



COUNTRY PROFILE, ESTONIA

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Introduction and Country Background

Estonia is the least populous Baltic state and also has the highest GDP per capita

Key Facts

Capital - Major Cities	Tallinn - Tartu, Narva, Pärnu
Area	45,226 km ²
Population	1.315million (07-2007 estimate)
Languages	Estonian, Russian (25% of inhabitants)
Currency	EUR (euro)
Telephone Code	+372
National / Bank Holidays	2011 1 Jan; 24 Feb; 22Apr; 23-34 Jun; 26 Dec
Bank Hours	9:00 - 17:00 Mon-Fri
Business Hours	9:00 - 19:00 Mon-Fri, 9:00 - 16:00 Sat
Stock Exchange	Tallinn Stock Exchange (NASDAQ OMX Group)
Overall Share Index	OMXT (replaced TALSE Index)

The Estonian economy has been growing at a breakneck speed, with a significantly negative trade balance

Economic Performance

	2004	2005	2006	2007
Exchange Rate - EEK/EUR ¹	15.647	15.647	15.647	15.6466
Exchange Rate - EEK/USD ¹	12.590	12.588	12.475	12.1901
Money Market Rate (%) ¹	2.45	2.32	3.06	4.71
Consumer Inflation (%) ²	3.00	4.10	4.6	3.8
Unemployment Rate (%) ³	9.7	7.9	5.6	4.7
GDP (EEK billions)	141.5	164.9	188.2	210.89
GDP (USD billions) ⁴	11.2	13.1	15.1	17.3
GDP Volume Growth (%) ²	10.5	9.10	9.5	8.0
GDP Per Capita (USD)	8,329	9,747	11,238	12,933
Current Account (% of GDP)	-12.2	-12.9	-12.0	-11.7

Sources: IMF, Statistical Office of Estonia, Central Bank of Estonia, ECB

¹ Period average

² Year on year

³ Per annum (seasons adjusted)

⁴ Per average exchange rate

Estonia joined the EU in 2004 and the current government aims to fully join the EMU as soon as possible

Government

Estonia regained its independence in 1991 from the Soviet Union. The constitution, which came into force in 1992, continued the democratic spirit of the 1920 constitution, with some added mechanisms to maintain the balance of power of the state.

Legislature Regime

Estonia is a parliamentary republic. The Unicameral Parliament (Riigikogu) is the legislative body, which is elected by proportional representation. The Parliament has 101 members and is elected for a period of four years. The last election was held in March 2007.

The executive power of the state - the Government - is responsible to the Parliament. Appointment to the office of the Prime Minister and withdrawal of the Government lies within the competence of the Parliament. The Government also enjoys the right to dismiss the Parliament with the consent of the President and call new elections if the Parliament expresses no confidence in the Government. This has, on several occasions, proved a balancing factor in situations where the wish to dismiss the Government has not been well-founded.

Head of State

Toomas Hendrik Ilves, elected to the post by an electoral college on the 23rd of September 2006. As Estonia is a parliamentary democracy, the President is mainly a symbolic figure and doesn't hold executive power.

Political Leader

Andrus Ansip, Prime Minister since April 2005 and member of the Estonian Reform Party (free market liberalist). His coalition government formed with Estonian Centre Party (populist) and the People's Union of Estonia (agrarian).

European Union

Estonia has been a member of the EU since May 2004. As a new member state of the EU, Estonia has an obligation to adopt the euro. For an open economy like Estonia, which is rapidly catching up to the standard of living in the euro area, a slightly higher inflation rate compared to the euro area is natural and does not pose a threat to price stability. However, the low inflation rate prescribed by the current interpretation of the requirements for the adoption of the euro will not be an easy target for the country. According to Eesti Pank's economic forecast, the introduction of the euro is also unlikely in 2009 and therefore will be postponed to at least 2011.

Banking Environment

Foreign banking groups own the majority of shares in Estonian banks

Overview

Introduction

After Estonia regained its independence in 1991, a significant number of new banks commenced operations - reaching a peak of 42 in 1992 - due in large part to low entry barriers. As the 1990's progressed, the banking environment experienced more change. 1998 saw many changes; several major mergers took place and a number of banks were declared bankrupt and shut down. Additionally, the government privatised all remaining state-owned banks, and today foreign banking groups own the majority of shares in Estonian banks.

Sector Figures

As of December 2009 there are 18 commercial banks operating in Estonia, of which 7 are domestic and 11 are branches of foreign banks. Also, there are 4 representative offices of foreign banks present, 12 savings and loan associations, and 12 insurance companies operating in Estonia.

Recent Years

In 2006 Denmark's Danske Bank Group acquired Finland's Sampo Bank Group, including its subsidiaries in Estonia, Latvia and Lithuania, for approximately EUR 4 billion.

The financial position of the Estonian banking system is strong; the equity capital of banks is substantial and their profitability good. Compared to many other banks in the world, the functioning of the Scandinavian banks has been affected by the financial crisis to a less serious extent. The capital adequacy (which is an indicator of solvency) of Estonian banks is 18%, which exceeds the mandatory minimum value of the EU by more than twice. The rate of the reserve requirement (i.e., the size of the banks' obligatory reserve) applied in Estonia is 15% of the total liabilities of a bank. This is considerably higher than the respective euro area indicator (2%).

Eesti Pank took a number of measures to increase the capital and liquidity buffers of banks already in 2006, when the central bank raised the banks' reserve requirement, i.e., their mandatory liquidity buffer, to 15% of all their liabilities. Eesti Pank also increased the risk weights attributed to housing loans when calculating capital adequacy, due to which in 2007 the amount of banks' mandatory minimum capital rose by approximately a tenth. The average capital adequacy of the banking system is currently 18%.

