

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 scope and aim of oversight

In its oversight of payment and settlement systems, Eesti Pank analyses the construction and functioning of payment and settlement systems, identifies risks to the systems, makes recommendations for minimising risks, and monitors compliance with those recommendations.

The aim of oversight is to maintain, and if necessary improve, the safety, efficiency and trustworthiness of the systems being overseen. Eesti Pank achieves that aim by issuing recommendations to system operators¹, and by publishing those recommendations where necessary. The system manager is responsible for the reliability of the system, which includes accepting residual risks.

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, execute monetary policy and ensure the smooth circulation of currency.

The principles of oversight

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. 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 joint oversight work of the Eurosystem, Eesti Pank uses principles of relative importance and risks to assess the impact of systems on financial stability, monetary policy and the smooth circulation of currency.

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 independence, the head of the Policy and Oversight Division is directly responsible for oversight to the Executive Board of Eesti Pank, independently of the role and interests of the operator of payment and settlement systems.

Eesti Pank is given the role of overseer by the Treaty establishing the European Community², the statute of the European System of Central Banks and of the European Central Bank³, the Eesti Pank Act⁴, the Payment Institutions and E-money Institutions Act⁵, the standards recognised internationally and by the Eurosystem, and this framework.

¹ Eesti Pank Act § 24 (2) 2).

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

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

⁴ Eesti Pank Act § 24. Oversight of payment systems

⁵ Payment Institutions and E-money Institutions Act § 15 (1) 18.

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 AS

Settlement systems for financial instruments

- the securities settlement system operated by Nasdaq CSD SE

The development of the single European market has meant that the Estonian payment market is affected ever more by pan-European payment and settlement systems. Estonian interbank retail payments are settled using the pan-European retail payment system STEP2 or instant payment system RT1 both operated by EBA Clearing. Some banks use the SEPA-Clearer clearing system or settle payments through their parent banks.

The 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 how the system impacts financial stability, monetary policy and the smooth circulation of currency, 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 the domestic payment and settlement systems that are overseen
- assessing how the systems meet those requirements and identifying risks arising in those systems
- making recommendations to operators of payment and settlement systems and advising them on how to improve security and efficiency, and observing how the advice and recommendations are followed
- approving the rules and principles of the functioning of payment systems in the cases defined in law
- 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

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 makes recommendations to system operators on making the systems more efficient and more secure where necessary.

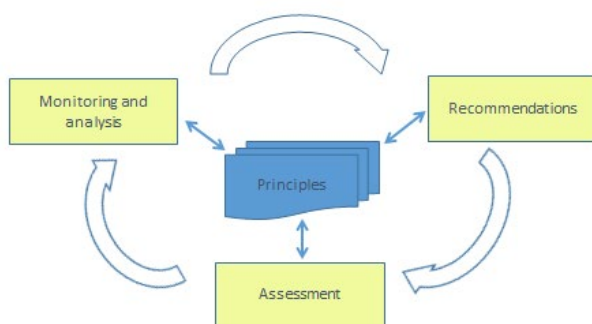


Figure. The process of oversight of payment and settlement systems

Monitoring and analysis of payment and settlement systems

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

Eesti Pank uses the international CPMI-IOSCO6 principles for financial market infrastructure adopted for oversight by the Eurosystem in assessing payment and settlement systems⁷. 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 for controls 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

⁶ CPMI-IOSCO Principles for Financial Market Infrastructures, CPMI (Committee on Payments and Market Infrastructures); IOSCO (Technical Committee of the International Organization of Securities Commissions – International Organisation of Securities Commissions).

⁷ 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.

- management procedures
- risk awareness and risk management, covering the identification, measurement and monitoring of legal, credit, liquidity and operational risks, general business risks, and 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 system participation
- disclosure of system rules.

Eesti Pank assesses the payment systems operated by payment institutions before they come into 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 system (Appendix 3).⁸

Inducing changes through recommendations on raising the efficiency of systems

The result of the assessment of payment and settlement systems can be either 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 deficiencies in compliance and the assessment is that the requirements are 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 suasion in giving its recommendations. The main findings and recommendations of the overseer's assessment report are published on the Eesti Pank website.

