VI PAYMENT SYSTEMS

SETTLEMENT SYSTEM OF INTERBANK PAYMENTS

The number of payments settled through the **Real-Time Gross Settlement (RTGS)** system has fallen 3% year-on-year (see Figure 6.1). The number of customer payments underwent the biggest decline (8%). Behind such a change lie the developments implemented in the Settlement System of Ordinary Payments (ESTA) as of October 2005: the increase in the number of settlement periods and the elimination of the limit on large-value payments.

Changes in the Designated Time Net Settlement (DNS) system have led to yet another structural change in RTGS payments. The sums paid in as collateral for ESTA settlements have decreased. Just a year ago the share of collateral in ESTA's turnover stood at 88%, while currently it stands at 65% as an annual average. The decline in the sums paid in as collateral for ESTA settlements stems from a more even distribution of ESTA settlement volume over the entire day and also from the possibility for a bank to re-transfer all the money paid in as collateral as well as the funds received into the bank's RTGS account after the end of the first settlement period.

The average volume of settlements in the RTGS during the past 12 months was 175 payments per day, of which 72% were customer payments. The average value of the transactions initiated by bank customers was 3.2 million kroons, compared to 2.2 million kroons a year ago (annual growth of 49%). Average turnover increased 13% and amounted to 2.8 billion kroons per day. Banks' ESTA collateral account transactions still accounted for most of the turnover (55%).

The **Settlement System of Ordinary Payments (ESTA)** was launched on 3 October 2005. The ESTA is an updated version of the former Designated Time Net Settlement (DNS) system. For banking customers the implementation of the ESTA has led to two significant changes: the settlement day is three hours longer now and the settlement cycle is more frequent. Instead of the former three times, beneficiary banks are informed of received payments nine times a day, i.e. on every full hour. Consequently, payments made from one bank to

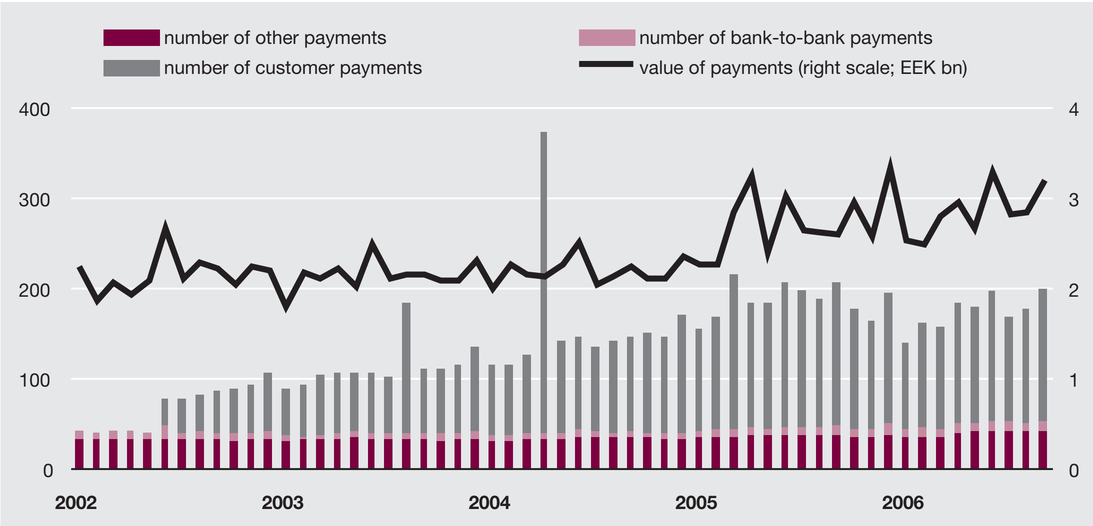

Figure 6.1. Number of payments processed per day in the RTGS system and their average daily value per month

another reach the beneficiary in no later than in an hour and a half.

An average of 77,000 payments a day was settled through the ESTA during the past 12 months, which is 15% more than a year ago (see Figure 6.2). The daily turnover of the ESTA grew rapidly during the past year, having increased 39% year-on-year and for the first time rising above the 1 billion kroon level (average turnover of 1.1 billion kroons). The average value of payments settled through the ESTA was slightly over 14,500 kroons, having increased 23% during the review period.