Sector Wide Agreements

In 2005, the EU reached political agreement on the proposed directive for new capital-adequacy rules, known as Basel II. The directive is to be transposed into national legislation of the member states effective from the beginning of 2007.

The Estonian kroon is the official currency of Estonia

Central Bank

Background

Founded in 1919, Eesti Pank is the Central Bank of Estonia. Its mission is to guarantee price stability in Estonia.

Currency

The Government and Eesti Pank (Central Bank) had planned to join the euro area on January 1, 2007, however, with inflation figures higher than expected, this was not possible. The objective is still to join as soon as possible and the Estonian kroon has participated in the Exchange Rate Mechanism (ERM) 2 since June 2004. The ERM2 is an agreement between a number of EU countries and the European Central Bank (ECB) to keep the rate of the national currency within a fluctuation span of $\pm 15\%$ vis-à-vis an agreed central rate. The central rate in Estonia is 1,564.66 EEK per 100 Euros.

Responsibilities

Its main tasks in carrying out its mission are:

- Participating in the national economic policy through the implementation of an independent monetary policy, consultancy to the government, and international cooperation;
- Ensuring financial stability in Estonia by creating policies for the financial sector and operating well-functioning settlement systems;
- Arranging the circulation of cash in Estonia;
- Making preparations to become one of the policy-makers among other national central banks of the euro area who design the coordinated economic policy and single monetary policy in Europe.

Financial Authorities

The Ministry of Finance is responsible for borrowing and debt management, including relations with the parliament

Ministry of Finance

The main functions of the Ministry of Finance of Estonia are to plan for and supervise the implementation of the Government's macroeconomic, fiscal and economic reform policies. This is carried out by preparing legislation, planning state revenues and expenditures, managing and supervising the state budgetary spending process and preparing a framework for economic policy and development.

The three Government institutions "Tax and Customs Board", "Statistical Office of Estonia" and "Public Procurement Office" all are under the jurisdiction of the Ministry of Finance.

The Central Bank handles administrative tasks, while the Ministry of Finance is responsible for borrowing and debt management, including relations with the parliament.

The Ministry elaborates and implements the state's economic policy and economic development plans in more or less all fields of business

Ministry of Economic Affairs and Communications

The objectives of the Ministry of Economic Affairs and Communications is to create overall conditions for growth in the competitiveness of the Estonian economy and its balanced and vital development through drafting and implementing Estonian economic policy and evaluating its outcomes.

The Ministry of Economic Affairs and Communications elaborates and implements the state's economic policy and economic development plans in more or less all fields of business (Industry, Trade, Housing, Transport etc.)

The Estonian FSA's scope covers the entire financial marketplace

Financial Supervisory Authority

In 2001 The Parliament passed the Financial Supervision Authority Act, for the operation of FSA, which started its activities in 2002 as a result of the merger of the former Banking Supervision, Insurance Supervision Authority and Securities Inspectorate.

The scope of supervisory functions of the agency covers credit institutions, insurance providers, investment funds, pension funds, management companies and principal fields of activity of the above institutions - receipt of deposits, lending, insurance and securities brokerage. The FSA is further responsible for the supervision of the securities market.

The goal of financial supervision as defined in the Financial Supervision Authority Act is to enhance the stability, reliability, transparency and efficiency of the financial sector, to reduce systemic risks and to prevent the abuse of the financial sector for criminal purposes, with a view of protecting the interests of clients and investors by safeguarding their financial resources and thereby supporting the stabil-

ity of the Estonian monetary system.

The Chairman of the Management Board of the Authority is the Minister of Finance and the Members of the Board include representatives of Eesti Pank, the Ministry of Finance and financial sector experts.

The Estonian Bankers' Association represents 12 banks

Estonian Bankers' Association

The Estonian Banking Association (EBA) was founded in 1992. EBA is a full member of the European Banking Federation (FBE) and the European Payments Council (EPC). EBA currently has 12 member banks who represent approximately 98% of Estonian banking sector's assets.

The mission and the primary objective of EBA are to promote the development of banking activities, to improve the banking operations of the member banks and to institute good business practices and ethics.

Legal & Regulatory Issues

The market for financial services is deregulated

Introduction

As such the market for financial transactions is deregulated. However, due to the continued existence of Central Bank reporting requirements for transactions between residents and non-residents, Estonia is not the ideal place for maintaining cash concentration pooling solutions involving non-resident companies.

Under the European Single Market's objective of free movement of capital Estonian Law has undergone strong harmonisation toward the rest of the EU, e.g. within Money Laundering where the law fully conforms to the EU directives.

Residency is gained via established under Estonian law

Resident and Non-Resident Status

A company is considered resident in Estonia if it is established under Estonian law. A permanent establishment (including an Estonian branch) of a foreign entity is considered a resident

Account ownership is independent of residency

Account Ownership

Any type of account can be owned by a resident as well as a non-resident company.

Most cash management practices are allowed

Cash Pooling Regulations

Cash concentration and notional pooling are allowed domestically as well as cross-border. Banks are not allowed to offset their own balances in a notional cash pooling solution. Cash pooling across legal entities within the same group is allowed. Resident and non-resident companies can participate in the same cash pool in Estonia, but Central Bank reporting requirements must be adhered to as well as withholding tax regulations must be observed. Estonian legislation allows for multicurrency cash pooling though it is not widely offered by the banks

A wide variety of account types are available with cross-border payment fees regulated at the EU level

Account Types and Charges

Current accounts can be held in all exchangeable currencies and are offered with or without overdraft limits. EUR accounts are convertible into foreign currency. Interest rates can be fixed using a basic rate of the bank. Account maintenance fees will normally apply but are small and negotiable

Payment Fees

From 1 January 2011 the fee for a cross-border transfer up to €50,000 and a domestic transfer is harmonized due to the transition to EUR as official currency in Estonia. The payer must provide the receiver's International Bank Account number (IBAN) and the receiving bank's Bank Identifier Code (BIC, the SWIFT code). If such information is not provided, or the information is wrong, an additional charge will be

levied.

