

## KEY MESSAGES

**The use of electronic payment methods continued to grow in 2015, with significant progress achieved in the area of contactless card technology.**

The number of credit transfer and direct debit transactions continued to increase at a similar pace as in recent years, rising by 2–3 per cent, but payment card purchases proved to be the fastest growing payment method. This process was boosted by the spreading of contactless cards and compatible payment terminals, which provided consumers with an electronic alternative for quick, convenient payments even in the case of retail transactions. In payment card turnover, online (primarily e-commerce) card-not-present transactions demonstrated the most dynamic growth, although they still comprise only a small part of total card transactions.

**In 2015, the efficiency of Hungarian payment system increased considerably by international standards.**

All three indicators measuring the level of development of credit transfers, electronic purchases and electronic bill payments increased in 2015. The share of electronic payment methods in retail purchases rose by 2.6 percentage points, thanks to the sharp, 20 per cent increase in the annual turnover of payment card purchases. As a result of the dynamic growth in payment card turnover in recent years, the indicator has improved by 5.7 percentage points since 2012, representing a 50 per cent increase. There was a robust, 8 percentage point increase in the share of electronic bill payments in the past year. Owing to the positive developments, one third of utility bills and other service charges are now paid electronically.

**Doubling the number of intraday clearing cycles in the Interbank Clearing System (ICS) operated by GIRO Zrt. and extending the operating hours from September 2015 accelerated domestic payment transactions further, to a degree that was also perceivable by customers.**

From the autumn of 2015, the number of intraday clearing cycles in the ICS rose from five to ten, which means that credit transfers are now cleared in the system in hourly cycles. As a result, the amounts transferred are credited to beneficiaries' accounts faster than ever. As expected, owing to the higher cycle frequency, the number and value of transactions cleared in individual cycles have essentially halved, which facilitated a more even distribution of intraday transaction turnover. Although the first cycle now starts an hour earlier, the highest number of transactions is still processed in this cycle, as it is responsible for clearing all (typically household) credit transfers initiated after the end of the previous business day. The extension of the operating hours of the ICS by half an hour in the afternoon primarily benefits corporations, leaving more time to execute their payment transactions. The introduction of the ten cycles and hence the more evenly distributed transaction turnover, reduced potential clearing and settlement risks, as ICS members need less liquidity to settle their positions.

**As of 1 January 2016, all credit transfers denominated in HUF submitted on paper to credit institutions for interbank clearing are processed in the intraday clearing system of the ICS.**

From the beginning of 2016, not only electronic, but also paper-based credit transfers must be submitted to the intraday clearing system. Thus, in addition to the credit transfers of the Hungarian State Treasury, at present, only debit transactions are cleared in the overnight system. The medium-term objective of the MNB is to ensure that all payment transactions are processed in the more state of art system, instead of overnight clearing.

**On 16 November 2015, the Hungarian forint was included in the CLS system as a settlement currency, whereby the forint became the first currency in the region to join the leading financial infrastructure of the international foreign exchange market.**

The inclusion of the forint in the CLS system was preceded by two years of intensive preparations and development work on the part of both the MNB and Hungarian foreign exchange market participants. The use of CLS may significantly reduce the probability of situations where – as in September 2008 – international foreign currency financing becomes inaccessible for Hungarian banks. Therefore, the MNB made it clear that it expects the banking sector to use the system actively. Turnover settled in CLS has been on the rise since the inclusion of the forint and the MNB expects further growth for 2016.

**As in previous years, the operation of the overseen financial market infrastructures was highly reliable in 2015, supporting the functioning of money and capital markets safely and efficiently.**

Developments implemented in domestic financial market infrastructures in 2015 improved the efficiency of the systems without any undesired increase in operational risks. The availability of VIBER (the Hungarian RTGS) and the ICS improved compared to the previous year, but deteriorated slightly in the case of KELER and KELER CCP. In respect of transactions processed in the payment systems, in 2015 the clearing and settlement execution time shortened compared to 2014.

