As a user of payment services, Eesti Pank is a member of TARGET2-Eesti and of the pan-European payment system STEP2⁶.

Under the Emergency Act, Eesti Pank works with the banks to arrange the continuity of payment services.

Cooperation

In promoting the smooth operation of payment systems Eesti Pank works with domestic partners both as a payment service provider and as a user. In a cross-border context Eesti Pank participates in the Eurosystem and other international committees and working groups.

Domestic advisory bodies operating under the leadership of Eesti Pank:

1. TARGET2-Eesti National User Group (T2 EENUG)
All the members of TARGET2-Eesti are members of T2 EENUG. T2 EENUG allows Eesti Pank to work as the TARGET2-Eesti owner with system members to develop the system, exchanging information and discussing other topics related to the development of the payment market where relevant.
2. TARGET2-Securities Estonian National User Group (T2S EENUG)
T2S EENUG was set up in 2009 to promote cooperation between providers and users of securities settlement services and to support the development and use of T2S in Estonia. Members of the user group come from Eesti Pank, the Estonian Central Securities Depository, the Ministry of Finance, the Financial Supervision Authority and the commercial banks.

Domestic cooperation bodies at the Estonian Banking Association:

1. The working group on standards
2. The SWIFT users working group

The Eurosystem and other international committees and working groups:

1. Payment and Settlement Systems Committee (PSSC)
 - a. Working Group on TARGET2 (WGT2)
 - i. TARGET2 Settlement Managers Sub-Group (SMSG)
 - ii. TARGET2 Testing Managers Sub-Group (T2 Testing)
 - b. Collateral Contact Group (CCG)
 - c. TARGET2-Securities sub-group (PSSC T2S Subgroup)
2. TARGET2-Securities Advisory Group (T2S AG)
 - a. T2S NUG Experts Network
 - b. Operations Managers Group (OMG)
 - c. Change Review Group (CRG)
 - d. Project Managers Group (PMG)
 - i. User Testing Sub Group (UTSG)
 - ii. T2S Migration Subgroup
3. High-Level Group on Payment Systems
4. The Nordic-Baltic Meeting for Nordic and Baltic central banks to work together on payment and settlement systems

⁶ Eesti Pank will become an indirect member of STEP2 by the 1st quarter of 2015

Regulation

The following decrees of the Governor of Eesti Pank have been passed in order to support the smooth operation of payment systems:

- [Terms and conditions for holding accounts in Eesti Pank](#) – Participation in the work of the payment systems of Eesti Pank requires an account to be held at Eesti Pank;
- [Approval of TARGET2-Eesti rules](#) – Settlement at and with Eesti Pank operates under the Eesti Pank Act and legislation arising from that act⁷.

The legal framework for TARGET2-Securities is still under development

⁷ Law of Obligations Act § 709 (16)

II.Oversight of payment and settlement systems

Eesti Pank promotes the safety and efficiency of payment and settlement systems by identifying and analysing risks to the systems and making recommendations for ways to minimise risks and make the system more efficient (see [Appendix 2](#)).

Principles

Eesti Pank aims to maintain, and if necessary improve, the safety, efficiency and trustworthiness of the systems it oversees.

The priority for Eesti Pank is to oversee the domestically operated systemically important payment and settlement systems, for which Eesti Pank has the sole oversight responsibility. In overseeing the important payment and settlement systems that are not systemically important and in contributing to the oversight of pan-European payment and settlement systems, Eesti Pank uses the principles of relative importance and risks to assess the impact of these systems on financial stability, the implementation of monetary policy and the smooth functioning of currency circulation.

Eesti Pank is given the role of overseer by the Treaty on the Functioning of the European Union⁸, the statute of the European System of Central Banks and of the European Central Bank⁹, the Eesti Pank Act¹⁰, the Payment Institutions and E-money Institutions Act¹¹, the standards recognised internationally and by the Eurosystem including the regulation of the ECB on oversight requirements for systemically important payment systems, and the oversight framework of payment and settlement systems¹². As a member of the Eurosystem, Eesti Pank works from the base of the [Eurosystem oversight policy framework](#) and the guidelines and recommendations it contains.

