

V PAYMENT AND SETTLEMENT SYSTEMS

Interbank payment and settlement system

Eesti Pank is managing three interbank settlement systems: the Settlement System of Ordinary Payments (ESTA) for domestic payments, the Real-Time Gross Settlement System (EP RTGS) and TARGET2-Eesti for pan-European euro payments.

Around 99,400 payments a day are settled via the interbank payment and settlement systems at a total value of 11 billion kroons.

Owing to the customer-friendly functionality of the **ESTA** the majority of domestic interbank kroon payments are settled through it: 99,000 payments a day, which comprise 99.6% of total interbank payments (see Figure 1). An average of 1.7 billion kroons a day were settled through the ESTA over the past six months.

Although the number and value of payments started to grow rapidly in September 2008 owing to the unstable financial markets, in the first

quarter this year the general economic decline became apparent also in the field of settlements. The value and number of payments dropped to the level of mid-2007, shrinking 12% year-on-year. The average amount of a payment decreased to 17,000 kroons.

Due to structural changes in the **EP RTGS**, i.e. the introduction of euro payments via TARGET2-Eesti and the decrease of customer transactions, the number of payments settled through the RTGS declined 26% over the year (see Figure 2).

On average, 202 payments per day were settled in the EP RTGS from October 2008 until end-March 2009. The express payments initiated by bank customers comprised 69% of total transfers.

The average value of express payments decreased 9% over the year and amounted to 5.7 billion kroons per day during the past six months. Banks' "compulsory" payments (transactions related to the collateral account of the ESTA) and interbank payments accounted for the largest share of the value with 39% and 30%,

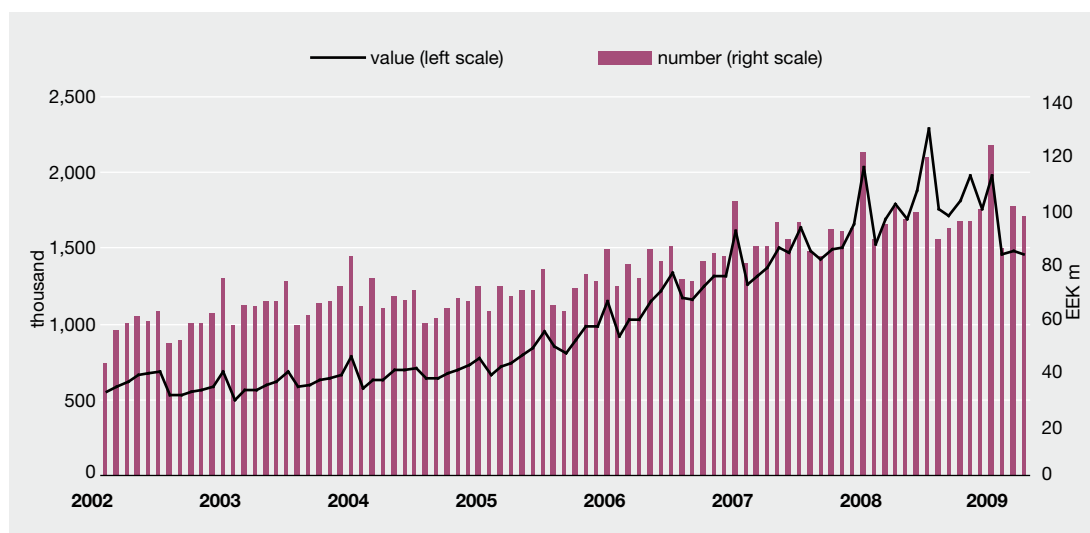


Figure 1. Number of payments processed per day in the ESTA and their average daily value per month

