

The oversight framework of payment and settlement systems

This framework describes how the responsibilities for oversight of payment and settlement systems are fulfilled and the principles observed 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.

The aim of oversight

The aim of oversight of payment and settlement systems is to promote the safety and efficiency of payment and settlement systems by identifying and analysing risks to the systems and making recommendations to minimise risks and make the system more efficient.

Oversight of the payment and settlement systems is the responsibility of the central bank. The secure and efficient operation of payment and settlement systems is important for the central bank to be able to maintain financial stability, implement monetary policy and ensure the smooth functioning of currency circulation.

The principles of oversight

The priority for Eesti Pank is to oversee of the domestically operated systemically important payment and settlement systems, for which Eesti Pank has the sole oversight responsibility. Eesti Pank also oversees important payment and settlement systems and participates in the cooperative oversight work of the Eurosystem.

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.

It is important that the role of overseer remain independent from the role of operator of payment and settlement systems to avoid any possible conflict of interest. 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 payment system.

Eesti Pank is given the role of overseer by the Treaty on the functioning of the European Union¹, the statute of the European System of Central Banks and of the European Central Bank², the Eesti Pank Act³,

¹ *The Treaty establishing the European Community, Article 127(2)*

² *Statute of the European System Central Banks (ESCB) and of the European Central Bank (ECB), Article 3*

³ *Eesti Pank Act § 24². Oversight of payment systems*

the Payment Institutions and E-money Institutions Act⁴, the standards recognised internationally and by the Eurosystem, and this framework.

Payment and settlement systems that affect the Estonian payment market.

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 AS⁵
- payment systems for use between payment institutions⁶

Settlement systems for financial instruments

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

Due to the development of the single European market the Estonian payment market is increasingly influenced by pan-European payment and settlement systems. Estonian interbank retail payments are settled using the pan-European payment system STEP2 operated by EBA Clearing.

Tasks of Eesti Pank as overseer

In order to promote the safety and efficiency of payment and settlement systems, Eesti Pank has the following tasks as overseer:

- monitoring the payment market and analysing the functioning of systems;
- assessing the impact of the system on financial stability, the implementation of monetary policy and the smooth functioning of currency circulation, and differentiating between systemically important and important payment and settlement systems;
- identifying the payment and settlement systems for which Eesti Pank has oversight responsibility;
- setting requirements for domestic payment and settlement systems within the oversight;
- assessing how the systems meet those requirements and identifying risks arising in those systems;
- giving recommendations to operators of payment and settlement systems on how to improve efficiency and security of the systems, and observing how the advice and recommendations are followed;
- in the cases provided in legislation, approving the rules and principles concerning the operation of payment systems;⁷
- participating in the facilitation of the payment market and in the design and implementation of the policy and legal framework in accordance with the oversight principles, independently of Eesti Pank's role as operator, and with regard to the needs of the market.

⁴ *Payment Institutions and E-money Institutions Act § 15 (1)18*

⁵ *On 24.03.2014 the payment manager Nets was taken over by Advent International, ATP and Bain Capital*

⁶ *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*

⁷ *Payment Institutions and E-money Institutions Act § 15 (1)18*

The oversight process

Oversight of payment and settlement systems is an ongoing process which sets the principles or policy to be followed (see Appendix 1). The central bank uses these principles in its monitoring and analysis of the payment and settlement systems that are being set up, developed and overseen, and it assesses how the systems meet the oversight requirements and gives the recommendations to the system operators on making the systems more efficient and more secure where necessary.

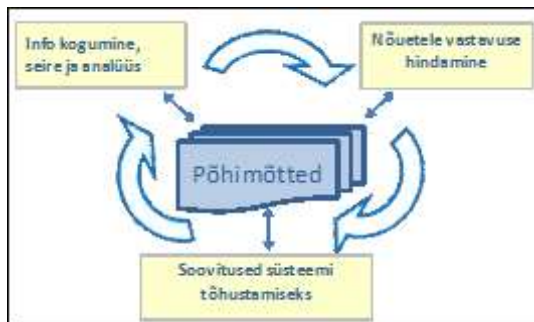


Figure. The process of oversight of payment and settlement systems

Monitoring and analysis of payment and settlement systems

To be able to fulfil its role the overseer must have sufficient information on the performance and functioning of the payment and settlement systems on the market, and on the interdependencies between the systems. The key sources of information for this are system rules, the principles of ensuring business continuity, regular or ad hoc reports from system operators, self-assessments of system operators, meetings with the system operator, evaluations of legal experts and auditors, and information provided by other central banks or supervisory authorities.