**Participants of the systems adjusted quickly and adequately to the effects exerted by the modification of monetary policy instruments and by the MNB's Self-Financing Programme on the liquidity of financial market infrastructures.**

There was sufficient liquidity in the financial market infrastructures for the smooth execution of payments both at system level and on an individual bank basis. The liquidity of system members was shaped by several events in 2015. However, thanks to adjustments in member-level liquidity management, this did not increase the level of clearing and settlement risks. As a result of the MNB's Self-Financing Programme and the modification of monetary policy instruments, participants raised the aggregate level of pledged collateral, including the liquidity available for payment transactions (intraday credit line). With respect to collateral, the share of government bonds exhibited the most marked increase in 2015, growing to 72 per cent after a 24 percentage point expansion. On the whole, the participants of day-to-day liquidity management used the available intraday credit lines more actively, taking advantage of the credit for longer periods and to a somewhat greater degree than before, which partly reflects the effect of the fixed, 2 per cent reserve requirement applicable to all members as of 1 December. As a result of the measure, the current account balance of participants decreased on average; consequently, they needed to rely on their intraday credit lines more strongly for the smooth execution of payments.

**In the first half of 2015, the risk management framework of KELER CCP successfully averted the spill-over of the defaults of brokerage firms subjected to supervisory measures to the rest of the capital market participants.**

In the wake of the broker defaults at the beginning of the year, defaults in the markets cleared by KELER CCP rose both in terms of number and aggregate value compared to 2014. Thanks to the prudent risk management rules of KELER CCP, the defaults did not spill over to other market participants. At the same time, KELER CCP did not sustain any losses in managing the series of defaults. Likewise, despite the insolvency of certain capital market participants, clearing and settlement risks did not arise across the infrastructure.

**Clearing and settlement risks in the markets cleared by KELER CCP were not exacerbated even by the shorter settlement deadline of domestic and foreign securities traded on the Budapest Stock Exchange.**

In line with European securities markets, pursuant to the rule adopted on 6 October 2014, spot securities transactions conducted on the Budapest Stock Exchange must be settled no later than the second business day (T+2) following the trading day, instead of the previously stipulated third business day (T+3). After analysing the data of the nine months preceding and following the adoption of the new rule, it was found that the change expedited the settlement of securities transactions, while the reduction of the period available for settling the transactions – as expected – had no major impact on the number and value of defaults.

**According to the regulatory inspections conducted in 2015, institutions providing payment services essentially complied with regulations; however, the MNB called for measures and imposed fines on a number of occasions with respect to the violations detected.**

In general, the payment inspections conducted in 2015 found that, despite being essentially compliant, all inspected credit institutions had committed violations to various degrees. Inspections conducted at 22 institutions found violations of regulations in 176 cases. Key violations involved failure to provide information, inadequate rectification of payment transactions and inappropriate liability and loss allocation. In consideration of the severity of the violations identified, the MNB imposed fines on 8 credit institution amounting to a total of HUF 90.3 million.

**Regulatory changes affecting domestic payment transactions and financial market infrastructures are intended to enhance modern payment services and to ensure safer access to the services concerned.**

The Payment Accounts Directive announced in 2014 is to be transposed into Hungarian law by the autumn of 2016. As a result, the pricing of retail payment services will become more transparent and comparable, customers will have easier access to basic and low-cost payment services, and account switching between service providers will become simpler. Moreover, a new Payment Services Directive was announced in January 2016, which is to be transposed into Hungarian law within two years.

**By 31 October 2016, payment service providers operating in Hungary and their customers must comply with the requirements of the EU regulation applicable to credit transfers and direct debits in euro.**

From that date, credit transfers and direct debits in euro must be executed in accordance with the common standards and technical requirements of the regulation commonly referred to as the “SEPA End Date Regulation”. The preparation of Hungarian participants is progressing at an adequate pace; at the end of 2015, nearly 85 per cent of euro credit transfers met the relevant requirements. One of the most challenging rules of the Regulation determines that after the deadline, payment service providers must ensure the use of SEPA message formats in all cases where a corporation or public authority initiates or receives individual credit transfers or individual direct debits which are not transmitted individually but are bundled together for transmission. Payment service providers may be allowed to provide their customers with conversion services to SEPA standards only with limitations, subject to specific conditions. Another important rule of the Regulation stipulates that payment service providers may not require their users to indicate the business identifier code of the beneficiary’s bank (“BIC code”) upon initiating the credit transfer.