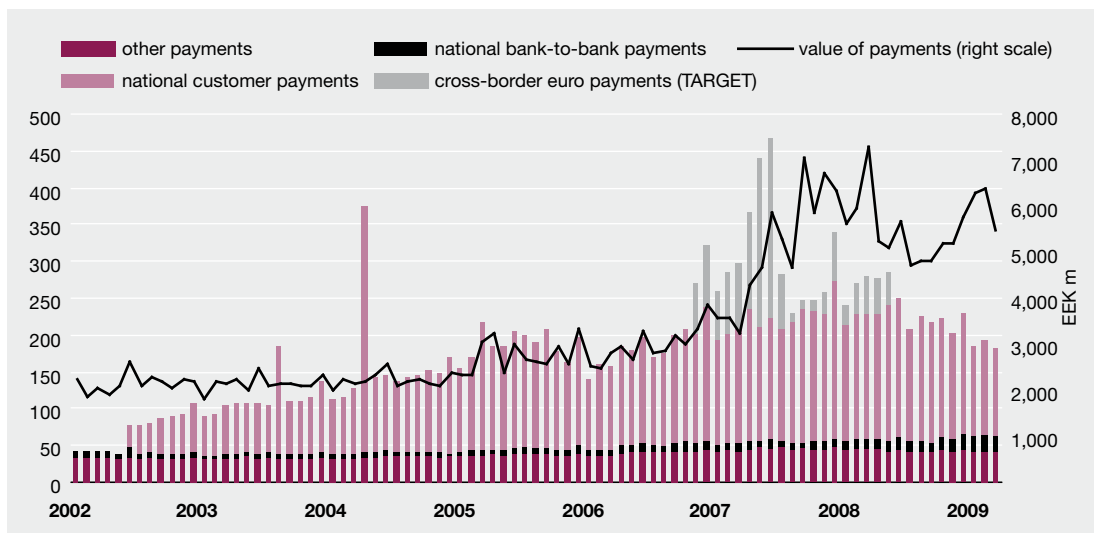


Figure 2. Average number of payments processed per day in the EP RTGS and their average daily value per month

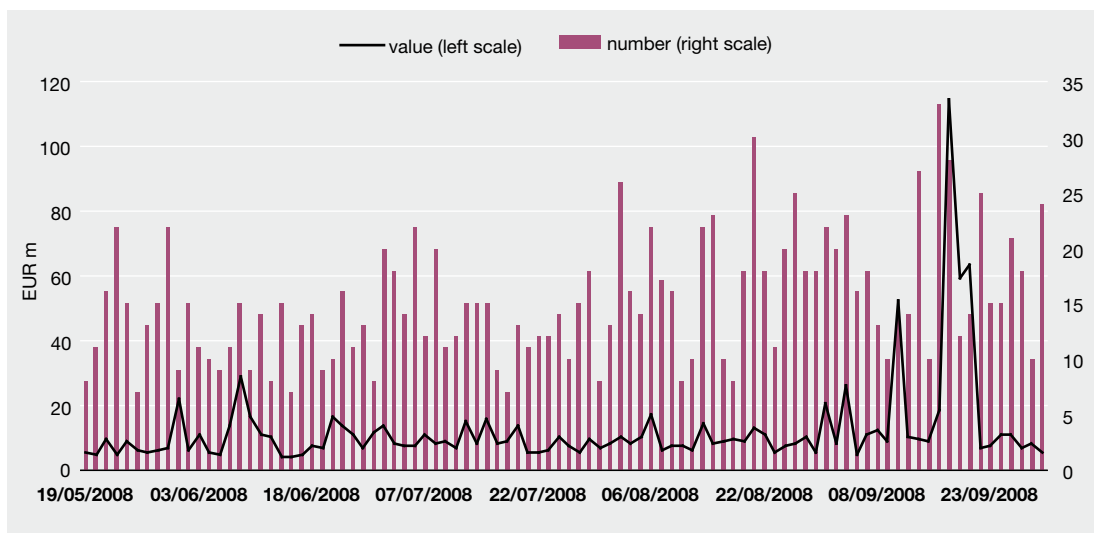


Figure 3. Number of payments processed per day in the TARGET2-Eesti and their daily value

respectively, whereas the latter have increased by 1.75 times. As a result of the stock market decline, the turnover of net settlement liabilities stemming from securities transactions is also on the wane, having shrunk 66% year-on-year.