PAYMENT INTERMEDIATION

Payment environment

No major changes have occurred in the environment of retail payments within the past year. According to a survey conducted by TNS Emor on payment habits, the usage of non-bank channels for payments[1] continues to decrease (from 68% in 1999 to 25% in 2006). 75% of Estonian households handle regular payments through banks by using electronic means of payment[2] and/or paying by paper-based credit orders in bank offices (see Figure 6.3).

In the course of five years the Internet banking and payment cards that we take for granted today quickly attracted new users and the growth trend has also continued in 2006 (see Figure 6.4). Furthermore, the increasingly improved availability of the Internet has enhanced the popularity of Internet banking: today every second Estonian resident aged 15 to 75 uses the Internet regularly[3].

During the year over 147,000 new Internet banking contracts were concluded, raising the total

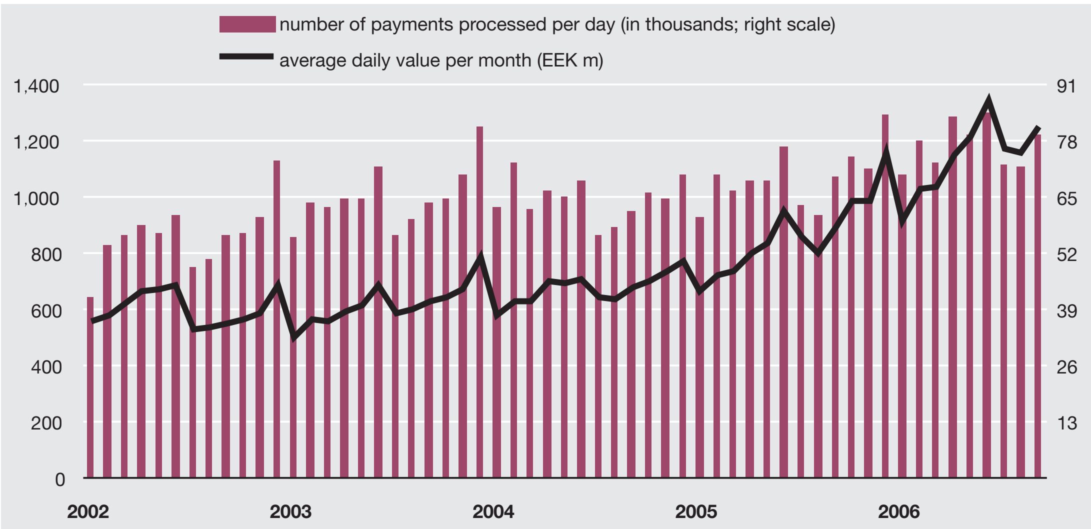

Figure 6.2. Number of payments processed per day in the DNS system and from 3 October 2006 in ESTA and their average daily value per month

[1] Making at least one regular payment per month either in cash or directly to their service providers in their offices or through the post office.
[2] Payment orders made through Internet banking, standing orders, direct debit, card payments to service providers in their offices, payments made through a self-service payment terminal or telephone banking.
[3] Source: TNS Emor e-monitoring.

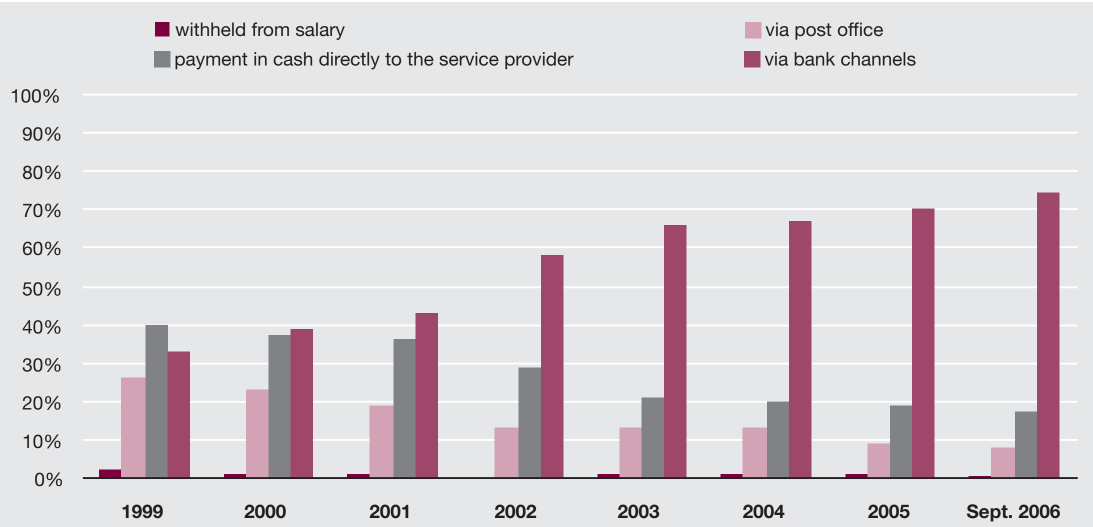

Figure 6.3. Regular payments via bank and other channels (% of all wide-spread regular payments made by households)

