

## The Eesti Pank principles for promoting the 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 functioning 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 for 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.

All these activities are brought together in the Eesti Pank mission as promoting a safe and efficient payment market. The payment market, including the operation of payment systems, is important for the maintenance of economic and financial stability, the execution of monetary policy and the smooth circulation of currency. The main components of the payment market are the payment and settlement systems and payment instruments (see Appendix 1) and payment instruments (see Figure 1)<sup>1</sup>.

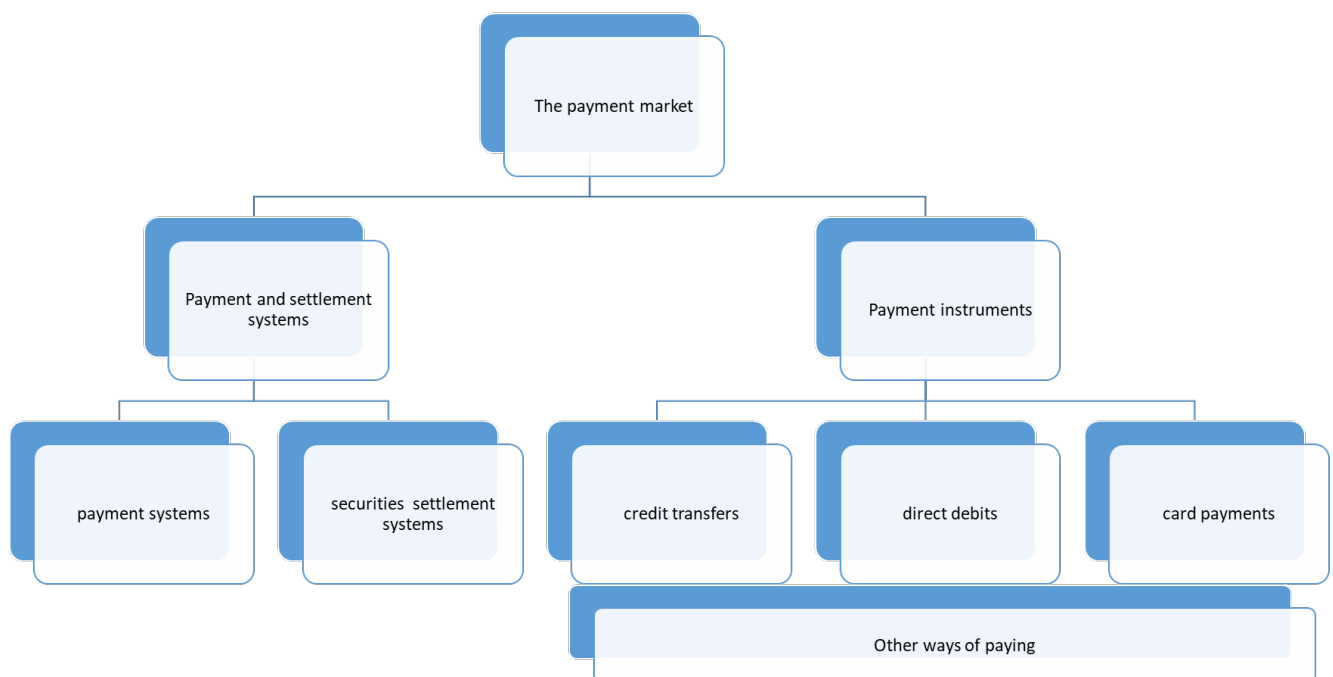


Figure 1. The payment market

<sup>1</sup> E-invoice standing orders are used for payments in Estonia in place of direct debits.

The **Eesti Pank** Payment and Settlement Systems Department is responsible for **promoting the payment market**. Eesti Pank has the right under the credit institutions act<sup>2</sup> and the law of obligations act<sup>3</sup> 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 necessary, and if there is no direct need for regulation, Eesti Pank looks first 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 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.

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<sup>2</sup> Credit Institutions Act § 87 (2). Eesti Pank sets the rules for the operation of payment systems administered by Eesti Pank.

<sup>3</sup> Law of Obligations Act § 709 (17). Eesti Pank may establish more detailed requirements on maintenance of payment accounts and settlement of payments by credit institutions and other financial institutions.