The cross-border settlement system **TARGET2-Eesti** – the alternative channel for euro payments – gained popularity in the final months

of 2008 (see Figure 3). From October 2008 until March 2009, an average of 68 payments were settled daily at the value of 234.8 million euros (3.7 billion kroons). The banks operating in Estonia received an average of 191 payments per day at the value of 234.8 million euros (3.7 billion kroons) via the TARGET2.

Overseer's assessment of payment and settlement systems

There were no such incidents in the operation of the Estonian payment and settlement systems in the past six months that would have threatened the stability of Estonia's financial sector. The functionality and principles of the systemically important settlement systems operating in Estonia – the TARGET2-Eesti, the EP RTGS and the ESTA – have been structured so as to minimise the materialisation of potential risks.

During the last six months, the EP RTGS encountered one serious failure¹, which interrupted the system's operation for 26 minutes. The reason for the interruption was the installation of the updates of the TurboSwift software. In order to avoid such incidents in the future, the manage-

ment procedures for updates were improved. The availability of interbank payment and settlement systems was 99.94% in the fourth quarter of 2008 and 100% in the first quarter of 2009 (see Figure 4).

The ESTA recorded two serious malfunctions over the past six months. Software errors occurred on 17 October and 15 December, causing an interruption in the operation of the system that lasted for 3 hours and 30 minutes in total. The errors have been eliminated. The availability of the ESTA was 99.44% in the fourth quarter of 2008 and 100% in the first quarter of 2009.

The availability of the TARGET2-Eesti remained at 100% throughout the period under observation.

The malfunctions of the settlement systems did not affect financial stability.

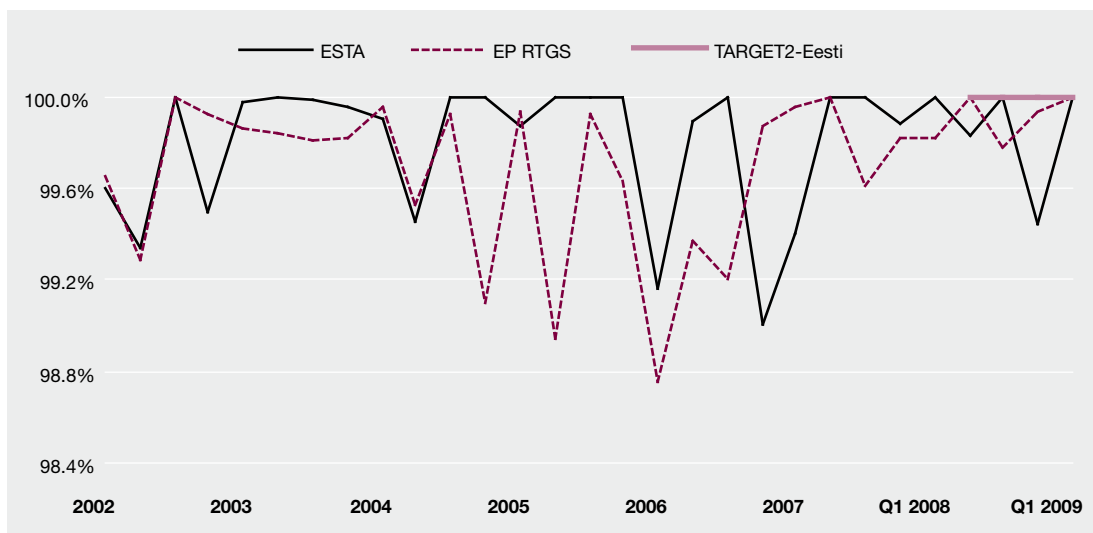


Figure 4. Availability of interbank settlement systems

¹ According to the risk management procedures, a failure is considered serious if the incident involves several system participants or if it entails the application of business continuity or a decrease in the operability of settlement systems.