Regular monitoring of payment and settlement systems through observation of system functioning, analysis, and investigation of incidents and their causes is used by Eesti Pank for general assessment of the functioning of payment and settlement systems. The general oversight assessment is published in the Financial Stability Review twice a year.

Assessment of payment and settlement systems

The central bank conducts a comprehensive assessment of those payment and settlement systems that are subject to oversight under this framework. Eesti Pank assesses how systems meet the requirements at least once every two years. This may involve a full assessment of the system or a review of a current assessment. In the meantime, assessments are made of changes planned in the system. Full assessment of payment and settlement systems is also carried out when the oversight requirements change.

Eesti Pank uses the international CPSS-IOSCO⁸ principles⁹ for financial market infrastructure adopted for oversight by the Eurosystem in assessing payment and settlement systems. Eesti Pank can also set requirements and criteria for domestic oversight to meet the needs of the Estonian market, on top of the international standards and principles.

Assessment of payment and settlement systems aims to ensure that the rules and procedures of the system allow to control and minimise the risks within the system, and that the measures taken to mitigate risks are strong enough to cope with any sort of problem. In overseeing the payment and settlement systems, the central bank looks at:

- the technical solution used in the system and its operational reliability;
- the legal framework of the system, covering the law, regulations and system rules;
- management procedures;
- risk awareness and risk management, covering the identification, measurement and monitoring of legal-, credit-, liquidity- and operational risks, general business risks, custody- investment and other risks, and the reduction of excessive risks;
- business continuity;
- the efficiency of the payment and settlement system, as the system must meet all the needs of its users and be cost-effective while maintaining operational reliability and meeting its targets for its level of service;
- terms for system access and participation requirements;
- disclosure of system rules.

Eesti Pank also assess the payment systems operated by payment institutions before they come in to operation and gives a technical, economic and legal assessment of the functioning of the payment system and the proposed rules for the operation of the system¹⁰ (Appendix 3).

Inducing changes through recommendations on raising the efficiency of systems

The result of the assessment of payment and settlement systems can either be positive if the system meets the requirements, or negative or partially negative if the system does not meet the requirements or only partially meets them. If the overseer identifies compliance deficiencies and the system is assessed as a) broadly observed, b) partially observed, or c) not observed, the overseer makes the recommendations to the system operator on improving the security or efficiency of the system and observes whether the recommendations are followed. The overseer mainly uses moral persuasion in giving its recommendations. The main findings and recommendations of the overseer's assessment report are published on the Eesti Pank website.

⁸ *CPSS-IOSCO Principles for Financial Market Infrastructures, CPSS (Committee on Payment and Settlement Systems); IOSCO (Technical Committee of the International Organisation of Securities Commissions),*

⁹ *The starting point for implementation of the requirements of the payment system overseer is the ECB regulation giving requirements for overseers of systemically important payment systems and the oversight framework for retail payments.*

¹⁰ *Payment Institutions and E-money Institutions Act § 15 (18)*

The main criteria for payment and settlement systems

Criteria for payment systems

A payment system is a formal arrangement between three or more participants with common rules and standardized arrangements for the execution of transfer orders between the participants.. Payment systems are classified in terms of their financial impact, market share, cross-border activity and interdependencies with other financial market infrastructures as either a SIPS (Systemically Important Payment System)¹¹ or a non-SIPS¹².