FX Controls

The Estonian kroon was indirectly pegged to the euro via its participation in the European Rate Mechanism 2. It is the Bank of Estonia's task to issue and enforce foreign exchange regulations. From 1 January 2011 the official currency of Estonia is euro.

Reporting is required for cross-border transactions

Central Bank Reporting Requirements

The Central Bank of Estonia collects statistics on balance of payments on cross-border transactions. All transactions exceeding EUR 50 000 must be reported.

Credit institutions report all transactions made through nostro and vostro accounts which exceeds EUR 10,000 in detail every 15 days to the Central Bank of Estonia, including declared transactions.

Reporting is made on single transactions.

The third EU directive on money laundering has been implemented

Money Laundering

Estonia is member of the Financial Action Task Force (FATF), and has incorporated most of the forty recommendations under Estonian Law.

In November 1998 (in effect since July 1999) Parliament passed the Prevention of Money Laundering Act which is aimed at preventing money or other property obtained through illegal means from being placed within the Estonian financial system. Among other things, the legal act defined the terms of money laundering, credit and financial institutions, regulated the activities of credit and financial institutions in preventing money laundering, provided for the creation of a bureau for collecting data on money laundering under the Ministry of Internal Affairs, as well as organised supervision over credit and financial institutions.

On September 21, 2004, five fuel merchants were convicted for Money Laundering in the Tallinn City Court, establishing a precedent in Estonian court history.

On 18 October 2007, the Estonian government approved a bill designed to implement the Third Directive for presentation to Parliament. The bill provides more detailed regulations for the identification of customers than the present law. Any lawyer, notary, accountant, real estate agent, casino, trust and company service provider receiving a cash payment of more than EUR 15 000 will be subject to the new regulations. Also, they will have to notify the money-laundering information bureau of each transaction involving a cash payment exceeding EUR 32 000.

E-signature legislation is in place

Regulations Applicable for Electronic Transactions

Under the Electronic Signature Act, which entered into force in December 2000,

an electronic signature has the same legal consequences as a handwritten signature if some requirements are met.

An electronic signature and the system of using the electronic signature shall:

- Enable unique identification of the person in whose name the signature is given
- Enable determination of the time at which the signature is given
- Link the electronic signature to data in such a manner that any subsequent change of the date or the meaning thereof is detectable

Market Dominant Banks

There are four large players in the Estonia banking sector

Introduction

The top 5 banks market share measured by total assets (at Q4 2007) are Swedbank (formerly Hansabank) (53%), SEB Eesti Ühispank (23%), Sampo Bank (12%), Nordea (9%) and Eesti Krediitipank (Credit Bank) (1%). The remaining commercial banks each have less than 1% of total assets.

Market Dominant Banks per 31 Dec. 2007

Bank	Assets (USDm)
Swedbank	237,843
SEB	346,778
Sampo Pank ¹	615,159
Nordea	533,243

¹ Part of the Danske Bank Group

Note: Figures are total group consolidated assets in millions USD.

Source: Banks' annual reports.

Swedbank is, measured by assets, the leading bank in Estonia and the Baltic region

Swedbank

Hansapank was established in 1991 in Estonia. In 1996 it expanded to Latvia and then in 1999 to Lithuania. In 1998 Swedish Swedbank purchased 50% of Hansabank shares, and steadily increased its ownership stake overtime, eventually owning 100% of the bank in 2005. Hansabank expanded to Russia in 2005, with the acquired bank later being renamed Swedbank. Following a decision taken by the Swedbank group on 15 September 2008, the Hansabank name will be discontinued in 2009 with all operations rebranded under the Swedbank name.

Swedbank's vision is to be the leading financial institution in the markets where present. With more than 22,000 employees Swedbank serves a total of around 9 million private customers and 500,000 corporate customers in Sweden, Estonia, Latvia and Lithuania. They also have a growing presence in Russia and the Ukraine.

In the Baltic region, the bank serves 5.1 million private customers and 228,000 corporate customers, through 284 branches and 1,287 ATMs. Approximately 2.6 million customers use internet banking. In Estonia the bank's scope of activities cover retail and corporate banking, asset management, investment management, and leasing.

The Swedish banking group, SEB, is the second biggest player in the Baltic region

SEB

SEB is the result of ten banks merging in 1992, and is today the second largest bank in Estonia. The Swedish SEB Group is the majority shareholder, reflected in a name change in 2005.

SEB focuses on the Estonian market, offering full financial services to large, small and medium-sized companies, the public sector and private individuals. Further it offers leasing services in Russia and supports the customers of the SEB Group in investing their assets in Central and Eastern Europe. In Estonia, The bank serves approximately 700,000 customers and operates over 60 branch offices.

SEB serves more than 400,000 corporate customers and institutions and more than five million customers in the Nordic and Baltic countries, Germany, Poland, Russia and the Ukraine and strategic presence through its international network in another ten countries.

SEB has a strong position on the private market in Sweden, Estonia, Latvia and Lithuania and is one of ten banks with nation-wide coverage in Germany. SEB has a total of 600 branch offices in these countries. SEB is represented in some 20 countries, with 20,000 employees, of whom half are found outside Sweden. Approximately 50 percent of SEB's operating profit is generated in markets outside Sweden.