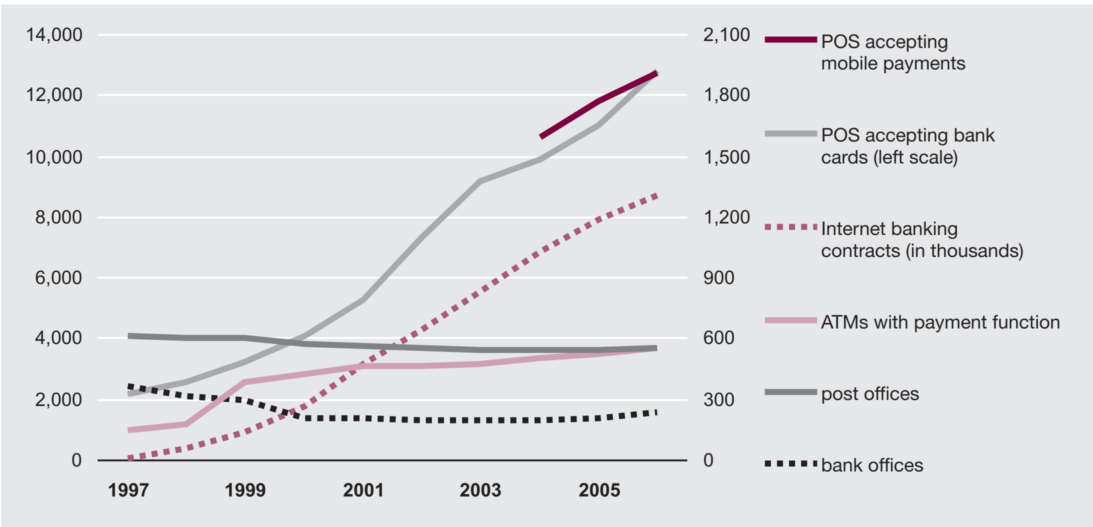

Figure 6.4. Retail payment channels in Estonia (as at end of period)

number to over 1.3 million by the end of the third quarter. However, the rate at which Internet banking contracts are concluded has been slowing down for several consecutive years. This year the pace slowed by 4 percentage points (from 17% to 13%).

The growth in the number of points of sale (POS) accepting payment cards has remained at last year's level of 16%. At the end of the third quarter, there were some 13,000 POS in Estonia. Payment terminal technology has developed further and in the future card payments should become even safer and more convenient as there will be payment terminals using a new type of radio communication, namely the Bluetooth technology.

The number of payments received and intermediated by the Estonian postal company Eesti Post has consistently decreased along with the development of banks' electronic channels. In 2005, the number of payments fell 28% on 2004[4].

Payments via credit institutions

During the past eight years the payment methods used in Estonia have not changed much. However, electronic and more convenient methods of payment are being increasingly preferred to cash, as well as paper-based and telephone bank credit orders. Furthermore, Internet banking is preferred to telebanking. In November 2002 the mobile payment order was introduced. Moreover, customers can also use their mobile phones to make payments at retailers.

As regards non-cash payment methods, card payments (103 million transactions per year; see Figure 6.5) have the largest share (56%). Internet bank credit orders (46 million transactions) have a considerably smaller share (24%) along with tele-