Oversight of payment and settlement systems is done independently of the operation of the systems. To ensure this independence, the head of the Policy and Oversight Division is directly responsible for oversight of payment and settlement systems to the Executive Board of Eesti Pank, independently of the role and interests of the operator of a payment system.

Tasks

⁸ The Treaty on the Functioning of the European Union, Article 127(2)

⁹ Statute of the European System of Central Banks (ESCB) and of the European Central Bank (ECB), Article 3

¹⁰ Eesti Pank Act § 24 (2), Oversight of payment systems

(1) The purpose of oversight of payment systems is to promote the structural and operational reliability of such systems.

(2) As the overseer of payment systems, Eesti Pank:

1) analyses the structure and operation of payment systems;

2) issues instructions to operators of payment system;

3) in the cases provided for in legislation, establishes specific requirements concerning operators of payment systems and their activities and structure;

4) in the cases provided for in legislation, approves the rules and principles concerning the operation of payment systems.

¹¹ Payment Institutions and E-money Institutions Act § 15 (1)¹⁸

¹² The oversight framework is approved by the Executive Board of Eesti Pank

Eesti Pank oversees the following systemically important and important payment and settlement systems:

- TARGET2-Eesti, the component system of the TARGET2 large value payment system (LVPS)
- the securities settlement system managed by the Estonian Central Depository for Securities (ECSD)
- the card payment system operated by Nets Estonia AS.

Under the Payment Institutions and E-money Institutions Act, Eesti Pank approves the rules and principles behind the functioning of the payment systems operated by payment institutions¹³.

Eesti Pank participates in oversight at the level of the Eurosystem. Oversight in the Eurosystem covers payment systems, securities settlement systems, payment instruments and payment schemes, central counterparties, trade repositories and major third-party service providers. As a member of the Eurosystem, Eesti Pank is involved indirectly in the cooperative oversight of payment and settlement systems by central banks of the Eurosystem¹⁴. Eesti Pank participates directly in oversight of the TARGET2 large-value payments system and the STEP2 pan-European payment system where necessary and possible¹⁵.

Cooperation

In overseeing payment systems Eesti Pank cooperates at both national and international levels.

In overseeing the securities settlement system managed by the ECSD Eesti Pank works with the Financial Supervision Authority under the cooperation agreement signed in 2011.

Oversight of TARGET2-Eesti is done jointly with the European Central Bank, as the primary responsibility for oversight of the whole of TARGET2 lies with the European Central Bank. Eesti Pank focuses on the operation of the TARGET2-Eesti subsystem.

Eesti Pank participates in the following Eurosystem and other international committees and working groups:

1. Payment and Settlement Systems Committee (PSSC)
 - a. Working Group on Oversight (WGO)
2. T2S Cooperative Arrangement of Overseers and Supervisors
3. High-Level Group on SWIFT Issues
4. SecuRe Pay forum on security of retail payments in Europe
5. The Nordic-Baltic Meeting for Nordic and Baltic central banks to work together on payment and settlement systems

Regulation

The Governor of Eesti Pank has not passed any decrees on the oversight of payment systems.

The Executive Board of Eesti Pank has confirmed the oversight framework for payment and settlement systems, which is publicly available on the Eesti Pank website.

¹³ Payment Institutions and E-money Institutions Act § 15 (1) 18

¹⁴ Eesti Pank works in the Working Group on Oversight and the Payment and Settlement Systems Committee, and in the decision-making process of the Eurosystem

¹⁵ Voluntary participation in the oversight process following the principle “no compulsion, no prohibition”

III. Facilitation of the payment market

Eesti Pank contributes to the functioning and the development of the Estonian payment market, facilitating cooperation between providers and users of payment services at national and international level and participating in designing and implementing the policies and legal framework that apply to payment market. The payment market is made up of payment and settlement systems, payment instruments and other payment solutions.

Principles

The payment market must function well and provide efficient and sound payment solutions.

The development of the payment market must be balanced and sustainable and in accordance with international changes.

The legal framework of the payment market must be up to date and widely accepted with positions defined in cooperation with the public sector and market participants.