A payment system is classified as systemically important (SIPS), if:

- a) the system settles in euros or its operator is established in the euro area and it is eligible to be notified as a system pursuant to Directive 98/26/EC; and
- b) at least two of the following occur over a calendar year:
 - i) the total daily average value of euro-denominated payments exceeds ten billion euros;
 - ii) its market share is at least one of the following:
 - 15% of total volume of euro-denominated payments;
 - 5% of total volume of euro-denominated cross-border payments;
 - 75% of the total volume of euro-denominated payments at the level of a Member State whose currency is the euro;
 - iii) its cross-border activity involves at least five countries through participants other than the SIPS operator or cross-border link with other payment systems, and generates a minimum of 33% of the total volume of euro-denominated payments processed by that SIPS;
 - iv) it is used for the settlement of other financial market infrastructures.

Systemically important payments systems can be large value payment systems (LVPS¹³) or retail payment systems (RPS¹⁴). An LVPS is a funds transfer system that typically handles large value or time-critical payments, even if there is no lower limit for the size of the payment. An RPS is a funds transfer system that typically handles a large volume of relatively low value payments in such forms as credit transfers, direct debits or cheques.

Mostly, all LVPSs are systemically important and if they are not, then all of the requirements for SIPS still apply to them. RPSs may be SIPS or non-SIPS.

RPSs which are non-SIPS but play an important role in the security of the financial system and in maintaining public confidence in the euro are important payment systems. Important payment systems are classified by their market share as

- Prominently important retail payment systems (PIRPS¹⁵), if the market share of the system is more than 25% of the euro-denominated payments of the member state;

¹¹ SIPS - Systemically Important Payment System

¹² The criteria for payment systems are given in the requirements for oversight of payment systems in the applicable ECB regulations.

¹³ LVPS – Large Value Payment System

¹⁴ RPS – Retail Payment System

¹⁵ PIRPS – Prominently Important Retail Payment System

- Other retail payment systems (ORPS¹⁶), if the market share of the system is less than 25% of the euro-denominated payments of the member state;

The importance of securities settlement systems

All securities settlement systems are systemically important because of their critical role in the markets they serve¹⁷, their interdependencies and their impact on the stability of the financial system.

Payment and settlement systems overseen by Eesti Pank

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

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

TARGET2-Eesti, the component system of the TARGET2 LVPS

TARGET2-Eesti is a component system of TARGET2, the Trans-European Automated Real-time Gross Settlement Express Transfer System, and is managed by Eesti Pank. TARGET2 settles payments in euros, in real time and one by one on a continuous basis. This system is for the settlement of express payments.

TARGET2 is a SIPS because of its financial impact and its interdependencies with other financial market infrastructures. TARGET2 and its component systems are subject to exceptions from the oversight requirements for SIPSs that apply to systems owned and operated by Eurosystem central bank.

The overseer of TARGET2 is the European Central Bank. Central banks of the Eurosystem can contribute to the oversight of TARGET2 on a voluntary basis. Eesti Pank has responsibility for oversight of the TARGET2-Eesti component system. In the oversight of TARGET2-Eesti, Eesti Pank applies both this oversight framework and the Eurosystem guidelines for oversight of TARGET2.

In its oversight of TARGET2-Eesti, Eesti Pank focuses on monitoring and analysis. The component system is not subject to separate assessment and separate recommendations are not made for it. Such things are a part of the Eurosystem-level oversight and Eesti Pank is involved with them in accordance with the principles of participation in Eurosystem oversight.

The securities settlement system managed by the Estonian Central Depository for Securities (ECSD)

The securities settlement system managed by the ECSD allows individuals to settle transactions with financial instruments, or securities. Fulfilment of the securities transactions may involve a settlement of cash leg of transactions with Delivery-versus-payment (DvP) method, or not if the transaction is Free-of-

¹⁶ ORPS – Other Retail Payment System

¹⁷ Under the CPSS-IOSCO principles central securities depositories, central counterparties and trade repositories are systemically important infrastructures alongside securities settlement systems because of their critical role in the markets they serve.

payment (FOP). Securities settlement systems are systemically important because of their critical role and the oversight requirements for securities settlement systems apply to it (see Appendix 2).