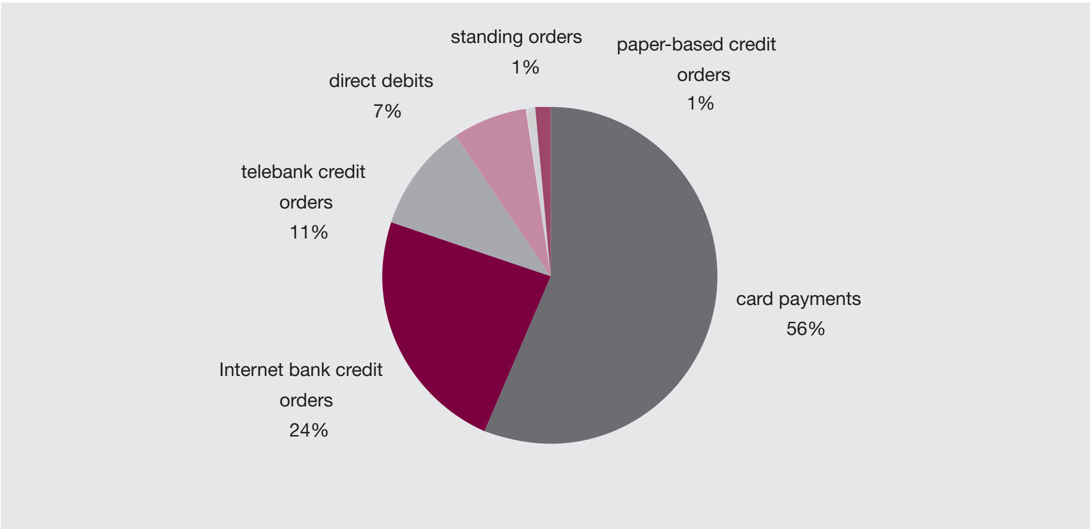

Figure 6.5. Percentage of non-cash payment instruments in Estonia (as at end of Q3 2006)

[4] According to the annual report of Eesti Post for 2005 (http://www.post.ee/failid/aastaraamat_preview_2005.pdf).

bank orders (11%; 23.5 million transactions). More extensive use of non-cash and electronic payment methods is above all possible on account of the residents who use cash the most (the retired, residents of Southern Estonia and small towns, non-Estonians and residents of Ida-Viru County).

The volume of card payments increased 18% year-on-year with the rate of growth remaining at the level of the preceding period (see Figure 6.6). The number of Internet bank credit orders grew 6% during the year and the number of direct debits 8%, with the growth rate thereof slowing by 5 and 2 percentage points, respectively. Meanwhile, the use of mobile payment orders[5] seems to be thriving: the number of transactions increased 51% year-on-year, whereas the total number of transactions is still modest (over 116,000 transactions in 2006). Standing orders are also gaining popularity with a year-on-year growth of 6%, amounting to more than 1.8 million transactions. According to TNS Emor, the popularity of direct debits and standing orders arises from the overall financial freedom and better awareness of banking services, as well as from the wish to make payments more conveniently.

Use of payment cards

According to a survey by TNS Emor, one third of households pay for purchases in cash while two thirds pay with a payment card. The use of payment cards is not limited by the lack of payment possibilities, but rather by general attitudes and preferences. For instance, some people do not have a need for payment cards or they consider them complicated to use.

By the end of the third quarter of 2006, credit institutions had issued over 1.5 million payment cards, of which 76% were active (i.e. at least one payment

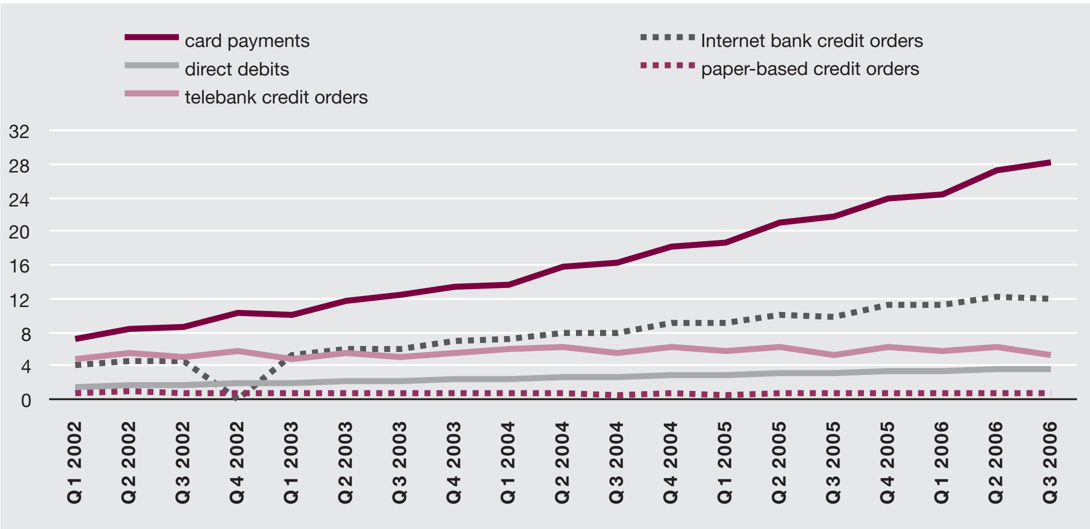

Figure 6.6. Widely used payment instruments in Estonia by number of payments (millions)

[5] A payment order not initiated at a POS that allows mobile phone payments for goods or services purchased to be forwarded by a payer to his/her credit institution via a mobile phone.

transaction per accounting period was made with the card). The total number of payment cards increased 13% during the review period and the growth rate increased by 5 percentage points.