The payment and settlement systems that operate in the payment market must be interoperable, so the technical standards used for transactions should be open and systems should be able to operate with similar systems and solutions.

The provision of payment services must consider the needs and wishes of payment service users.

Payment services must be transparent and cost-effective and service fees must be set in accordance with the principle of an open market economy with free competition.

Interbank settlement speed is important as a higher speed allows the transactions by economic agents to be confirmed faster, which has a positive overall effect on the whole economy.

Tasks

Eesti Pank monitors and analyses the Estonian, European and global payment markets.

Eesti Pank identifies and analyses hindrances in the payment market in order to find ways of eliminating them to make payments better and more secure.

Eesti Pank helps make the Estonian payment market to operate following the SEPA requirements.

Eesti Pank participates in setting rules and recommendations that affect the payment market.

Eesti Pank is involved in designing the legal framework for the European payment market and in developing the legal framework for the Estonian payment market under the leadership of the Ministry of Finance, and in adapting the Estonian framework to meet the requirements of the European legal framework.

Eesti Pank participates in development and assessments to determine the eligibility of the options for use in Eurosystem credit operations.

Eesti Pank promotes understanding of the payment market among the people of Estonia.

Cooperation

In facilitating the payment market, Eesti Pank works domestically with market participants, mainly payment service providers, and institutions responsible for regulating the market and for supervision, which is the Ministry of Finance and the Financial Supervision Authority. Eesti Pank participates internationally in the Eurosystem and other international committees and working groups.

Domestic advisory bodies operating under the leadership of Eesti Pank:

- The Estonian Payment Forum
The Forum was set up in spring 2012 by a tripartite agreement between Eesti Pank, the Ministry of Finance and the Estonian Banking Association to allow discussion of important issues for the payment market. The members of the forum are Estonian credit institutions; users of payment services; representatives of interest groups affected, including some from the public sector; and infrastructure companies. The Financial Supervision Authority is also invited to attend meetings of the Forum.

Other domestic cooperation:

- The Payment Committee of the Estonian Banking Association
- The round table for account holders at the ESCD
- The Estonian working group of Giovannini Barrier 3

The Eurosystem and other international committees and working groups

1. Payment and Settlement Systems Committee (PSSC)
 - a. Payment System Policy Working Group (PSPWG)
 - b. Securities Experts Working Group (SEWG)
2. SEPA High-Level Meeting (SEPA HLM)
3. European Retail Payments Board (ERBP)
4. The meeting of domestic SEPA coordination groups at the European Commission (SEPA EU Forum)
5. SecuRe Pay forum on security of retail payments in Europe
6. Contact Group for Euro Securities Infrastructures (COGESI) for the European System of Central Banks and market participants
7. The Nordic-Baltic Meeting for Nordic and Baltic central banks to work together on payment and settlement systems

Regulation

Because of the need to set up payment accounts and regulate settlements, the Governor of Eesti Pank issued a decree on the conditions for acceptance of payment orders ([Governor's decree No 4 11.05.2010](#)), which sets the requirements for the acceptable content of payment orders originated by credit or financial institutions.

Appendix 1. The objectives of payment and settlement systems and the need for them

There are several different types of payment and settlement system in Estonia, but they all serve the same purpose of enabling system participants to settle claims and obligations between themselves directly, or to send the claims for settlement.

A payment system is a system for transferring money (funds) that allows parties to carry out their financial obligations to each other. The term 'payment system' is sometimes used in a wider sense to cover both funds transfer systems and payment instruments. **Payment instruments** are the set of procedures that enable the transfer of funds and the ways that a payment can be initiated. The main payment instruments are credit transfers, direct debits and card payments.

A securities settlement system allows parties to carry out their obligations involving financial instruments to each other. The financial obligations executed in a securities settlement system derive from securities transactions. Execution of the securities transactions may involve a monetary settlement for Delivery-versus-payment (DvP), or not if the transaction is Free-of-payment (FOP).

Payment and settlement systems are necessary for many reasons.