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 standardised arrangements for the execution of transfer orders between the participants. A payment system can be classed as a Systemically Important Payment System (SIPS) or an important system (non-SIPS) depending on its financial impact, market share, cross-border activity and interdependencies with other financial market infrastructures.⁹

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 meets the definition of a system in Directive 98/26/EC; and
- b) at least two of the following apply during a calendar year:
 - i) the total daily average value of its euro-denominated payments processed exceeds ten billion euros
 - ii) its total euro-denominated payments processed represent at least one of the following:
 - 15% of the total volume of euro-denominated payments in the European Union
 - 5% of the total volume of euro-denominated cross-border payments in the European Union

⁸ Payment Institutions and E-money Institutions Act § 15 (18).

⁹ The criteria for payment systems are given in the ECB regulations that set the requirements for oversight of payment systems.

- a market share of 75% of the total volume of the euro-denominated payments at the level of a member state whose currency is the euro;
- iii) its cross-border activity covers at least five countries through participants other than the SIPS operator or through cross-border links with other payment systems, and generates at least 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 payment systems can be large value payment systems (LVPS) or retail payment systems (RPS). 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 amount of relatively low value payments in such forms as credit transfers, direct debits or cheques.

LVPSs are almost always systemically important but even if they are not, then all 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. An important payment system is classified by their market share as:

- a Prominently Important Retail Payment System (PIRPS), if its market share is more than 25% of the euro-denominated payments of the member state
- an Other Retail Payment System (ORPS), if its market share 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 serve¹⁰, 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 Estonian securities settlement system managed by Nasdaq CSD
- the card payment system operated by Nets Estonia AS

¹⁰ Under the CPMI-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.

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. Payments are settled one by one. This system is intended for the settlement of large-scale 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 banks. These requirements are defined in the Regulation of the European Central Bank ECB/2014/28¹¹.

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 assessed separately 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 Estonian securities settlement system managed by Nasdaq CSD SE

The securities settlement system allows individuals to settle transactions between themselves with financial instruments, or securities. Fulfilment of the securities transactions may involve settlement of the cash leg of the transaction if it is Delivery-versus-payment (DvP), or not if the transaction is Free-of-payment (FOP).

A securities settlement system is systemically important because of its critical role, and the oversight requirements for securities settlement systems apply to it (see Appendix 2).

The Nasdaq CSD SE is a depository operating across the Baltic states and has been established in Latvia. Eesti Pank has responsibility for oversight of the Estonian securities settlement system managed by Nasdaq CSD. The Estonian securities settlement system is subject to oversight by Eesti Pank under the oversight process described above of monitoring, analysis, assessment and recommendations. The Baltic central banks work together in assessments and in making recommendations as the Baltic securities settlement systems managed by Nasdaq CSD operate on a single technical platform. Eesti Pank also works with Finantsinspektsioon and with the other Baltic central banks and supervision authorities in the supervisory college for Nasdaq CSD, which is led by the Latvian financial supervisor (FCMC¹²).

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.

¹¹ The ECB regulation on oversight of systemically important payment systems, known as the SIPS Regulation.

¹² Financial and Capital Market Commission.

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

The 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 works together with Finantsinspektsioon in overseeing the card payment system, as the reciprocal financial obligations or the money settlement between the banks are the responsibility of the banks and not of the system.

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 operating between payment institutions

Payment systems of payment institutions are defined by the Payment Institutions and E-money Institutions Act¹³ 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 monetary policy, and are not important for the smooth circulation of currency. Under the Payment Institutions and E-money Institutions Act, Eesti Pank has responsibility for assessing 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 at 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).

Eesti Pank participates indirectly in oversight at the Eurosystem level through the Payment and Securities Oversight Working Group, PSOWG¹⁴, the Market Infrastructure and Payments Committee, MIPC¹⁵ and the decision-making framework of the Eurosystem.