The breakdown of debit and credit cards as of 2004 was as follows: approximately 80% were debit cards and 20% credit cards. 80% of debit card holders and 60% of credit card holders consistently used their cards to make payments at least once a month. The use of credit cards has slightly accelerated since 2004 – the growth in active credit cards has picked up by some 10 percentage points (see Figure 6.7). The use of credit cards has increased both as a result of product campaigns of credit institutions as well as by more active travelling.

Most of the credit cards are instalment cards (42%; see Figure 6.8).[6] More revolving credit cards have been issued during this period than during the preceding period (the growth rate increased by 4 percentage points) while fewer charge cards have been issued (the growth rate decreased by 5 percentage points).

On average, every adult aged 20 to 74 has a debit card while one in five people have a credit card, which they use actively. Also on average, each adult makes use of their credit card 30 times a year to make payments, a rise of seven transactions on last year.

ASSESSMENT BY THE OVERSEER OF THE PAYMENT SYSTEMS

Regarding the oversight of payment systems, the most significant activity of 2006 has been the assessment of the **compliance of Estonia's payments and securities settlement systems with the requirements of the Eurosystem**. In all EU

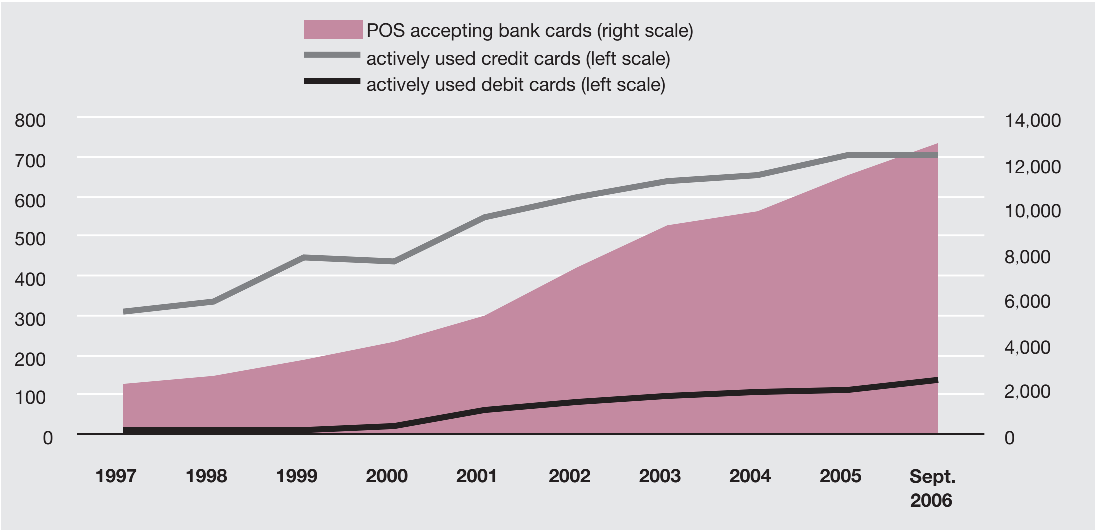

Figure 6.7. Number of payment cards in Estonia per thousand residents and number of POS terminals accepting payment cards as at end of period

[6] *Instalment card* – a payment card with a fixed repayment schedule for the credit generated upon using the card. *Revolving credit card* – a payment card without a fixed date for repayment of the credit generated upon using the card. *Other credit card* – a payment card with several different possibilities of repayment of the credit generated upon using the card. *Charge card* – a payment card with a fixed repayment date of the credit generated.