Sampo was acquired by Danske Bank, Denmark's leading bank, late 2006

Sampo Pank in Estonia dates back to 1995 through a non-life insurance subsidiary. Later in 2000 Optiva Bank was acquired and since 2001 the bank has been operating under the name Sampo Pank. In November 2006, the Danske Bank Group acquired Sampo Pank's parent, the Sampo Bank Group, for approximately USD 5 billion in cash. Sampo Bank is Finland's third-largest bank with a market share of 16% and 120 branches; subsidiaries in Estonia, Latvia and Lithuania; and a recently acquired bank in Russia. The transaction also comprised various investment services companies, the most significant of which are Mandatum Asset Management Ltd, Sampo Fund Management Ltd, Mandatum & Co Ltd and Mandatum Stockbrokers Ltd.

Sampo Pank specialises in investment and savings and provides banking services for retail, corporate and institutional customers. Sampo Pank's branches and other service channels also play a central role in offering the investment and savings services of other companies in the Danske Bank Group. Sampo Pank has a network of 24 branches and offices, covering the main industrial and tourist centres of Estonia.

Sampo Bank is a branch of Danske Bank since June 2008.

Measured by total assets, the Danske Bank Group is the largest financial enterprise in Denmark and one of the largest in the Nordic region offering services in banking, insurance, mortgage finance, and asset management. The vision of the Group is "One platform - exceptional brands" and its mission is to be "the best local financial partner". In total, the Group serves 5 million retail customers and a large number of public sector and institutional organisations. Some 2 million customers use the Bank's online services in Scandinavia, and the isle of Ireland.

The Nordic's leading bank, with a smaller presence in the Baltic states

Nordea

Nordea opened its first branch office in Estonia under the name of Merita Bank (based in Finland) in 1995. Today Nordea in Estonia is a branch of Nordea Bank Finland, which is a part of Nordea Bank AB (the parent bank of the Nordea Group). Nordea Bank AB also includes banks in Denmark, Norway and Sweden, plus insurance companies and subsidiaries that deal with leasing, real estate, and securities services. The group operates three business areas: Nordic Banking, Banking & Capital Market Products, and Savings & Life Products (asset management, insurance and pension products).

Nordea Bank Estonia belongs to the Retail Banking Poland and Baltic countries. The group's subsidiary bank in Poland is Nordea Bank Polska. Nordea Bank Latvia Branch has been in operation since 1998, and a Lithuania branch was opened in 2000.

The bank's largest shareholder, the Swedish state, is expected to sell its 20% stake in 2008 putting the bank in play for either a Nordic or European acquisition. Furthermore, the Sampo Group owns 10% of the bank following its sale of its banking operations to Danske Bank.

Clearing Systems

Three interbank settlement systems are in operation in Estonia; there are no local bilateral or multilateral systems

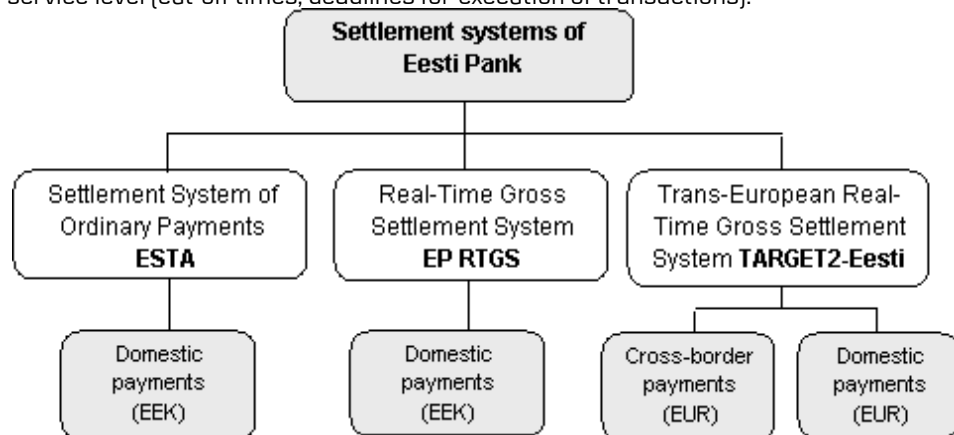
Overview

There are two main interbank payment systems used in Estonia – TARGET2 and ESTA. Estonia migrated to the pan-European TARGET2 RTGS system on 19 May 2008 for large-value and urgent payments in EUR.

Eesti Pank operates the ESTA retail payment system, a multilateral net settlement system, which is a modified version of the former Designated-Time Net Settlement System (DNS). ESTA allow the banks use the IBAN instead of the domestic account number in payment orders.

The Estonian Post Office operates a closed retail payment system, processing payments between its own account holders.

Estonia does not have any alternative local bilateral or multilateral system. This means that all banks in Estonia can participate in the aforementioned settlement systems and all banks have possibilities to offer customers domestic payment service in the same service level (cut-off times, deadlines for execution of transactions).



Eesti Pank acceded to TARGET2 on 19 May 2008

TARGET2

The pan-European RTGS system, TARGET, migrated to a single shared platform (SSP) called TARGET2 making the 16 decentralised RTGS systems of individual Eurosystem countries and the ECB's payment mechanism (EPM) obsolete. The changeover took place in three migration waves, starting 19 November 2007 and ending 19 May 2008. Eesti Pank acceded to TARGET2 in the third wave on 19 May 2008 with Denmark, the ECB, Greece, Italy and Poland. The Swedish Central Bank and the Bank of England did not migrate to TARGET2.