## I. Promoting the smooth functioning of payment systems

### **Principles**

To promote the smooth operation of payment and settlement systems, Eesti Pank is involved in setting up and managing the payment and settlement systems of the ESCB and their supporting systems. Eesti Pank also supports the operation of private payment and settlement systems. Eesti Pank does not set up payment systems of its own.

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.

Eesti Pank provides account management services to achieve its main objectives. Credit institutions have to have an account at Eesti Pank. Legal entities that are not credit institutions can open an account at Eesti Pank if holding that account for them helps Eesti Pank achieve its objectives.

### **Scope**

Eesti Pank is the owner of the TARGET2-Eesti payment system, and is the joint owner with the other Eurosystem central banks of the securities settlement platform TARGET2-Securities and of the ECMS collateral management system that is being created.

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 euro payments. Since November 2018 the TIPS<sup>4</sup> service in TARGET2-Eesti has allowed instant payments<sup>5</sup> to be settled too. Settlement is made in central bank money in accounts opened in Eesti Pank.
2. **TARGET2-Securities** is a multi-currency platform for securities settlement. TARGET2-Securities is linked to TARGET2 as the cash leg of the securities transaction is settled using central bank money.
3. Eesti Pank provides the CCBM<sup>6</sup> and allows the use of some remote access arrangements to securities settlement systems for settling collateral issued outside Estonia for the monetary policy operations of the Eurosystem. The central bank is also involved in developing the Eurosystem collateral management system (ECMS).

Under the Emergency Act, Eesti Pank works with the banks to arrange the continuity of payment services if a pan-European payment system becomes unavailable for use. Ensuring the functioning of critical payment services is a strategic goal of Eesti Pank<sup>7</sup>.

Eesti Pank provides account management services to monetary policy counterparties, participants in ESCB payment systems, providers of vital payment services, holders of mandatory reserves, international financial organisations, and state institutions of the Republic of Estonia, Finantsinspektsioon, and the

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<sup>4</sup> TARGET instant payment settlement.

<sup>5</sup> These are payments that reach the payee within seconds, round the clock and round the year.

<sup>6</sup> Correspondent central banking model.

<sup>7</sup> See [Goal four of the Eesti Pank strategy 2018-2022](#) "Eesti Pank is ready to carry out its duties in the event of a crisis".

Guarantee Fund. Account management services are not provided to private sector entities or private individuals. The Eesti Pank Executive Board decides whether or not to provide account management services.

As a user of payment services, Eesti Pank is a participant in TARGET2-Eesti and TARGET2-Securities and is an indirect participant in the pan-European payment system STEP2<sup>8</sup> and a direct participant in the SEPA-Clearer payment system.

### **Cooperation**

Under the guidance of Eesti Pank, the Payment and Settlement Systems Estonian User Group operates as a **domestic advisory body**<sup>9</sup>. The members of the user group are all the credit institutions operating in Estonia that are participants in TARGET2-Eesti and users of TARGET2-Securities services. The user group was set up to support the functioning of the payment and settlement systems that Eesti Pank is involved in managing and the development of the Eesti Pank collateral management services, and to exchange information and promote cooperation between entities set up by the European System of Central Banks.

Eesti Pank participates in the domestic cooperation forums led by the Estonian Banking Association that deal with the standards used for making payments and issues of network services.

Eesti Pank participates in the cooperation forums led by the European Central Bank that discuss management and development of the market infrastructures of the Eurosystem ([see Appendix 3](#)).

### **Regulation**

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

- [Terms and conditions for opening and using the accounts of credit institutions in Eesti Pank](#)
- [TARGET2-Eesti rules](#)

The [decree on terms and conditions for opening and using accounts in Eesti Pank regulates the opening and use of accounts by non-credit institutions](#).

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<sup>8</sup> Eesti Pank is an indirect participant in STEP2 through the SEPA-Clearer system of the Deutsche Bundesbank.

<sup>9</sup> Decree No 36 of the Governor of Eesti Pank of 17.04.2018.

## II. Oversight of payment and settlement systems<sup>10</sup>

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 ([see Appendix 2](#)).