1. Payment systems allow the safe and timely settlement of monetary obligations between participants in the system. For private persons, a payment system is important for receiving wages, benefits or other income, and for paying bills. Businesses use them for buying and selling goods. The state needs payment systems for collecting taxes and paying benefits.
2. The interbank payments system provides bank customers greater freedom in choosing a commercial bank as their main bank as they need not worry about which commercial bank holds the beneficiary's account when initiating payments. This means they can pay more attention to factors such as the availability of suitable services, commission fees or the quality of services.
3. The card payments system allows retailers who are customers of one bank to accept card payments from customers whose cards have been issued by another commercial bank.
4. Securities settlement systems form the basis for the effective functioning of financial markets. The claims and obligations arising from securities transactions and the monetary claims and obligations deriving from the purchase and sale of securities are settled through the related settlement system.

The following multilateral payment and settlement systems operate in Estonia:

Payment Systems

- the interbank payment system TARGET2-Eesti managed by Eesti Pank
- the card payment system, operated by Nets Estonia AS¹⁶
- payment systems for use between payment institutions¹⁷

Settlement systems for financial instruments

- the securities settlement system operated by AS Eesti Väärtpaberikeskus (the Estonian Central Securities Depository, ECSD)

Estonian interbank retail payments are settled using the pan-European payment system STEP2 operated by EBA Clearing.

¹⁶ On 24.03.2014 the payment manager Nets was taken over by Advent International, ATP and Bain Capital. The full impact of this takeover on Nets Estonia AS is not yet known.

¹⁷ The TLVD&EasyPay payment system managed by AS Talveaed has now started operating and Eesti Pank has been informed about plans to set up payment systems by some other payment institutions

Appendix 2. Risks to Payment and Settlement Systems

The Estonian financial system is underpinned by payment and settlement systems. Therefore it is essential to ensure the smooth functioning of payment and settlement systems so as to maintain a stable and smooth financial system in the country. This means, above all, managing and minimising various risks. The identification, measuring, monitoring and management of risks help to prevent the transfer of risks to domestic and international financial markets through payment and settlement systems, as this can lead to major financial crises.

Payment and settlement systems may encounter the following risks.

- Liquidity risk or the risk that a participant in the system has insufficient funds to meet obligations within the system, although it may have them at some time in the future. This arises when a system participant experiences a temporary shortage of settlement assets.
- Credit risk or the risk that a participant in the system cannot meet its obligations within the system in full either when due or at any time in the future.
- Legal risk or the risk that a weak legal framework or unexpected interpretation of the law causes unforeseen financial losses to the system operator or system participants. The realisation of the legal risk could in turn lead to the realisation of credit or liquidity risks.
- Operational risk or the risk that the smooth functioning of the system is disrupted by the failure of an information system or a lack of internal procedures, human error, management error or external activity such as malicious activity or the failure of a purchased service, and that this causes unforeseen financial obligations to the payment system operator or to system participants. The realisation of an operational risk could in turn lead to the realisation of credit or liquidity risks.
- General business risk, or the risk that system revenues fall or system expenses rise to such an extent that an unexpected and large loss cannot be covered from current capital and the continuation of the service is brought into question.
- Custody risk or the risk that a loss arises from the assets held by a custodian for an indirect system participant. This may be the result of insolvency, negligence, fraud, poor administration or inadequate recordkeeping by the custodian, if the custodian transacts with the securities of the indirect participant without informing the indirect participant of this for example, or if it does not account separately for its own securities and those of the indirect participant.
- Investment risk, or the risk that the investment of the assets of a system operator or participant, such as their collateral, causes a loss to the system operator or participant.
- Principal risk or the risk that one party to a transaction is unable to fulfil its obligations and the other party loses the entire value of the transaction. This could happen if the seller of a financial asset irrevocably assigns the asset but does not receive the payment, or the buyer of the financial asset makes an irrevocable transfer of funds but does not receive the asset in return.
- Systemic risk or the risk that temporary or constant liquidity problems of one participant of the system could lead to similar problems for some other participant of the system in a domino effect. Systemic risk is the potential chain reaction triggered by liquidity or credit risk that can lead to an economic and financial crisis in the entire country or group of countries. Systemic risk can arise when other risks emerge. Although the likelihood of a systemic risk is small, it can lead to a major financial crisis.