Eesti Pank has responsibility for oversight of the securities settlement system. In the oversight of the securities settlement system, Eesti Pank is cooperating with the Financial Supervision Authority pursuant to the cooperation [agreement](#) signed in 2011. The securities settlement system managed by the ECSD is subject to oversight by Eesti Pank under the oversight process described above of monitoring, analysis, assessment and recommendations.

The card payment system operated by Nets Estonia AS

The card payment system operated by Nets Estonia AS processes card payments. Interbank obligations arising from the processing of card payments are settled by interbank payment systems. The card payment system operated by Nets Estonia AS is one part of various schemes for card payments¹⁸.

The card payment system is an important payment system because of its high market share and the impact to the smooth functioning of currency circulation. The requirements for prominently important payment systems apply to card payment system (see Appendix 2).

Card payment system managed by Nets Estonia AS is subject to oversight by Eesti Pank under the oversight process described above of monitoring, analysis, assessment and recommendations.

Eesti Pank also has oversight duties for other domestically operated payment systems and as a member of the Eurosystem, Eesti Pank is involved in the cooperative oversight of payment and settlement systems.

Payment systems operated between payment institutions

Several payment systems of payment institutions have started operating or are currently starting up. Payment systems of payment institutions are defined by the Payment Institutions and E-money Institutions Act¹⁹ as systems for transferring funds that operate under agreed and standard rules and that are used for processing and settling payment transactions.

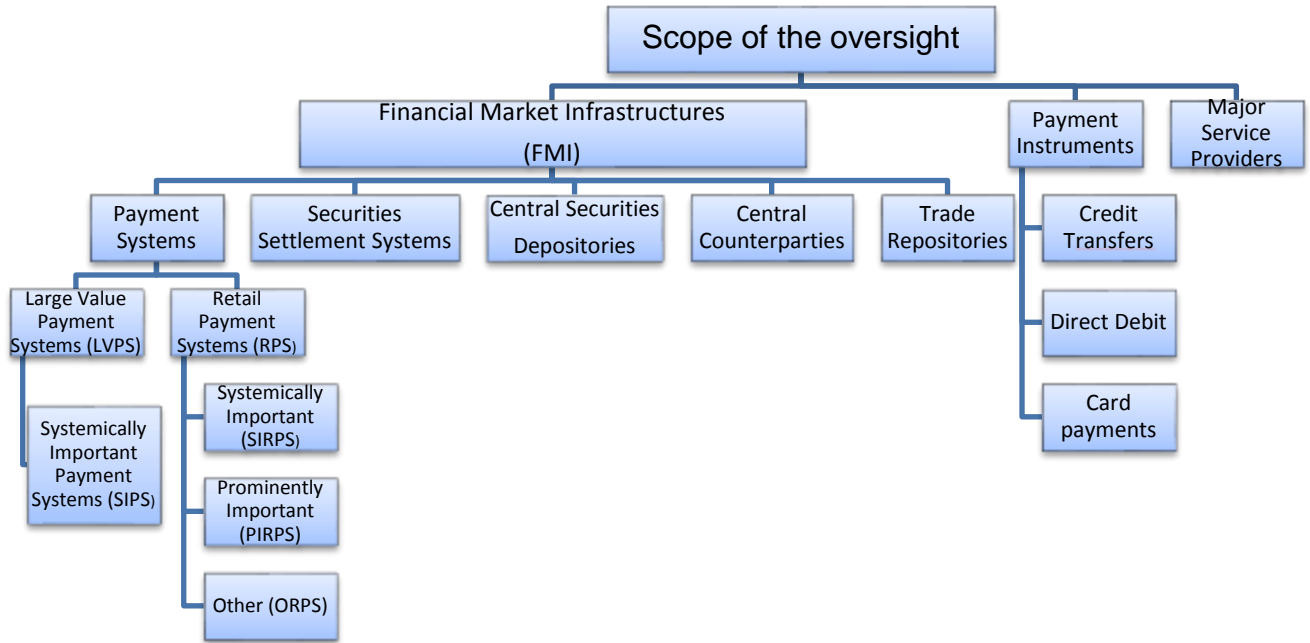
Payment systems operated by payment institutions do not affect the stability of the Estonian financial system or implementation of monetary policy, and are not important for the smooth functioning of currency circulation. Under the Payment Institutions and E-money Institutions Act, Eesti Pank has responsibility for approving the rules and principles behind the functioning of these payment systems (see Appendix 3).