Eesti Pank (the Central Bank) does not offer a commercial banks gateway to TARGET2. Banks in Estonia therefore have to participate directly or find another agent (for indirect participation).

- Participation: options include direct and indirect participation, “addressable BICs” and “multi-addressee access” to the system, also known as “technical BIC access”. Direct participation criteria for TARGET2 is the same as previously for TARGET. Only supervised credit institutions established within the EEA can become indirect participants.
- Transaction types: focus on large-value payments related to inter-bank operations
- Price indication: between €0.125 and €0.80 depending on type of participation.
- Operating hours: the operational day in TARGET2 is be longer than that of the current TARGET system. TARGET2 starts the new business day on the evening of the previous day. The night-time window is be available from 19:30 to 6:45 the next day, with a technical maintenance period of three hours between 22:00-01:00. Daytime hours for customer payments 07:00-17:00 CET with the day ending at 18:00 + 30 minutes for the use of standing facilities on the last day of a minimum reserve period.
- Transaction details: Direct participation: For the exchange of payments information, TARGET2 uses the SWIFTNet FIN service, while the SWIFTNet services “InterAct”, “Browse” and “FileAct” are used for information and control services.

ESTA issued for processing batch payments of ordinary credit-type payment orders

Low Value / Net Clearing – ESTA

The Settlement System of Ordinary Payments, known colloquially as ESTA, in operation since 3 October 2005, operates based on a fixed time schedule and is used for processing batch payments of ordinary credit-type payment orders of the participants. In order to settle the batch payments, the ESTA uses cash collaterals deposited by each participant (the cash collateral of the payer is decreased and the cash collateral of the payees is increased, respectively).

- Participants: at 1 June 2008 there were 13 direct participants in ESTA, comprising five credit institutions, six branches of foreign banks, the ECSD and Eesti Pank.
- Transaction types: Batch payments of ordinary credit-type payment orders
- Price indication: To ensure equal treatment of participants with both a small and a large quantity of payments, Eesti Pank, as the system manager, has imposed an entrance fee of €6,391.00 and a fixed fee for payment settlement of €0.03
- Operating hours: 8:15 to 18:00 during which the system immediately processes payments based on batches of payment orders sent by participants using their cash collaterals, if the payer has sufficient funds to have it done.
- Clearing cycle details: System participants are notified of the incoming payment orders ten times a day - on every hour from 9:00 to 18:00. Such notifications include only reports on payment orders sent to the specific participant during the last settlement period.

In order to participate in the operation of ESTA on a specific banking day, each member of the system must establish their debit cap by 8:15 a.m., by transferring a respective amount of funds (cash collateral) from its account with Eesti Pank into the account of the ESTA manager. The cash collateral should be at least equal to

the minimum cash collateral, i.e. minimum debit cap determined by the manager of ESTA (Eesti Pank). At the end of the day, after 6:00 p.m., the ESTA manager returns the balance of the cash collateral into the participant's account with Eesti Pank.

Payments & Collections Methods & Instruments

Electronic means of payments are dominant in Estonia

Introduction

Cash is losing its status as the dominant form of payment in Estonia. A breakthrough for payments made via banks compared with other payment options occurred in 2002, when, for the first time, more than half of regular payments were made through banks.

Instead of less efficient payment instruments, such as telebank and paper-based credit orders, Internet banking and debit orders are used. Non-cash payment instruments have significantly larger volumes than cash payments in Estonian banking areas. In 2006, a half a million cash payments were processed while non-cash payment volume in the same period was well over 201 million.

The table clearly illustrates the still ongoing shift towards electronic transfers, card transactions and direct debits. Credit transfers account for the vast majority of the payments, in value terms. Also in value terms, direct debits continue to see strong growth. In volume terms, card payments, particularly debit cards, are dominant.

Banks in Estonia have been implementing SEPA (Single Euro Payments Area) standards for EUR-denominated payments. The country's banks now only issue SEPA-compliant debit cards (since 1 January 2008) and also now offer pan-European SEPA credit transfers (since 28 January 2008). SEPA direct debits however will not be available until 1 November 2009 at the earliest.

Volume of Transactions (millions)

	2004	2005	2006	% change
Card payments	60.17	81.88	106.76	30.4
Debit cards	53.18	73.99	96.37	30.3
Credit cards	6.99	7.89	10.39	31.7
Credit transfers	63.98	71.30	79.81	11.9
Direct debits	10.34	12.44	14.34	15.2
Cheques	0.03	0.02	0.014	-41.7
Other	0.007	0.006	0.007	16.7
Total	134.52	165.64	200.92	21.3

Value of Transactions (EEK billions)

	2004	2005	2006	% change
Card payments	14.65	20.59	29.97	45.6
Debit cards	11.61	16.93	24.64	45.5
Credit cards	3.04	3.66	5.34	45.9
Credit transfers	1,063	1,416	1,985	40.2
Direct debits	4.34	7.11	15.68	120.5
Cheques	0.219	0.221	0.168	-24.0
Other	0.430	0.420	0.561	33.6
Total	1,082	1,444	2,030	40.6

Note: Percentage change calculated from 2005-2006

Sources: ECB Statistical Data Warehouse

Card payments popularity is steadily increasing

Card Payments

Among the non-cash payment instruments, the popularity of cards has increased significantly in Estonia. As of end-June 2008, Estonian credit institutions had issued 1.8 million cards with a payment function, although some 35% are non-active. 1.36 million were debit cards and more than 445,000 were credit cards.. Debit cards issued consist exclusively of either Cirrus/Maestro debit cards or Visa Electron debit cards. Further, Visa and MasterCard are both in use as credit cards in Estonia.