THE INTEGRATION OF THE PAYMENT ENVIRONMENT OF THE EUROPEAN UNION AND THE DEVELOPMENT OF DIRECT DEBITS

The harmonisation of the principles of the payment systems (e.g. TARGET2) and payment instruments (payment orders and direct debits, cheques, debit and credit cards, etc.) available in various countries forms an important component of the EU integration. Some years ago the payment environments differed significantly across the EU Member States. Payment habits vary primarily because the majority of the solutions for payment environments have so far been designed for domestic markets.

Currently, the **Single Euro Payments Area (SEPA)** is being developed in order to harmonise the European payment systems. The key goal of the SEPA is to eliminate the borders between EU payment environments and increase the level of electronic payments.

To this end, common rules and procedures have been prepared for the three major payment instruments: payment orders, direct debits and card payments. In addition to the different infra-

structure and procedures available in EU countries, another bottleneck of integration is the differences in legislation, which have hindered the harmonisation of direct debit schemes. Thus, finding suitable solutions for direct debit schemes to provide domestic and pan-European direct debiting has become one of the key issues in establishing the Single Euro Payments Area. A new EU directive on payment services has been adopted to eliminate legislative obstacles. EU Member States are expected to transpose the directive into national law by 1 November 2009 at the latest.

Comparing the popularity of direct debits and also the general payment environment in Estonia to that of several other European Union countries, Estonia is highly advanced and electronic. The amount of currency in circulation in Estonia (4.9% of GDP) is relatively smaller than the euro area average (over 6% of GDP). The most popular payment instruments in Estonia include payment orders, card payments and direct debits, comprising 37.8%, 55.3% and 6.8% of total transactions, respectively (see Figure 5). The majority (88%) of payment orders consist of transactions via the Internet and telebank. While cheques are still quite popular in the euro area,

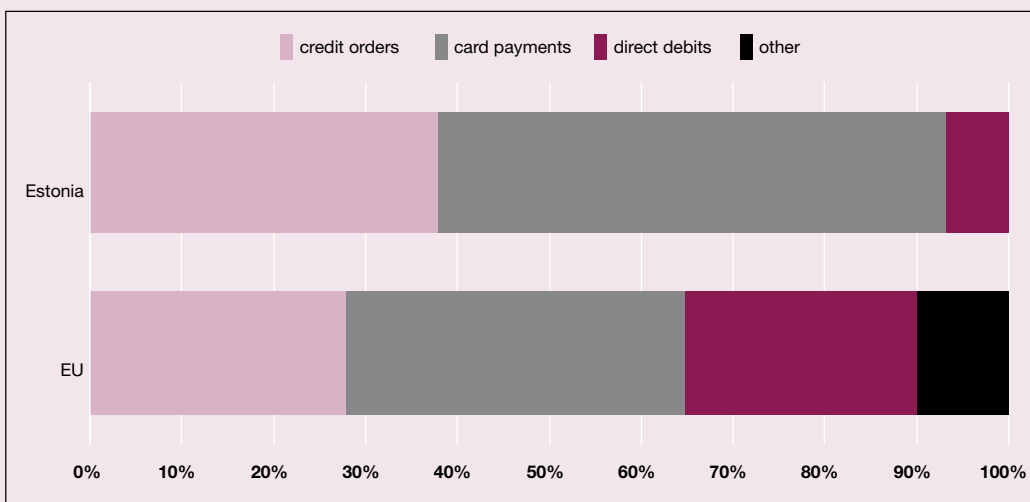


Figure 5. Structure of non-cash payments in Estonia and the EU at end-2007

comprising 8.6% of all non-cash payments, the use of cheques in Estonia is very rare.