Participation in oversight at the Eurosystem level

Oversight of the financial market infrastructures in the Eurosystem level covers payment systems, securities settlement systems, securities depositories, central counterparties (CCP) and trade repositories (TR). Central banks also contribute to oversight of important payment instruments and major third-party service providers (see Figure below).

¹⁸ *VISA, MasterCard*

¹⁹ *Payment Institutions and E-money Institutions Act § 3 (4)*



Eesti Pank participates indirectly in oversight at the Eurosystem level through the Working Group on Oversight, WGO²⁰, the Payment and Settlement System Committee, PSSC²¹ and the decision-making bodies of the Eurosystem.

Eesti Pank can participate directly in Eurosystem oversight on a voluntary basis, working actively in the oversight process depending on the importance of a specific infrastructure and from a risk-based principle.

The retail payment system STEP2 operated by EBA Clearing, being a financial market infrastructure that is subject to oversight at the Eurosystem level, is important for settlement of obligations between Estonian market participants and has an effect on financial stability and on the smooth circulation of currency.²² STEP2 is a systemically important payment and settlement system, which is subject to the oversight requirements for systemically important payment systems. The overseer of STEP2 is the European Central Bank. Central banks of the Eurosystem can contribute to the oversight of STEP2 on a voluntary basis. Eesti Pank participates indirectly in oversight of the pan-European payment system STEP2, and directly where necessary and possible.

²⁰ Working Group on Oversight, WGO

²¹ Payment and Settlement System Committee, PSSC

²² Estonian interbank payments settled in STEP2 account for a significant proportion of Estonian credit transfers

Appendix 1. The principles of oversight and oversight agreements

1. Principles for payment systems

- 1.1. [Principles for financial market infrastructures, 2012 \(CPSS-IOSCO\)](#)
- 1.2. [Disclosure framework and assessment methodology for the principles for FMIs, 2012 \(CPSS-IOSCO\)](#)
- 1.3. [Eurosystem oversight policy framework, 2011 \(ECB\)](#)
- 1.4. [Regulation of the European Central Bank on oversight requirements for systemically important payment systems, 2014](#)
- 1.5. [Guide on the implementation of the Eurosystem's TARGET2 oversight function, 2008, \(ECB\)](#)
- 1.6. [The Eurosystem policy principles on the location and operation of infrastructures settling euro-denominated payment transactions; specification of "legally and operationally located in the euro area", 2008 \(ECB\)](#)
- 1.7. [The Eurosystem policy principles on the location and operation of infrastructures settling euro-denominated payment transactions, 2007 \(ECB\)](#)
- 1.8. [Oversight Framework for retail payment systems, 2014 \(ECB\)](#)
- 1.9. [Policy statement on euro payment and settlement systems located outside the euro area, 1998 \(ECB\)](#)

2. Principles for securities settlement systems

- 2.1. [Principles for financial market infrastructures, 2012 \(CPSS-IOSCO\)](#)
- 2.2. [Assessment methodology for the principles for FMIs and the responsibilities of authorities, 2012 \(CPSS-IOSCO\)](#)
- 2.3. [Recommendations for securities clearing and settlement systems in the European Union, 2009 \(ESCB, CESR\)](#)

3. Principles for methods of payment

- 3.1. [Oversight framework for direct debit schemes, 2010 \(ECB\)](#)
- 3.2. [Oversight framework for credit transfer schemes, 2010 \(ECB\)](#)
- 3.3. [Oversight framework for card payment schemes – Standards, 2008 \(ECB\)](#)
- 3.4. [Electronic Money systems security objectives, 2003 \(ECB\)](#)

4. Agreements

- 4.1. [Agreement between the European Union central banks and banking supervisors](#)
 - 4.1.1. [Agreement from 2001 updated in 2004](#)
- 4.2. [Agreement on the distribution of confidential information gained from oversight of card payment schemes](#)