Eesti Pank can participate directly in Eurosystem oversight on a voluntary basis, working actively in the oversight process to an extent that depends on the importance of a given piece of infrastructure or on a risk-based principle

The STEP2 retail payment system operated by EBA Clearing and the TARGET2-Securities single settlement platform for securities are financial market infrastructures that are subject to oversight at the Eurosystem level, and that are important for settling obligations between Estonian market participants and have an effect on financial stability and on the smooth circulation of currency¹⁶. The overseer of STEP2 and T2S is the European Central Bank. Central banks of the Eurosystem contribute to the oversight of those infrastructures

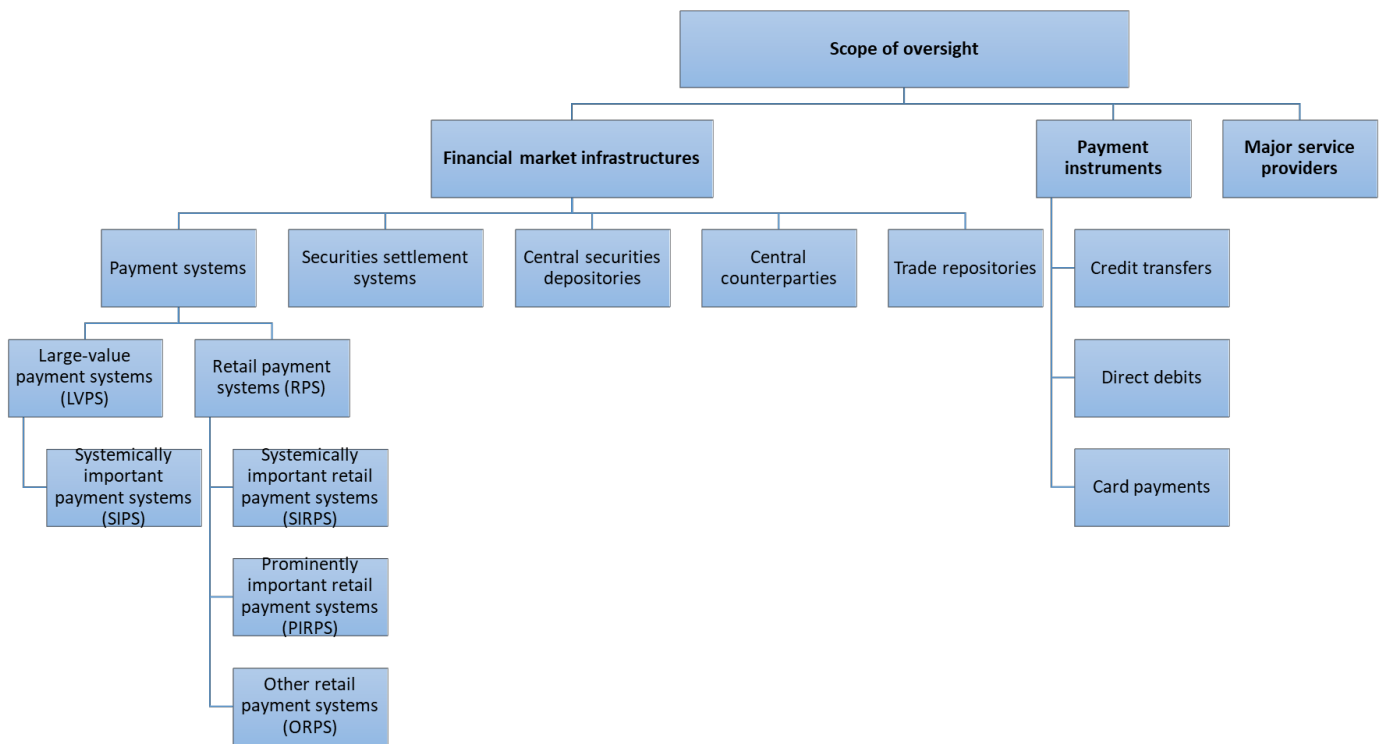
¹³ Payment Institutions and E-money Institutions Act § 3 (4).

¹⁴ Payment and Securities Oversight Working Group, PSOWG.

¹⁵ Market Infrastructure and Payments Committee, MIPC.

¹⁶ Estonian interbank payments settled in STEP2 and RT1 account for a significant proportion of Estonian credit transfers.

on a voluntary basis. Eesti Pank participates indirectly in Eurosystem oversight, and directly where necessary and possible.



