

## EXECUTIVE SUMMARY OF THE REPORT ON PAYMENT SYSTEMS 2013

**The MNB strives to make the infrastructure of electronic payments accessible to the broadest possible groups of society and to promote the extensive use of cashless payment instruments**

**The effects of the financial transaction tax can be evaluated only in the longer term; nevertheless, payment service providers increasingly orient their clients towards electronic payment services**

**The introduction of intraday clearing in the ICS (Interbank Clearing System) was one of the most momentous payment-related projects in the past years in Hungary, bringing about numerous benefits for clients**

**The payment audits of the MNB completed after the introduction of intraday clearing in the ICS confirmed**

The more extensive use of electronic payment instruments may have a number of positive effects on the Hungarian economy. It may help in reducing the resource requirement of transactions and in repressing the shadow economy, which may in turn have a beneficial effect on economic growth. The widespread use of electronic payment solutions requires broad access to the electronic payment infrastructure and payment instruments. As an indication of the importance of the subject, the European Commission has recently proposed a directive on access to payment accounts. In addition to ensuring access, appropriate incentives must be put in place to make the choice between payment methods more efficient. The achievement of these objectives necessitates intervention in several areas because market participants on their own initiative may not necessarily make the required improvements in the short term. A less cash intensive economy may reduce financial exclusion and it may also promote the development of financial literacy.

The financial transaction tax covers a wide range of payment transactions but the effect of the tax on domestic payments is influenced by the way payment service providers pass through the tax to their clients. As clients adjust gradually, the effect can be assessed with any accuracy only in the longer term. The spring ad hoc survey of the MNB reveals that the majority of payment service providers pass through the cost increase caused by the tax to their retail and corporate clients in some way. From the payments' efficiency perspective, it is a favourable development that, reflecting the structure of the tax, service providers tend to steer their retail clients towards electronic payment services more vigorously. The effect of the transaction tax may be more complex in the case of corporate clients, thus the possibility to determine accurately the exact rate and structure of the pass-through is rather limited. The structure of the tax could be revised to promote the growth of cashless payments even more. Changes may include increasing the relative difference between cash withdrawals and electronic transactions and the abolition of the cap on the taxable amount of cash withdrawals.

The MNB survey indicates that the introduction of the intraday clearing is widely known among Hungarian consumers. The launch of intraday clearing has accelerated the execution of retail payments as in the case of credit transfers submitted electronically, the maximum time between the debiting of the account of the payer and the crediting of the account of the payee's payment service provider may not exceed four hours. This is the time limit specified in the MNB decree, but in reality, transactions are typically cleared and settled within 1 to 2 hours. This means that, in contrast with the one-day time lag in the overnight clearing, the payer does not lose one day's interest income and the payee can transfer the funds received on the same day. Despite the substantial system development and the loss of the interest (float) income, credit institutions only raised the fees slightly for electronically submitted credit transfers.

The MNB decree on execution of payments specifies the so-called four-hour rule for the clearing and settlement of electronically submitted credit transfers. The payment audits of the MNB reveal that the examined credit institutions have set up compliant procedures overall. Apart from an

**that payment service providers broadly comply with the four-hour time limit**

**A county-level programme has been launched to expand the payment card acceptance network while nation-wide POS network growth requires government intervention**

**The MNB considers it necessary that the proposed legislation on interchange fees enters into force on 1 January 2014**

**To promote the re-routing of regular payment transactions to electronic channels on a large scale, differentiated pricing of the available payment methods must be introduced and interoperability between service providers facilitating electronic bill presentment and payment must be assured**

occasional exception or two, no breach of the four-hour rule was encountered. The introduction of intraday clearing had a beneficial effect on other payment procedures as well because, due to the five intraday clearing cycles of the ICS, credit institutions must assure their operation until the end of the fifth cycle on each working day of the week. In many cases this has resulted in longer business hours, thus the frequency of non-compliance found in previous audits due to early close of business has also decreased.