Appendix 2. Requirements for oversight of financial market infrastructure and payment instruments

The application of international CPSS-IOSCO principles to financial market infrastructure

PRINCIPLES	Payment Systems			Securities settlement system	Depositories	Central counterparty	Trade repositories
	SI(R)PS ²³	PIRPS ²⁴	ORPS ²⁵				
1. Legal basis	X	X	X	X	X	X	X
2. Governance	X	X	X	X	X	X	X
3. Framework for the comprehensive management of risks	X	X	X	X	X	X	X
4. Credit risk	X			X		X	
5. Collateral	X			X		X	
6. Margin						X	
7. Liquidity risk	X			X		X	
8. Settlement finality	X	X	X	X		X	
9. Money settlement	X	X		X		X	
10. Physical deliveries				X	X	X	
11. Central securities depositories					X		
12. Exchange-of-value settlement systems				X		X	
13. Participant-default rules and procedures	X	X	X	X	X	X	
14. Segregation and portability						X	
15. General business risk	X			X	X	X	X
16. Custody and investment risk	X			X	X	X	
17. Operational risk	X	X	X	X	X	X	X
18. Access and participation requirements	X	X	X	X	X	X	X
19. Tiered participation arrangements	X			X	X	X	X
20. FMI links				X	X	X	X
21. Efficiency and effectiveness	X	X	X	X	X	X	X
22. Communication procedures and standards	X	X		X	X	X	X
23. Disclosure of rules, key procedures, and market data	X	X	X	X	X	X	X
24. Disclosure of market data by trade repositories							X
Number of principles applied to the system	17	11	9	20	15	22	12

²³ Systemically Important (Retail) Payment System

²⁴ Prominently Important Retail Payment System

²⁵ Other Retail Payment System

Payment instruments and payment schemes – requirements for credit transfers, direct debits and card payment schemes

1. The legal basis must be reasonable, clear and transparent, and must apply under all relevant jurisdictions.
2. The comprehensive information on the payment scheme, including appropriate information on financial risks, must be available to the actors of the scheme.
3. The owner of the scheme should ensure an adequate degree of security, operational reliability and business continuity.
4. The governance arrangements of the payment scheme must be effective, accountable and transparent.
5. The owner of the scheme must manage and contain financial risks in relation to the clearing and settlement process.

Appendix 3. Assessment of the rules and principles for payment systems operated by payment institutions

1. Under the Payment Institutions and E-money Institutions Act § 15 (1) 18, Eesti Pank assesses the technical, financial and legal principles of the functioning of the payment systems provided by payment institutions and the proposed rules for the operation of the system.
2. Application for assessment of the principles and rules of the payment system by Eesti Pank must be submitted in writing with the following documents attached:
 - 2.1. documents describing the legal status and activities of the applicant (statutes, licence to provide payment services);
 - 2.2. description of the organisational structure of the applicant, covering where necessary the use of agents or branches or the procedures for transferring services, and its participation in domestic and international payment systems;
 - 2.3. a description of the payment services provided or proposed;
 - 2.4. a description of the payment service being set up, with the general and technical conditions of the functioning of the system and the legal principles;
 - 2.5. other additional information and documents required by Eesti Pank.
3. Whether the system being set up by the payment institution is a payment system is decided with reference to the Payment Institutions and E-money Institutions Act § 3 (4), which describes payment systems as systems for transferring funds that operate under agreed and standard rules and that are used for processing and settling payment transactions.

4. If Eesti Pank does not consider the system being set up by the payment institution to be a payment system, a written response to this effect is sent to the applicant.
5. Eesti Pank gives its assessment of the operating principles of the payment system and the rules on its functioning within six months of receiving all the materials needed for the assessment.
6. If it is not possible to tell for certain from the documents and information submitted whether or not the payment system being set up by the payment institution meets the requirements or if it is necessary to check other details concerning the applicant, Eesti Pank may request further information and documents.
7. Eesti Pank sets the oversight requirements for the payment system using the criteria of importance of payment and settlement systems as its base.