

## V PAYMENT SYSTEMS

### SETTLEMENT SYSTEM OF INTERBANK PAYMENTS

Eesti Pank has been participating in the euro area payment system TARGET since 20 November 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)<sup>1</sup>. While to date, the central bank provided interbank settlements only in Estonia, it now also offers a cross-border payment channel for the financial sector via the TARGET.

Joining the TARGET was executed through the Banca d'Italia. Besides Eesti Pank, four EP RTGS members joined the TARGET: OMX Tallinn, the Estonian branch of AS Parex Banka, AS Sampo Pank and the Estonian branch of Svenska Handelsbanken AB.

Along with joining the TARGET also the working day of the Settlement System of Ordinary Payments (ESTA) was extended by one hour. Thus, as of autumn 2006 retail payments intermediated by Eesti Pank are settled from 8 AM to 6 PM. Adding the tenth file exchange period has unified the daily pattern of settlements, decreasing the number of payments settled during the first file exchange period.

The number of payments settled through the EP RTGS has increased by 52% within the year (see Figure 1). The growth was brought about by new cross-border TARGET payments initiated in euros. Estonian bank customers originate an average of 67 express euro transfers and receive about 5 payments settled via the TARGET per day.

Until the end of the first quarter of 2007, an average of 274 payments per day were settled via the

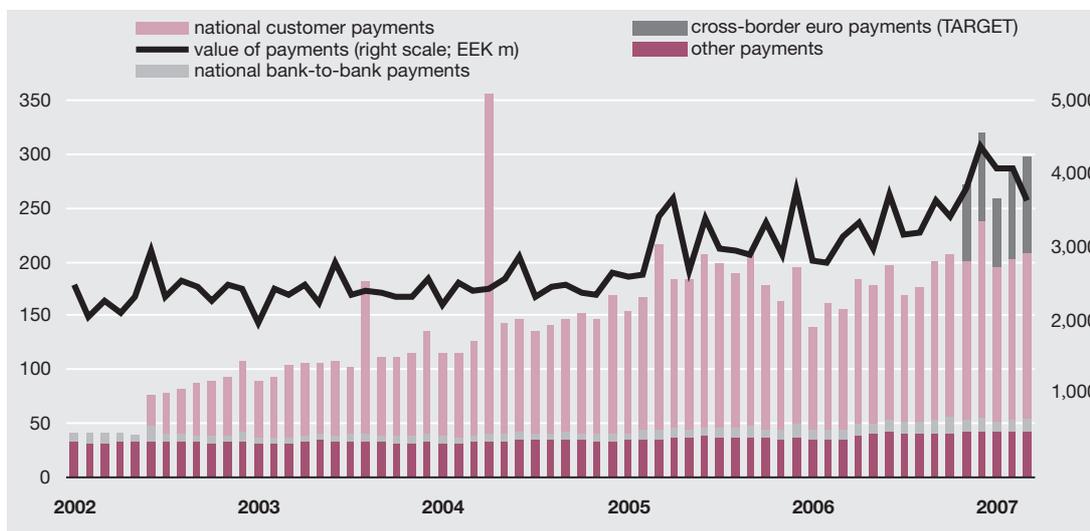


Figure 1. Number of payments processed per day in the EP RTGS and their average daily value per month

<sup>1</sup> Eesti Pank and credit institutions operating in Estonia plan to connect to the TARGET2, a system functioning on a single shared platform developed to replace the current TARGET, in the third wave on 19 May 2008.

EP RTGS on a rolling year basis. 79% of them were customer payments. The average value of domestic express payments originated by bank customers was 3.9 million kroons. The average value of cross-border payments is substantially smaller, remaining at the level of 240,000 kroons. The average turnover of payments settled through the EP RTGS increased by 16%, reaching 3.2 billion kroons per day. The largest share of the turnover (47%) still consisted of banks' collateral account transactions of the ESTA.

The number of payments settled via the **ESTA** grew steadily throughout the year: by 15% to an average of 85,000 payments per day (see Figure 2).