Eesti Pank aims to maintain, and where necessary improve, the safety, efficiency and trustworthiness of the systems being overseen. Eesti Pank achieves that aim by issuing recommendations to system operators<sup>11</sup>, and by publishing those recommendations where necessary. The system operator is responsible for the safety of the system, which includes accepting residual risks.

### **Principles**

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 systems on financial stability, the implementation of monetary policy and the smooth circulation of currency.

Eesti Pank is given the role of overseer by the Treaty establishing the European Community<sup>12</sup>, the statute of the European System of Central Banks and of the European Central Bank<sup>13</sup>, the Eesti Pank Act<sup>14</sup>, the Payment Institutions and E-money Institutions Act<sup>15</sup>, the standards recognised internationally and by the Eurosystem including the oversight requirements of systemically important payment systems, and the oversight framework for payment and settlement systems<sup>16</sup>. 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.

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<sup>10</sup> Oversight is significantly different from supervision. Supervision in Estonia is carried out by Finantsinspektsioon and the subjects of it are banks and other financial institutions. The responsibilities of Finantsinspektsioon are exhaustively defined by law and Finantsinspektsioon has the right to apply measures or sanctions defined by law if it discovers a breach of the rules. Oversight in Estonia is carried out by the central bank and the subjects of it are payment and settlement systems. The overseer generally does not have the right to impose sanctions on payment and settlement systems. The exception is systemically important payment systems, which are subject to the requirements of the European Central Bank Regulation ECB/2014/28 on oversight of systemically important payment systems.

<sup>11</sup> Eesti Pank Act § 24 (2) 2).

<sup>12</sup> The Treaty establishing the European Community, Article 127(2).

<sup>13</sup> Statute of the European System of Central Banks (ESCB) and of the European Central Bank (ECB), Article 3.

<sup>14</sup> 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 overseer of payment systems, Eesti Pank:

1) analyses the structure and operation of payment systems;

2) issues instructions to operators of payment systems;

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.

<sup>15</sup> Payment Institutions and E-money Institutions Act § 15 (1) 18.

<sup>16</sup> The oversight framework is approved by the Executive Board of Eesti Pank.

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 the payment system.

### **Tasks**

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 Estonian securities settlement system managed by Nasdaq CSD SE
- the card payment system operated by Nets Estonia AS

It is a strategic goal for Eesti Pank to assess the cyber resilience of the Estonian card payment<sup>17</sup>.

Under the Payment Institutions and E-money Institutions Act, Eesti Pank assesses the rules and principles behind the functioning of the payment systems operated by payment institutions<sup>18</sup>.

Eesti Pank participates in oversight at the level of the Eurosystem. Oversight in the Eurosystem covers payment systems and securities settlement systems, the TARGET2-Securities platform, 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 Eurosystem<sup>19</sup>. Eesti Pank participates directly in oversight of the TARGET2 large-value payments system, the TARGET2-Securities platform and the STEP2 pan-European payment system where necessary and possible<sup>20</sup>.

### **Cooperation**

Eesti Pank works with Finantsinspektsioon in overseeing the settlement of cash and securities.

In overseeing the Estonian securities settlement system managed by Nasdaq CSD SE Eesti Pank works with Finantsinspektsioon and the central banks and supervision authorities of the other Baltic states.

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 component system.

Eesti Pank participates in the cooperation forums led by the European Central Bank, which discuss the oversight of market infrastructures and of major service providers, and the pan-European cooperation forum set up to oversee the TARGET2-Securities platform, in which financial supervisors also participate.

### **Regulation**

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

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<sup>17</sup> See [Goal four of the Eesti Pank strategy 2018-2022](#) "Eesti Pank is ready to carry out its duties in the event of a crisis".

<sup>18</sup> Payment Institutions and E-money Institutions Act § 15 (1) 18.

<sup>19</sup> Cooperation is achieved through working groups and committees, and the decision-making framework of the Eurosystem.

<sup>20</sup> 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 and pan-European 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 the payment market. The payment market is made up of payment and settlement systems, payment instruments and other payment solutions, including those relating to securities settlement (see Figure 1).