Upon the initiative of the MNB a county-level programme will be launched in mid-2013 with the participation and funding of market participants to make the card payment method available at the largest possible number of merchants in the chosen county. However, the re-channelling of retail transactions to electronic means on a large scale requires a major expansion of the payment card acceptance network, which calls for government involvement. In addition to providing financing and coordinating implementation, the government must also play a part in the growth of cashless payments through its regulatory role. For instance, following a number of international examples, the use of cash in retail transactions should be gradually restricted, and simultaneously an obligation to offer electronic payment facilities should be introduced step by step.

The regulation of interchange fees proposed by the MNB, the GVH (Hungarian Competition Authority) and the MNE (Ministry for National Economy) would reduce the cost of merchants relating to the acceptance of cards, thereby contributing to the promotion of card use based on the cooperation of payment service providers and merchants. Pursuant to the proposed requirements, the weighted average of interchange fees applied in domestic payment card transactions shall not exceed the weighted average of fees applied in cross-border transactions carried out with cards issued in Hungary. This would reduce the average level of fees applicable to the most common retail debit cards to one half or one third of the current level.

The postal inpayment money order ('yellow cheque') continues to be the most common payment instrument for regular retail transactions, though the volume of transactions going through that channel is continuously decreasing. Consumers need to be made aware of the real cost of the use of the 'yellow cheque' to steer them towards more efficient payment methods; consequently, the pricing of payment instruments must be made transparent. The legislative amendments adopted last year do not encourage service providers to pass through the costs of services used by households and corporates in a differentiated and transparent manner. Consequently, households and businesses receive no price signal that would allow them to make more efficient decisions when choosing between payment methods. Electronic bill presentment and payment systems are suitable for reducing the cash intensity of regular transactions, but the conditions for socially efficient competition between systems must be enhanced. This calls for interoperability, which allows households to use a single service provider for the presentment and payment of all their bills and facilitates the entry of large numbers of bill issuers in the system.

To promote the large-scale use of electronic payment methods, financial literacy relating to their use must be improved

The legal regulation of the issuance of negotiable vouchers in Hungary facilitates the more transparent, safer and supervised functioning of the market

The overseen systems demonstrated a high level of operational reliability in 2012 as well

The oversight assessments showed that the overseen systems broadly and fully observed the international principles and recommendations

Based on EU regulation (EMIR) and the oversight expectations, the re-organisation of the securities clearing and settlement infrastructure is in progress

The extensive growth of electronic payment methods is not hindered primarily by security reasons, but naturally the sense of security has a significant effect on their use. At present, the ratio of fraud in domestic electronic payments is fairly low. The confidence of users in electronic payment methods can be increased if they understand the operation of the payment instrument concerned and the related rules. Consequently, strong user authentication must be used for the initiation of transactions through the internet and for accessing bank services, which enhances user confidence. To maintain confidence, users must be provided more information while the risks and fraud events arising in the context of the use of electronic payment instruments in new areas must be closely monitored.

The absence of domestic regulation on the market of negotiable vouchers entails risks for the consumers using the vouchers and presents a reputational risk for the authorities responsible for the well-functioning of financial services. The risks identified in the market of negotiable vouchers are adequately managed by the regulation proposed by the MNB. The rules that are expected to enter into force in the near future set requirements concerning the operation of the issuers of negotiable vouchers, the information to be given to users and the protection of clients' funds. This is also conducive to maintaining confidence in the existing systems of negotiable vouchers. The regulation designates the MNB as a competent authority for the supervision of the issuers of negotiable vouchers.

The MNB promotes and follows up the efficient, reliable operation of payment and securities settlement systems in the framework of its oversight activities. The risk of service continuity was low in the overseen systems. The experience of the first three quarters of the operation of the new ICS intraday clearing shows that following the initial adaptation period, the system has shown a high level of operational reliability. Processing times are in line with prior expectations: the processing of a single cycle takes 14 minutes on average.