Along with the growth in the number of bank cards, the possibilities for their use also increased. The number of automated teller machines (ATMs) as of end-June 2008 was 998, and 23,252 point-of-sale (POS) terminals are located in the country. More than 86% of ATMs accept most widespread international bank cards issued by credit institutions worldwide.

16.3 million card transactions were processed from residents with a turnover of more than 653 million euro in June 2007.

Credit transfer is the dominant payment instrument in both volume and value terms

Credit Transfers

Credit transfer is the dominant payment instrument in Estonia in both volume and value terms. Business to business transactions are almost exclusively executed as credit transfers, as many companies initiate payments via their own ERP-system, and send the payment requests directly to the bank in batches.

The maximum payment execution time allowed by the regulations of the Bank of Estonia is +1. Current market practice is that all payments initiated before cut-off time (mostly banks have the cut-off time for domestic payments around 16:00 CET and for book transfers around 20:00 CET) are executed with same day value. It means that in general, the beneficiary receives the money on the same day the payment was initiated.

In 2007 the banks launched a new service allowing customers to make domestic direct debit payments across banks

Direct Debits

The use and limitations of the direct debit have to be previously agreed upon by the payer and the beneficiary. Direct debits expenses in Estonia are borne by the beneficiary's account, service is free for the debtor.

On the Estonian non-cash payment instruments market, direct debit is still a novelty and its share is small as compared to the credit order, for example. The vast majority of direct debits are transferred from private accounts.

In June 2007, banks launched a new service allowing customers to make domestic direct debit payments even if the remitter and beneficiary's accounts are at different banks. The service was designed for companies who wish to receive direct debit payments from customers who hold current accounts at different banks, without entering into contractual relations with all of the banks where customers have opened current accounts. For consumers, this means that they will in the future be able to pay invoices to all companies who settle accounts using direct debiting, regardless of which financial institution they bank with.

Cheque usage is marginal

Cheques

Payment cheques have never played an important role in the payment instrument market within Estonia. However, there is a certain small group of people who prefer this way of payment.

Electronic Banking

Many banking services have over the years been migrated to the internet

Introduction

In recent years a plethora of banking services suited for electronic processing has been migrated to the internet. There are no country-wide standards or any multi-banks offerings on the Estonian market.

People are used to use the internet for banking:

- 90% of customers have electronic banking agreement
- 98 % of the local payments are submitted via electronic channels
- 85% of tax declarations are delivered electronically
- Salaries, pensions and social/welfare benefits are mostly paid directly to people's accounts

EBS are based on the banks own proprietary formats

General Functionality of EBS Offerings

Most banks have shifted the focus from PC based electronic banking systems to web-based platforms. The services offered through the World Wide Web include payment transactions, account information, inter-company netting solutions, FX dealings and information etc. (in quasi real-time). Majority EBS support Estonian, Russian and English language. A number of banks still offer simpler base services via PC-based tools.

Electronic Banking Systems are offered based on the banks own proprietary formats.

Foreign owned banks support host-host solutions

EDIFACT / Host-to-Host Solutions

For payment handling is in use two market practises formats. Most banks and ERP-systems providers support both local formats, EDIFACT is not supported. (Many banks start develop Nordic xml formats support)

The corporations growing effort of streamlining payment processing is primarily supported by the banks with foreign ownership, as the demand for the most part comes from corporates with headquarters outside Estonia. Host-to-host solutions are provided for domestic as well as international payments.

E-payments and e-invoices are not that widespread

E-payments and E-invoice / EBPP

E-payments and E-invoices are emerging in the Estonian marketplace, both as B2B and B2C services. Paperless billing has witnessed very good growth. In summer 2007 e-bills comprised 11% of all private bills and are expected to account for 20% by year-end 2008. B2B e-invoices are in particular an emerging service.

For e-payments, many banks provide a service that allows immediate and secure payment for goods bought on the internet. A similar solution is provided to electronic identify clients.

Cash Pooling Solutions

Central Bank reporting requirements make Estonia a less attractive environment for pooling

Introduction

Cash pooling solutions offered are influenced by the fact that banks cannot set off their credit and debit balances for capital adequacy ratio purposes.

Foreign banks, primarily Nordic, which have entered the Estonian market by purchasing large share holdings, have however pushed the use of cash pooling in recent years.

The Central Bank's reporting requirements however, make Estonia a less attractive environment for pooling of resident and non-resident cash balances.

Various notional pooling solutions are available

Notional Pooling

A notional cash pool has been developed by many banks in the region using the framework of the European cash pool, which is based on the notional consolidation of group account balances in single or multi currencies. The conversion from local currency to the euro is done without a large expenditure because the Estonian kroon, like it's Baltic neighbours' currencies, is pegged to the euro. E-banking tools provide the possibility of applying limits to group account balances and the easy distribution of funds, which ensures that money is moved quickly to the place where it is most needed. Of course, no actual transactions are involved in this process.

Banks are now also offering interest compensation pooling as an alternative to notional cash pooling because it is less complicated. The bank takes all of a company's same-currency accounts and joins them together in a collective pool.

Nordic owned banks offer cash concentration

Cash Concentration

Cash concentration is allowed and available as both single legal account pooling - balance netting - and zero and target balancing solutions. It is primarily the banks with Nordic ownership that offer these solutions.

Multicurrency cash pooling is not common

Multicurrency and Cross Border Pooling

On a cross-border basis notional as well as cash concentrating pooling schemes are offered. However, the primary tool for pooling continues to be the sweeping and funding of cash across borders.

Cash pooling solutions across currencies are usually not part of the services offered by the banks. However, one or two of the more sophisticated banks (owned or dominated by Nordic banks) do offer such solutions, domestically as well as cross-border, as interest compensation / enhancement solutions.