#### **Principles**

It is important for Eesti Pank that the payment **market function** well and provide efficient and sound payment solutions. For this it is vital that:

1. the development of the payment market be balanced and sustainable and in accordance with international changes
2. the legal framework of the payment market be up to date and widely accepted with positions defined in cooperation with the public sector and market participants
3. the payment and settlement systems that operate in the payment market be interoperable, so the technical standards used for transactions should be open and systems should be interoperable with similar systems and solutions

Eesti Pank finds that faster payments make transactions through the electronic channels of banks, e-commerce, and physical points of sale more efficient. This then has a positive impact on the whole economy. This makes it important that:

4. the payment market allow fast or instant interbank settlement
5. banks and payment institutions can treat their clients under equal technical conditions and fair business terms regardless of whether they are directly or indirectly linked to payment systems for that purpose

Eesti Pank considers it important that consumers and businesses can use payment instruments efficiently and safely. It is important for this that payment service providers bring the terms of their payment services under the legal framework in force and allow payments to be made and received through efficient payment solutions. For this it is vital to be sure that:

6. payment services providers consider the needs and wishes of consumers and businesses. As technology evolves for instance, customers should be enabled to use open banking to choose the best services from across the whole digital single market
7. payment solutions be transparent and cost-effective. Eesti Pank is neutral about service fees, but monitors that they are set under the free market principles that underlie free competition

8. payment solutions based on pan-European<sup>21</sup> payment instruments be interoperable and integrated with solutions that make the entire payment chain more efficient, including e-invoices and e-receipts

### **Scope**

Eesti Pank analyses the Estonian payment market and writes reviews on it, and monitors the European and global payment markets.

Eesti Pank compiles payment statistics from banks and other market participants to:

- get an overview of the functioning of the Estonian payments market, and market shares and volumes in it
- provide inputs for the statistical database of the European Central Bank and economic analysis
- produce statistics for the whole market

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

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

Eesti Pank works with market participants as a neutral party in developing the principles, rules and recommendations that affect the payment market, on which the payment service providers can build their payment services and solutions.

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

Eesti Pank participates in developing and assessing the options for executing Eurosystem monetary policy operations.

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

The strategic goal of Eesti Pank is to monitor and assess financial innovation and the opportunities and risks that come with new technology and services for clients and the Estonian payment market, and it also considers the need for changes to the law. If there is demand from businesses, then Eesti Pank is ready to consider working directly with companies that can meet the requirements for using the payment and settlement systems provided by the central bank.<sup>22</sup>

### **Cooperation**

Eesti Pank leads the Estonian Payment Forum, where it works with the Ministry of Finance and the Estonian Banking Association, which is a forum for discussing issues in the payment market. The members of the forum are Estonian credit institutions; users of payment systems; representatives of interest groups affected, including some from the public sector; and infrastructure providers. Finantsinspektsioon is also invited to attend meetings of the Forum.

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<sup>21</sup> SEPA.

<sup>22</sup> See [Goal three of the Eesti Pank strategy 2018-2022](#) "Eesti Pank is an influential expert on new financial technology that affects the payment environment and financial stability".



Eesti Pank is part of the Payments Committee of the Estonian Banking Association.

Eesti Pank participates in the cooperation forums led by the European Central Bank, which discuss policy issues concerning market infrastructures, payments, securities and derivatives ([see Appendix 3](#)). Eesti Pank is also part of discussions about the security of retail payments.

### **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

The purpose of payment and settlement systems in the payment market is to enable 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 or 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 to be initiated. The main means of payment are credit transfers, direct debits<sup>23</sup> and card payments.

A **securities settlement system** allows parties to carry out their obligations involving financial instruments to each other. 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, while businesses use them for paying for the goods they have purchased or in order to gather incoming payments, and the state needs payment systems for collecting taxes and paying benefits.
2. The interbank payments system gives 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 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 AS

### Settlement systems for financial instruments

- the securities settlement system operated by Nasdaq CSD SE

Estonian interbank retail payments are settled using the STEP2 pan-European payment system or the RT1 instant payment system, which are operated by EBA Clearing. Some banks use the SEPA-Clearer clearing system or settle payments through their parent banks.

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<sup>23</sup>

E-invoice standing orders are used for payments in Estonia in place of direct debits.

## Appendix 2. Risks to Payment and Settlement Systems

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. The transfer of risks 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 costs 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, weak management or insufficient documentation 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 get the money for it 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.

### Appendix 3. The Eesti Pank principles for facilitating the payment market