Appendix 1. The principles of oversight and oversight agreements

1. Principles for payment systems

- 1.1. [Principles for financial market infrastructures, 2012 \(CPMI-IOSCO\)](#)
- 1.2. [Assessment methodology for the principles for FMIs and the responsibilities of authorities, 2012 \(CPMI-IOSCO\)](#)
- 1.3. [Recovery of financial market infrastructures, 2014 \(CPMI-IOSCO\)](#)
- 1.4. [Guidance on cyber resilience for financial market infrastructures, 2016 \(CPMI-IOSCO\)](#)
- 1.5. [Eurosystem oversight policy framework, 2016 \(ECB\)](#)
- 1.6. [Regulation of the European Central Bank on oversight requirements for systemically important payment systems, 2014, as updated in 2017](#)
- 1.7. [Decision \(EU\) 2017/2097 of the ECB of 3 November 2017 on the methodology for calculating sanctions for infringements of the oversight requirements for systemically important payment systems](#)
- 1.8. [Oversight guide for SIPS, 2015 \(ECB\)](#)
- 1.9. [Revised oversight Framework for retail payment systems, 2016 \(ECB\)](#)
- 1.10. [Revised assessment methodology for payment systems, 2018 \(ECB\)](#)
- 1.11. [Oversight expectations for links between retail payment systems \(OELRPS\), 2012 \(ECB\)](#)
- 1.12. [Eurosystem Cyber Resilience Strategy for financial Market Infrastructures, 2017](#)
- 1.13. [Cyber Resilience Oversight Expectations, 2018](#)
- 1.14. [TIBER-EU Framework, 2018](#)

2. Principles for securities settlement systems

- 2.1. [Principles for financial market infrastructures, 2012 \(CPMI-IOSCO\)](#)
- 2.2. [Assessment methodology for the principles for FMIs and the responsibilities of authorities, 2012 \(CPMI-IOSCO\)](#)
- 2.3. [Central Securities Depositories Regulation \(CSDR\)](#)
- 2.4. [CSDR Regulatory Technical Standards](#)
- 2.5. [European Market Infrastructure Regulation \(EMIR\)](#)
- 2.6. [EMIR Regulatory Technical Standards](#)
- 2.7. [T2S Oversight Framework, 2018](#)

3. Principles for payment instruments

- 3.1. [Harmonised oversight approach and oversight standards for payment instruments, 2009 \(ECB\)](#)
- 3.2. [Oversight framework for direct debit schemes, 2010 \(ECB\)](#)
- 3.3. [Guide for the assessment of direct debit schemes against the oversight standards, 2014 \(ECB\)](#)
- 3.4. [Oversight framework for credit transfer schemes, 2010 \(ECB\)](#)
- 3.5. [Guide for the assessment of credit transfer schemes against the oversight standards, 2014 \(ECB\)](#)
- 3.6. [Oversight framework for card payment schemes – Standards, 2008 \(ECB\)](#)
- 3.7. [Guide for the assessment of card payment schemes against the oversight standards, 2015 \(ECB\)](#)
- 3.8. [Report on electronic money, 1998 \(ECB\)](#)

3.9. *Electronic Money systems security objectives, 2003 (ECB)*

4. Agreements

4.1. *Cooperation agreement between Eesti Pank and Finantsinspeksioon on oversight and supervision for settlement of cash and securities transactions, 2019*

4.2. *Cooperation agreement between the Latvian and Estonian supervision authorities and the Latvian, Estonian and Lithuanian central banks on oversight and supervision of Nasdaq CSD SE, 2017*

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

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

PRINCIPLES	Payment Systems			Securities settlement system	Depositories	Central counterparty	Trade repositories
	SI(R)PS ¹⁷	PIRPS ¹⁸	ORPS ¹⁹				

¹⁷ Systemically Important (Retail) Payment System
¹⁸ Prominently Important Retail Payment System.
¹⁹ Other Retail Payment System.

PRINCIPLES	Payment Systems			Securities settlement system	Depositories	Central counterparty	Trade repositories
	SI(R)PS ¹⁷	PIRPS ¹⁸	ORPS ¹⁹				
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 delivery				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

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

1. The legal framework must be reasonable, clear and transparent, and must apply in all jurisdictions concerned.
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 the financial risks of the clearing and settlement process.

Appendix 3. Assessment of the rules and principles for payment systems between 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 payment systems provided by payment institutions and the proposed rules for the operation of the system.
2. Applications 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.