**Establishing the basic infrastructure for instant payment services is considered to be one of the most crucial developments affecting Hungarian payment system, which will enable the use of payment solutions that are much faster than the currently available electronic payment services and can be used 24 hours a day.**

With a view to accelerating the execution of payment transactions even further and to broaden the potential use of electronic payment methods, in 2015 the MNB commenced preparations for developing the infrastructure for instant payments. This may have a profound effect on the functioning of the existing payment systems and entails extremely complex payment system developments, both on the part of banks and on the part of the central systems. The new payment system will enable payment transactions to be executed within a few seconds every day of the year, twenty-four hours a day, and electronic payment will be an option in numerous situations where so far only cash payment has been possible. In the case of private individuals, person-to-person payments and in retail payments, new payment solutions may emerge, and the possibility of prompt execution may curb the distrust-driven incentive to use cash in the corporate sector. In addition, the new basic infrastructure may promote the development of new, innovative payment solutions, which, on the one hand, will improve the competitiveness of the Hungarian banking sector in the long run and, on the other hand, will simplify the market entry of new participants providing innovative services.

**With more frequent daily clearing of forint payment card transactions, merchants may receive the amounts of payment card purchases faster than before, which may encourage the expansion of the card acceptance infrastructure.**

One of the fundamental goals of the MNB's payment system developments is to accelerate payment transactions, including the clearing of card purchases. In the case of the most dynamically growing electronic payment method, payment card purchases, merchants accepting payment cards generally cannot collect the value of purchases until 1 or 2 days after the transaction. This is a serious lag compared to credit transfers, which have been processed in intraday clearing system for the past 4 years; therefore, accelerating the crediting to merchants' payment accounts is clearly justified. To that end, GIRO Zrt. has launched a project to commence preparations for developing a multi-cycle intraday clearing process for transactions executed by domestically issued payment cards in the Hungarian card acceptance network.

**In 2015, the KELER Group continued to implement its institutional development strategy, assigning key priority to taking advantage of international business opportunities. The Group is expected to join TARGET2-Securities – the common, pan-European settlement infrastructure – in 2017.**

KELER Ltd. and KELER CCP Ltd. – in which the MNB holds a direct and an indirect majority interest, respectively – continued to expand the range and quality level of its services in 2015. During the year, the KELER Group expanded its customer base primarily in the energy market and the gas market, establishing partnerships with larger actors in the region. It also introduced new services, such as an order routing platform (WARP) supporting the distribution and settlement of open-ended investment fund units, and its Trade Reporting service, which facilitates the discharge of the reporting obligations prescribed by European regulations. KELER Ltd. continued its preparations for joining the common pan-European securities settlement platform, TARGET2-Securities (T2S) on 6 February 2017.

**Cyber risk is an increasing threat worldwide, and also impacts financial market infrastructures; addressing this issue, therefore, is of key significance.**

Addressing the issue of cyber risk is considered to be one of the most significant challenges of our time, as cyber attacks on financial market infrastructures – due to their central role in the financial sector – also carry systemic risks. Recognising the problem, numerous international organisations, including BIS-IOSCO, have drawn up recommendations regarding the containment of cyber risk. The MNB has also offered a number of proposals, with respect to the relevant application guidelines. The adaptation and implementation of the international recommendations into the Hungarian oversight methodology is in progress.

**The ratio of payment card fraud to total turnover remains low, despite the fact that fraud associated with domestically issued payment cards and with the Hungarian acceptance network increased in the past period.**

Payment card turnover increased dynamically in the past period with an inevitable increase in payment card fraud. At the same time, the number of fraud cases and the value of losses sustained remained low relative to total turnover and also by European comparison. Based on the European Central Bank's card fraud report published in July 2015, according to data available for 2013, Hungary has the lowest rate of fraud from an issuing perspective. Thanks to consumer protection regulations, customers bore only 11 per cent of all fraud losses.