Last year the biennial oversight assessment of the Hungarian overseen systems was carried out against the requirements laid down in the relevant international principles. Since the previous assessments, several improvements have been made in the overseen systems that enhanced operational reliability and efficiency. The degree of observance of the oversight expectations by the systems was in the top two categories ('broadly observed' or 'fully observed') on a scale of four in every subject (e.g. operational risk, governance). As a result of the assessments, the MNB recommended some improvements to the systems to promote the further enhancement of operational reliability and efficiency. Based on those recommendations, system operators prepared action plans, the implementation of which is continuously monitored by the MNB.

The re-structuring process of the securities clearing and settlement infrastructure was accelerated by the adoption of the EMIR, which lays down requirements for the operation of KELER CCP additional to the considerations provided before by the MNB as an overseer and owner. The EMIR sets forth detailed requirements for the operation of the central counterparty and its risk calculation and management model, in particular the capital requirement. Within the KELER Group, KELER CCP needs to reach the final phase of full compliance with EMIR by mid-September 2013. As the first step, KELER transferred the clearing function of guaranteed markets to KELER CCP as of 31 December 2012. As the next step of the change, a capital increase

Clearing and settlement risk was low in the payment systems. After the introduction of intraday clearing, intraday transaction and liquidity management adapted gradually

The MNB is in discussions on the possible eligibility of the Forint for the CLS settlement, which could facilitate the elimination of the FX settlement risk of foreign exchange transactions based on a payment versus payment principle

In June 2015, upon the launch of the TARGET2-Securities (T2S) platform, the European securities post-trading infrastructure will undergo a radical change; KELER will join the system in September 2016

was implemented at the 2013 ordinary general meeting of KELER CCP, and by the end of the year the guarantee callable on first demand provided by KELER to KELER CCP is planned to be terminated. The harmonisation of Hungarian law with the EMIR is ongoing in parallel with the KELER CCP's preparation for the re-authorisation.

After the launch of intraday clearing, the growing turnover in the ICS did not increase the clearing and settlement risks at the aggregate (system) level. The netting effect in the overnight clearing decreased significantly as the majority of the credit transfer orders of credit institutions (including the ones posted to the Treasury) were migrated to the intraday clearing platform. However, the Treasury stayed in the overnight clearing platform and thus its outgoing payments are executed there. From the aspect of the intraday liquidity management of the Treasury it would be beneficial if it were to follow credit institutions and re-route its credit transfers to the intraday clearing platform. The introduction of the intraday clearing brought significant changes in the intraday transaction- and liquidity management of credit institutions, which adjust to the change through a gradual, still ongoing learning process. At the beginning there were cases in the first two intraday cycles when some transactions were rolled over from one cycle to the other. However, this was always attributable to temporary insufficient liquidity. The balance sheet of the participants rolling over had sufficient eligible collateral which still could be pledged. The timing of the initiation of VIBER transactions has shifted noticeably later during the day. This is due to the fact that VIBER participants try to manage the uncertainty in forecasting the exogenous transactions outgoing in ICS intraday clearing with a more disciplined sending behaviour.

The data available to the MNB show that the Hungarian credit institutions are exposed to a significant FX settlement risk. The importance of the FX settlement risk is indicated by the fact that in February 2013 the Basel Committee on Banking Supervision published its revised supervisory guidelines, which encourage the widespread use of the payment versus payment settlement (in particular the CLS settlement method). An FX transaction can be settled via the CLS if the currencies concerned are eligible, however, the Forint is not yet CLS-eligible. In addition, the counterparties of the foreign exchange transactions must have access, directly or indirectly, to the CLS system. Recently interest has been increasing in the CLS model. The MNB considers this to be a real opportunity to resolve the management of a sizeable FX settlement risk by the introduction of the Forint into the CLS system, which may have a beneficial effect on the whole (both domestic and offshore) Forint FX market.

The purpose for creating the T2S Pan-European settlement platform is to have a common and harmonised infrastructure of the single European market for securities services, making the settlement of cross-border securities transactions considerably cheaper and more efficient. Following KELER's entry, if the cash settlement is in euro, transactions relating to securities kept in KELER will be settled in the T2S system. The participants of KELER will be able to use a custodian service that will give them access to the entire euro-denominated European securities market.