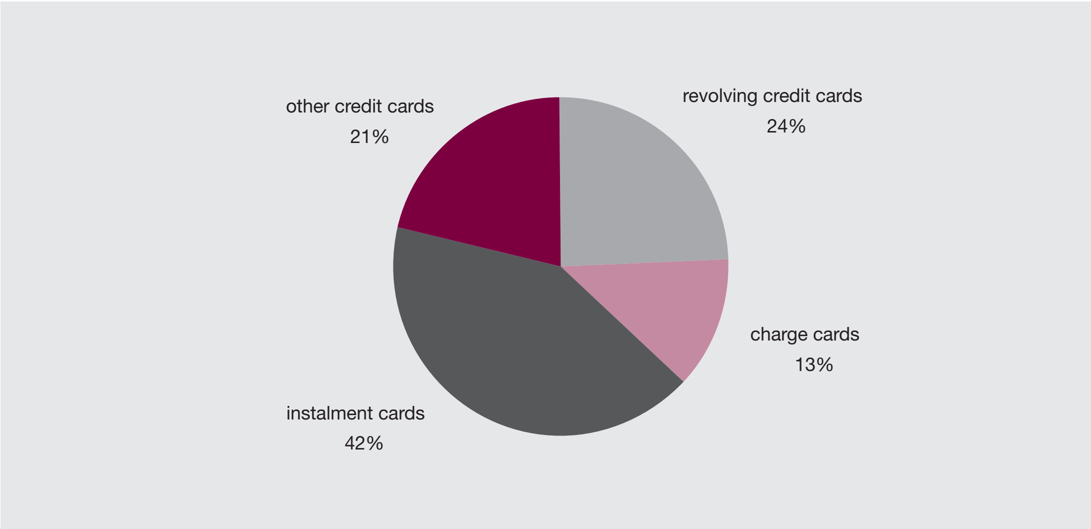

Figure 6.8. Percentage of credit cards in Estonia (as at end of September 2006)

Member States whose currency is the euro or who want to join the euro area, systemically important settlement systems have to comply with the principles of the Eurosystem and these systems must be officially recognised as eligible for the Eurosystem. The settlement systems that belong to the scope of the Trans-European Automated Real-Time Gross Settlement Express System (TARGET), i.e. the Real-Time Gross Settlement (RTGS) systems operating in the Member States, as well as the systems used for the settlement of claims and liabilities arising from central bank's monetary policy operations and liquidity providing transactions, are regarded as systemically important settlement systems.

The European System of Central Banks (ESCB) assessed the following systems: the EP RTGS system managed by Eesti Pank and the securities settlement infrastructures, which, more precisely, is an arrangement created in conjunction with international central securities depositories for concluding transactions between Estonia's central bank and commercial banks, as well as the securities settlement system managed by the Estonian Central Depository for Securities (ECSD). According to the ESCB, **all the above-mentioned systems were eligible for the Eurosystem**.

Regarding the RTGS system managed by Eesti Pank, most attention was paid to the legal basis of the system, its compliance with the security requirements of TARGET and the definition of settlement finality in the system's rules. Proceeding from the assessment given by the overseer, Eesti Pank has made or will soon make all appropriate changes. To date, the system's rules that specify more precisely the principles of settlement finality have been approved. The EP RTGS system has been declared to be a settlement system under the scope of the settlement finality directive[7] and has been included on the respective list.

The **arrangement created for transactions with international central securities depositories**

[7] Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems.

was assessed to be compliant with the standards, but prior to its adoption the Governing Council of the European Central Bank must approve it as a possible arrangement to be used as an exception in the Eurosystem. The assessment report suggests two different options. The first implies the continued use of the arrangement created with the international depositories while being a member of the Eurosystem and at the same time maintaining the current domestic securities settlement system. The other option involves the possibility of using the arrangement created with the international depositories while giving up the current domestic securities settlement system, which, according to the report, implies closing down the domestic securities settlement system entirely. Proceeding from the possibility that in the future the settlement of securities compliant with the requirements of the Eurosystem could be performed through the ECSD either independently or proceeding from the consolidation of the companies in the OMX group, Eesti Pank prefers the first option.

Even though Eesti Pank is not currently using the domestic securities settlement system managed by the ECSD to conduct central bank transactions with securities as collateral, at the request of the ESCD the system managed by the ECSD was also assessed. As a member of the Eurosystem the central bank will only use the securities settlement system managed by the ESCD if it settles securities eligible as collateral for Eurosystem credit operations. According to the assessment, the securities settlement system managed by the ECSD is eligible for the Eurosystem, but there are time limits on conducting transactions for securing intraday settlement finality. Furthermore, in order to be fully compliant with the requirements of the Eurosystem, the ECSD must apply ESCB guidelines in risk management and arising from the operational requirements of TARGET.