Tax Issues

Tax information is general and individual advice should be sought

Introduction

The following tax information, last updated by PricewaterhouseCoopers in November 2008, should be considered general and individual advice should always be sought.

Resident companies are subject to tax on their worldwide income

Tax Liability

A company is considered resident in Estonia for tax purposes if it is established under Estonian law. A permanent establishment (including an Estonian branch) of a foreign entity is deemed to be a non-resident taxpayer. Resident companies are subject to tax on their worldwide income whereas non-resident companies are limited liable to tax on Estonian source income only.

For corporate tax purposes Estonian general and limited partnerships are treated as companies and not as transparent entities.

Under certain circumstances, foreign entities without legal status may be classified as transparent entities for Estonian tax purposes.

Estonian companies qualify for benefits under EC Directives and Estonia's tax treaties.

Estonia has no local income tax

Tax Base

The Estonian Income Tax Law, effective from 1 January 2000, provides exemption from income tax on undistributed corporate profits but imposes tax on all distributions (both actual and deemed), including dividends and other profit distributions, fringe benefits, gifts, donations, and representation expenses, as well as expenses and payments not related to business. All corporate income is tax exempt when earned. This includes both active (e.g. trading) and passive (e.g. dividends, interest, royalties) income, as well as capital gains from the sale of all types of assets, including shares, securities and immovable property.

Dividends distributed by Estonian resident companies in 2008 are subject to 21/79 deferred corporate income tax at the level of the distributing company. It is expected that from 2010 the income tax rate will be gradually reduced by 1% per year to 18/82 by 2012.

Estonia has no annual net basis taxation of corporate profits, which means that companies are not subject to tax depreciation or loss carry forward rules.

The tax period is a calendar month. The tax return for income subject to 21/79 income tax or any withholding tax must be submitted by the 10th day following the month during which the payment was made or the taxable expense was incurred.

Estonian companies and permanent establishments of foreign companies are not required to submit annual income tax returns.

Income tax must also be remitted to the local Tax and Customs authorities by the 10th day of the month following a taxable distribution, payment or taxable expense.

Generally, all companies and permanent establishments (including branches) are subject to the same tax rules.

Estonia has no local income taxes.

Until recently, the existing Estonian corporate taxation system was believed not to be fully in line with EC Parent-Subsidiary Directive (90/435/EEC) and in the EU Accession Treaty Estonia was granted a transitional period ending on 31.12.2008 to amend its present corporate taxation system. However, the ECJ's new favourable interpretation of withholding tax under the EC Parent-Subsidiary Directive in the recent judgement on Burda case (C 284/06) is understood to legitimize the Estonian corporate taxation system. Therefore the new draft law currently pending in the Parliament is expected to introduce certain amendments from 2009, but no fundamental changes to the Estonian corporate taxation system are foreseen.

Group tax consolidation is not available

Tax Consolidation

No group taxation concept exists in Estonia for corporate income tax purposes.

Under the EU accession treaty, Estonia may apply its corporate tax on dividend distributions until 31 December 2008, after which the Estonian corporate tax system must fully comply with the Parent-Subsidiary Directive

Inbound and Outbound Taxation of Dividends

Dividends between Estonian resident companies are subject to 21/79 income tax at the level of the distributing company. In order to avoid the double taxation of dividends, Estonian companies are entitled to an exemption from the corporate tax on dividends received from other domestic companies. Such exemption, however, is only granted when dividends are received from domestic subsidiaries where the dividend-receiving company holds at least 15% of the share capital or voting rights at the time of distribution. The 15% threshold is expected to be reduced to 10% from year 2009.

Distributions from EEA or Swiss resident companies that are subject to tax are fully exempt from Estonian 21/79 income tax if these profits are paid out of dividends received from qualifying participation, i.e. at least 15% holding in the share capital or voting rights; or dividends are paid on account of profits attributed to permanent establishment(s) located in EEA or Switzerland. The 15% threshold is expected to be reduced to 10% from year 2009. Distributions from foreign companies (other than EEA or Switzerland resident companies) are fully exempt from Estonian 21/79 income tax if these profits are paid out of dividends received from qualifying participations, i.e. at least 15% holding (from 2009 is expected to be reduced to 10%) in the share capital or voting rights provided that the underlying profits have been subject to foreign tax or the dividends paid to Estonian company were subject to foreign withholding tax; or dividends are paid on account of profits attributed to permanent establishment(s) located in the foreign territory and the

profits have been subject to foreign tax.

No separate capital gains tax is imposed in Estonia

Taxation of Capital Gains and Losses on Shares, Bonds, Debts, Receivables and Financial Contracts

No separate capital gains tax is imposed in Estonia. Capital gains are taxed as ordinary income. Gains derived by resident companies are not subject to tax until further distributions are made (or deemed made).

Estonian CFC rules do not apply to Estonian companies

CFC Taxation

Estonian CFC rules do not apply to Estonian companies, but only to resident individuals who have certain participations in legal entities located in low tax jurisdictions which are not included on the Estonian “white list”.

Withholding taxes of up to 22% can apply

Withholding Tax

Estonia has exempted from withholding tax all dividends paid to non-resident individuals regardless of the level of their participation in the Estonian company. Under domestic law, the 21% withholding tax applies to dividends paid to non-resident legal entities which own less than 15% of the capital or voting power in the Estonian company. The threshold is expected to be reduced to 10% from 2009. Also, a 21% withholding tax applies to all dividends paid to legal entities located in low-tax territories, regardless of their participation in the Estonian company.