In the summer of 2007, the **interbank direct debit infrastructure** was introduced in the Estonian market. It has improved the efficiency of the payment environment and competition in the Estonian banking market. The Estonian national direct debit scheme differs from the SEPA direct debit scheme mainly with respect to the holder of the authorisation. In the current scheme it is the payer who manages and owns the rights over the applications for using direct debit services, but the SEPA scheme favours giving the application management rights to the receiver of payment. In other words, in Estonia payers are entitled to terminate the use of a direct debit service at their own will, but the SEPA requires permission to terminate the contract from receivers.

Based on the data of 2007, direct debits comprised about 6.8% of total non-cash transactions performed in Estonia; in this respect, Estonia was most similar to Finland and Romania (see Figure 6). Growth in the number of direct debits in Estonia has slowed, year-on-year, and their share in total non-cash payments has declined

(6.7% in 2008, see Figure 7). Although the number of direct debits has been growing faster in Estonia compared to the EU average, their share (25%) in total non-cash payments remains nearly four times smaller than in the EU on average.

Direct debits are widely used in Germany, Spain and Austria, where they accounted for over a third of total domestic non-cash payments in 2007. Such vast differences in the use of direct debits have been also caused by the fields where direct debit services are used. Several EU Member States use direct debiting also for loan repayments, which statistically boosts the share of direct debits among total non-cash transactions both in terms of number and amount. In Estonia, loans are repaid by standing orders rather than by direct debits. Neither are the transactions regarding various service fees and interest charges reflected in Estonian payment statistics, which may elsewhere be settled by direct debits, thus increasing their relative importance.

In 2007, direct debits comprised 0.7% of the total value of non-cash domestic payments in Estonia (see Figure 8). The total share of direct debits

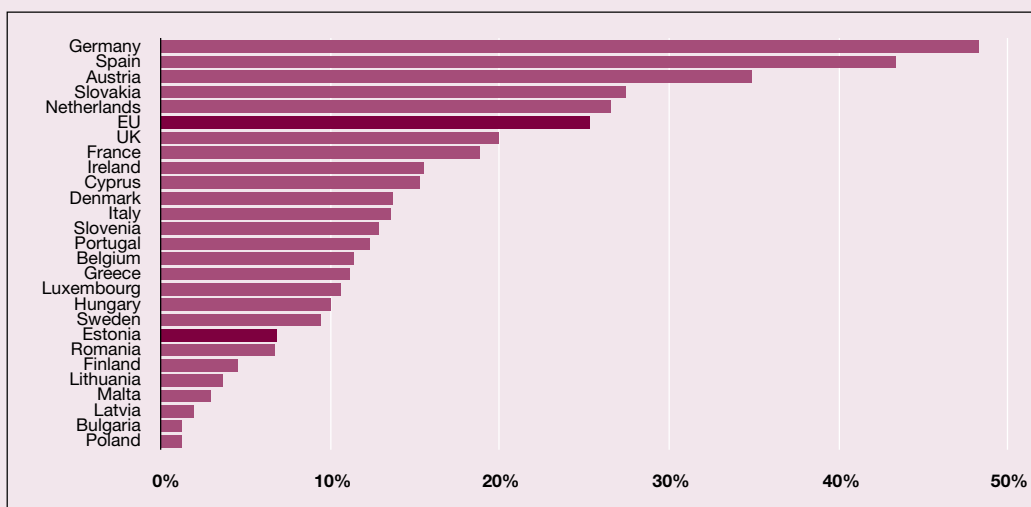


Figure 6. Direct debit payments as a ratio of total domestic non-cash payments in 2007

Source: Blue Book (2008)

