

KEY MESSAGES

The turnover of purchases by payment cards and the number of physical points of sale are increasing dynamically, by nearly 25 percent annually, and Hungary is among the leaders in Europe in terms of the prevalence of the contactless technology.	The number of both physical points of sale and POS terminals increased by nearly one quarter during the year. In addition, 2017 was also the year of a breakthrough in the use of the comfortable and fast contactless technology, which became a determinant in domestic card payments; this technology accounted for most of the card purchase turnover. This was facilitated by the expansion in the contactless infrastructure, as a result of which more than 70 percent of payment cards and 80 percent of POS terminals support the use of the new technology. The development in e-commerce is indicated by the significant increase in the turnover of card-not-present online payment transactions, although the ratio of this turnover to all payment card transactions is still relatively low.
The efficiency of the Hungarian payment system is continuously approaching the EU average.	The efficiency of payments improved in 2017 as well, and came even closer to the EU average. Inter alia as a result of the central bank's active role as a developer, now there is only a slight lag in the ratio of credit transfers to GDP compared to the European average. In addition, primarily as a result of an expansion in the domestic payment card infrastructure and the purchase turnover, significant development was seen both in retail electronic payments and in the field of the electronic payment of utility bills and other service charges.
Compared to the turnover, the magnitude of payment card frauds declined further, i.e. safety, which is outstanding in international comparison as well, continued to improve.	Although the number of card frauds slightly increased in 2017, this increase is well below the expansion in the total payment card turnover, i.e. on the whole, the use of cards became even safer. Moreover, as a result of the consumer-friendly regulatory background, less than ten percent of the losses caused by fraud is borne by card holders, while most of it is borne by card issuers and acquirer payment service providers.
At present, neither the level, nor the structure of	Compared to other countries, the prices of payment services – even with the exclusion of the price increasing effect of the

the prices of payment services stimulate sufficiently the spreading of electronic transactions.

financial transaction levy – are relatively high in Hungary. With special regard to credit transfers, the ratio of fees applied depending on the number of transactions and the value of the payment order is high, which significantly increases the costs of electronic payments for those who use them. At the same time, the ratio of package pricing, which is independent of the number and value of transactions, applied by payment service providers is lower than in other European countries. In 2018, the MNB is preparing a detailed analysis of the pricing of payment services and is initiating a dialogue with payment services market participants in order to identify what steps could be taken in Hungary already in the short term for a pricing that is more favourable for customers and that encourages the usage of electronic transactions.

Financial institutions' revenues from payment services proportionate of turnover show a slightly declining trend.

Based on the data of the first three quarters, financial institutions' revenues from payment services rose by 6 percent compared to the previous year. Comparing revenues as a proportion of transactions to the number of electronic payments, a slightly declining trend is seen, i.e. payment services became specifically cheaper for consumers. The situation is similar in the case of the value of transactions and revenues as a proportion of them. At the same time, a slightly rising trend is seen in the case of revenues per payment card.

The overseen financial market infrastructures worked efficiently and safely in 2017, supporting the functioning of financial and capital markets with their high availability.

The value of payments executed in the overseen systems increased considerably, while the number of transactions rose to a lesser extent. In 2017, VIBER and the ICS realised a more than 10 percent increase in turnover value, while the turnover of KELER and the value of capital market transactions cleared by KELER CCP remained practically unchanged. The operation of the systems was robust during the whole year. Compared to the previous year, the availability of KELER, KELER CCP and the ICS deteriorated slightly, while that of VIBER improved. With increase in the recovery time of incidents, the operational risk was slightly up in the overseen systems in 2017. The CLS and T2S financial market infrastructures, which are under international cooperative oversight with the participation of

the MNB, operated safely and efficiently, similarly to the domestic systems.

In 2017, the participants in the payment systems conducted efficient liquidity management, as a result of which there was sufficient liquidity for the execution of payment transactions.