Estonia has exempted any interest paid to non-residents (regardless of whether related party or not) from tax, unless the interest significantly exceeds the arm's-length interest payable on similar loans when undertaking and repaying the loan. The 21% Estonian withholding tax on interest is only applied to the part of interest significantly exceeding the arm's-length level.

Royalties paid to resident individuals are taxed at a rate of 21% and to non-residents at a rate of 15%. From 1 May 2004, in order to comply with the Interest and Royalties Directive (2003/49/EC), Estonia has also exempted certain royalty payments from the 15% withholding tax. No withholding tax is applicable on royalty payments to directly associated EU/Swiss companies that qualify for the 2-years holding period requirement. This means that no withholding tax is applied on royalty payments to EU/Swiss companies that own at the time of payment and during the period of at least two years immediately preceding the payment at least 25% of the share capital in the paying Estonian company or the Estonian company owns at least 25% of the share capital in the recipient company or a third EU/Swiss company holds at least 25% of the share capital in the recipient and the distributing company.

Rental payments to non-residents and resident individuals are taxed at a rate of 21%. However, payments for the use of industrial, commercial or scientific equipment (deemed as royalties) to non-residents are subject to 15% withholding tax.

Payments to non-residents for services provided in Estonia, including management and consultancy fees, are subject to withholding tax under the domestic law at a rate of 15% but an exemption may be available under double tax treaties. All payments to entities in low-tax jurisdictions are subject to 21% withholding tax, irrespective of where the services were provided.

Transfer pricing must be on arm's length terms

Transfer Pricing and Thin Capitalisation

From 1 January 2007 Estonia has introduced transfer pricing rules and documentation requirements. Transactions between related parties (both resident and non-resident) and between a head office and its permanent establishment(s) should be conducted on arm's-length terms. Transfer pricing adjustments are treated as deemed profit distributions, which should be declared on a monthly basis and which are subject to 21/79 corporate income tax in 2008. Five transfer pricing methods are accepted according to the regulation: comparable uncontrolled price, resale price, cost plus, profit split and transactional net margin method. Estonia has also introduced special transfer pricing documentation requirements for certain taxpayers in line with the EU Transfer Pricing Documentation Code of Conduct.

Estonia has no thin capitalization rules.

There are no capital or stamp duties

Capital or Stamp Duties

Estonia has no capital, transfer or stamp duties. However, state fee and notary fee are payable in relation to the formation of an Estonian company or registration of an Estonian branch of a foreign company. The state fee is generally payable at EEK 2200 (approx. EUR 140) but EEK 2900 (approx. EUR 185) in case of expedited proceedings which enable a company formation within 2-3 hours.

The notary fee payable in relation to the establishment of a company depends on the amount of the registered share capital and is calculated according to a fixed fee schedule established in the Notary Fees Act.

The standard VAT rate is 18%

VAT and Payroll Duty

A new VAT Act in accordance with the principles of EU Directives is effective from 1 May 2004. The following transactions are subject to Estonian VAT:

taxable supplies of goods and services (the place of supply is Estonia);

- taxable imports of goods; and
- taxable intra-Community acquisitions of goods.

The standard VAT rate is 18%. The 5% reduced rate applies to books, most periodicals, hotel accommodation services, certain listed medicines and medical equipment and the treatment of hazardous waste. It is expected that from 2009 the reduced rate will be increased to 9% and will be applied only to books, periodicals, hotel accommodation, and listed medicines and medical equipment. The VAT rate on the export of goods and certain services is 0% (i.e. exemption with credit).

Some supplies are exempt (i.e. exemption without credit), such as medical services, certain financial transactions and insurance.

If the taxable supply of the Estonian company or the permanent establishment of the foreign company in Estonia exceeds EEK 250,000 (EUR 15,978) in a year, VAT registration is required. Voluntary registration is also possible.

The VAT taxation period is a calendar month, and the VAT should be declared and paid on or before the 20th day of the following month.

In 2007, the employment income is subject to withholding tax at 22% by the Estonian registered employer

Employer Obligations – Tax and Social Security Withholdings

The employment income is subject to withholding tax at 21% by the Estonian registered employer. In case of a resident employee's principal place of employment, the monthly tax-exempt personal allowance (which is EEK 2,250) may be taken into account for withholding purposes. It is expected that from 2010 the flat individual income tax rate will be gradually reduced to 18% (1% per year) by 2012.

Fringe benefits are subject to an exceptional tax treatment in Estonia. A local employer has the obligation to pay income and social tax (on a grossed-up basis) on fringe benefits provided. Fringe benefits received by a resident employee from a local employer are not included in the employee's taxable income.

An Estonian registered employer has the obligation to remit the withheld amount of income tax as well as social security contributions (33% social tax and unemployment insurance contributions, the rates of which in 2008 are 0.3% for the employer and 0.6% for the employee) and 2% compulsory accumulative pension contributions (if any) to the local Tax and Customs Authorities at the latest by the 10th day of the month following payment.

Source and Contacts

Sources used for this country profile

Sources

Bank of Estonia	www.eestipank.info
Hansabank	www.hansa.ee
Estonian Banking Association	www.pangaliit.ee
Card Centre of Banks	www.estcard.ee
Tallinn Stock Exchange	www.ee.omxgroup.com
Ministry of Finance	www.fin.ee
Ministry of Economic Affairs and Communications	www.mkm.ee
The Estonian Financial Supervisory Authority	www.fi.ee
Statistical Office of Estonia	www.stat.ee
Estonian Chamber of Commerce and Industry	www.koda.ee
Enterprise Estonia	www.eas.ee

Contact Danske Bank for cash management services

Danske Bank Contacts

See www.danskebank.com/corporate for contact persons.

Tax information provided by PricewaterhouseCoopers

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