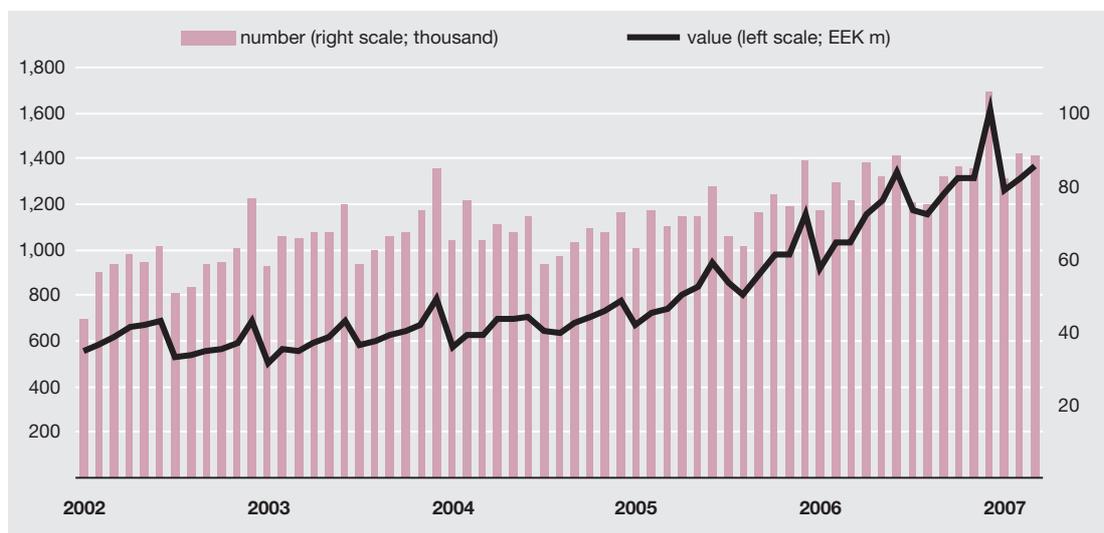
The average daily turnover of ESTA payments has also increased. During the year, the average turnover picked up by 37%, reaching a record 1.6 billion kroons in December 2006. The average value of payments settled through the ESTA during the period under analysis was 15,700 kroons.

### Availability of settlement systems **ESTA and RTGS**

By the end of the first quarter of 2007, ten serious failures had occurred in the EP RTGS, year-on-year<sup>2</sup>. The incidents were caused by software errors and failures in the operation of the network. The ESTA also posted ten serious malfunctions during that period. The availability was disturbed by changes resulting from the transition to the new technical platform. The failures have been analysed and the causes eliminated. During the last 12 months the payment and settlement systems managed by Eesti Pank have not experienced malfunctions that might endanger the operation of the financial sector.

### Assessment by the overseer of payment systems to the **Delivery versus Payment service for the settlement of securities in real time**

To date, financial claims and liabilities resulting from domestic securities transactions intermediated by



**Figure 2. Number of payments processed per day in the ESTA and their average daily value per month**

<sup>2</sup> According to the procedural rules of risk management, a failure is considered serious when the incident concerns several system participants or decreases the performance consistency or the availability of payment and settlement systems.

the Estonian Central Register of Securities (ECRS) have been met only in terms of settling net positions. Settlements of the cash leg<sup>3</sup> of the net positions of credit institutions acting as custodians are performed on EP RTGS accounts held with Eesti Pank once a day in case of stock exchange transactions and three times a day in case of over-the-counter transactions (at 11:30 AM, 1:45 PM and 3:45 PM). Cross-border over-the-counter (OTC) transactions originated by the ECRS and other depositories in the OMX group have been available via links between the omnibus accounts of depositories only as free of payment transactions<sup>4</sup>. For the settlement of claims and liabilities resulting from cross-border stock exchange transactions, depositories have also provided delivery versus payment, combining the central bank money and the correspondent banking money.

In order to offer effective solutions for emergency situations and enable the delivery versus payment settlement of claims and liabilities resulting from cross-border OTC transactions, in cooperation with Eesti Pank and credit institutions operating in Estonia the ECRS launched the **Real-Time Delivery Versus Payment (RT DVP)** service for the cash leg settlement of securities transactions. The new service is available as of 30 April 2007.

In case of a delivery versus payment settlement, the securities custodians intermediate the transfer of both the securities and the money. The purchased securities are transferred to the purchaser's securities account and the funds on the seller's settlement account as soon as the sum has been transferred from the custodian's account of the credit institution representing the purchaser in the

EP RTGS to the custodian's account of the credit institution representing the seller.

As the RT DVP service reduces risks to the payment and settlement systems, the overseer considers the implementation of this service justified and positive. Developing a functionality similar to the RT DVP was discussed already at the time the EP RTGS was introduced, but as market participants had no interest in the service at the time, it was disregarded during the launch of the RTGS at the beginning of 2002.

For the smooth operation of the financial system, the functionality of the RT DVP service must guarantee that credit institutions are able to manage their own liquidity, which is especially crucial in the event of a crisis. Thus, the overseer of payment and settlement systems considers the following conditions essential for the application of the RT DVP service:

1. The RT DVP payment instruction priority in RTGS is four or lower<sup>5</sup>;
2. The mandates of the parties, especially those of the ECRS and credit institutions, are clearly stipulated and they incur no additional risks on payment and settlement systems or the financial system as a whole;
3. The price of the service covers the costs of elaborating and providing the service and is brought out separately on the price list of the EP RTGS.

<sup>3</sup> Securities settlements are performed via two systems: the transfer of securities on securities accounts and transfer of cash on cash accounts.

<sup>4</sup> Free of payment transaction means that the transfer of securities and cash is performed independently, i.e. they are not directly related.

<sup>5</sup> In the EP RTGS, payment instructions have priorities from 1 to 5. Payment instructions carrying the first priority are the most essential and are fulfilled first and payment instructions with the lowest, i.e. fifth priority level are fulfilled when other payment instructions with priorities of 1–4 have been fulfilled.