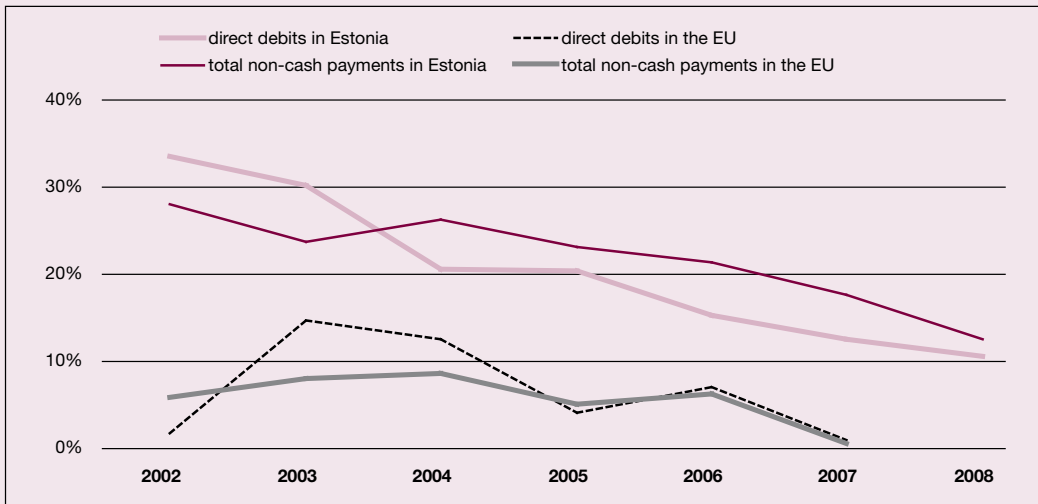


Figure 7. Growth in non-cash payments and direct debits in Estonia and the EU

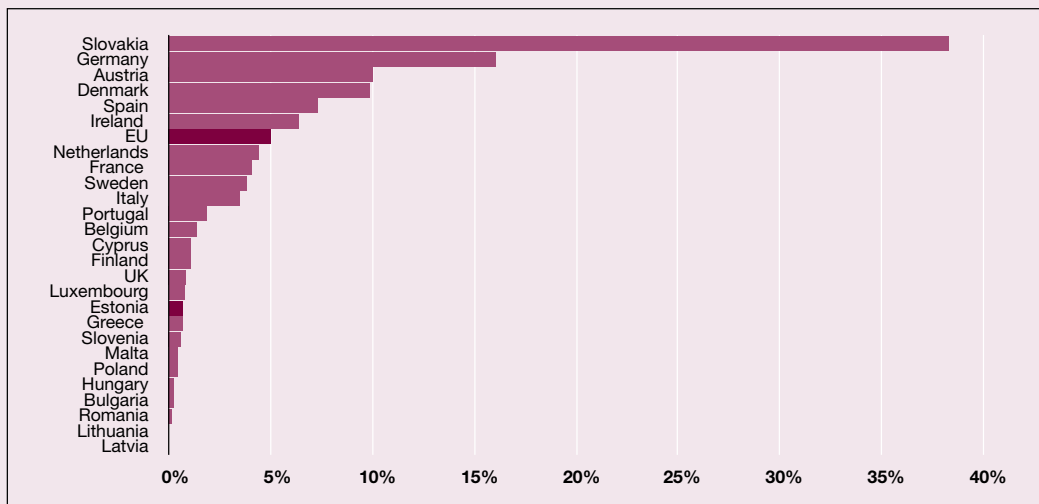


Figure 8. Volume of direct debits as a ratio of total volume of domestic non-cash payments in 2007

Source: Blue Book (2008)

in the European Union was also relatively low, reaching an average of 5%. In terms of number and size of transactions, direct debits are popular in Germany, Spain, Austria and Slovakia. Direct debits are more widespread in Western Europe, where they are mainly used for regular retail payments similarly to Eastern Europe.

Given that the electronic payment environment is highly advanced in Estonia, the market of direct debits has reached a relatively stable

level over the past years. The payment habits of Estonian residents have been shaped by the availability of comfortable and inexpensive services. The integration of the financial sector and pan-European direct debit schemes, but also the integration of the field of the non-financial market, facilitates the appearance of new international companies in the Estonian market that use the direct debit services, which, in turn, may foster a further increase in direct debits in Estonia.