The liquidity of the participants of the payment systems was affected by the quantitative limit on the three-month deposit as well as by the reduction of the required reserve ratio to 1 percent in December 2016. As a result, during 2017, participants' payment account balance with the MNB declined to a HUF 2–300 billion lower level compared to the previous year, which was offset by the participants by increasing their government securities holdings. As a result of participants' efficient liquidity management, the decline in the balance of the payment account did not lead to an increase in the maximum utilisation of intraday credit lines. Actually, they used their respective intraday credit lines for the execution of their payment turnover for a shorter period of time and at a lower value on average. Although the number of queuing in VIBER increased in 2017, the average time spent in the queue declined, and was typically shorter than 1 hour.

There was no default event in 2017, and the late payment events did not generate any loss either to the KELER CCP or to the clearing members.

The risk management framework of KELER CCP successfully managed the increased risks stemming from clearing members' late payment events in 2017. Compared to the previous year, in 2017 KELER CCP recorded two and a half times more late payment events with one and a half times higher total value. Three quarters of them were related to the capital market, while the rest to the cleared energy markets. In all cases in the capital market the late payment events were connected to late delivery of securities, while in the energy market late payment of financial obligation and collateral took place. In 2017, in the energy market one clearing member's liquidity problem caused late payment event lasting for several days, which was adequately handled by KELER CCP. The clearing membership of the clearing member concerned in this latter case was finally terminated, therefore, the clearing member cannot pose any risk to KELER CCP or the markets any longer.

KELER Central Securities Depository submitted its

The CSDR is a set of rules promoting the safe, efficient and sound settlement of financial instruments in the European

application for CSDR authorisation on time. Union. Also, CSDR determining uniformized regulatory requirements for CSDs. KELER CSD had to submit its application for authorisation to the MNB within six months following the publication of the regulatory technical standards (RTS), which are containing the detailed rules of authorization an operation of a CSD. KELER as a specialised credit institution needs a licence not only for its central securities depository services but also for its banking type ancillary services. The authorisation procedure is expected to be closed in 2018 H2.

The Supervisory College of KELER CCP chaired by MNB has discussed the 2017 activity of KELER CCP and concluded that the operation of the CCP complies with EMIR requirements. The annual meeting of KELER CCP Supervisory College was held in November 2017., The College discussed the most important issues of 2017 regarding the provided services as well as the short- and medium-term plans of the central counterparty. The main topics of the meeting included the clearing and guarantee undertaking of the spot transactions of the SME market, the cross-border clearing and guarantee undertaking service planned for the Romanian Commodities Exchange BRM, the change in the clearing currency of the CEEGEX transactions from forint to euro as well as the transfer of the CEEGEX forward gas transactions to the HUDEX gas market. The Supervisory College has found that the operation of KELER CCP is in line with EMIR requirement.

Closer cooperation with international market participants makes the preparations against cyber attacks more efficient. The MNB continuously follows the international sectoral recommendations concerning cyber security, and includes their relevant parts in its own oversight methodology, decrees and recommendations. In addition, the MNB has participated in the ECB working group dealing with the cyber security of financial infrastructures for years. The working group assessed and evaluated the preparedness of the relevant European financial infrastructures. It also made specific proposals for remedying the deficiencies observed. In the near future, an international working group dealing with cyber security will be set up with the involvement of market participants and regulators and with the objectives of strengthening cooperation as well as simpler and faster sharing of information.

According to the The general experience of the payment inspections

regulatory payment inspections conducted in 2017, payment service providers were most likely to violate rules pertaining to the notification of customers and to the immediate crediting of the amounts of payment transactions.

conducted in 2017 is that the operation of the inspected payment service providers is adequate, although all of them violated regulations. The inspections conducted at 15 institutions found violations of regulation in 156 cases. In terms of their business effect, on some occasions they jeopardised the predictability of the performance of payment transactions. With late or faulty fulfilment of payment orders and as a result of providing inadequate information, payment service providers also caused smaller or greater losses to customers (e.g. customers could only later dispose of the amounts due to them, or they did not have information about the possibility of cost-free subsequent information). Based on the regulatory payment inspections conducted in 2017 and together with the inspections carried over from 2016, fines amounting to a total HUF 75 million were imposed.

In the interest of customers, the MNB started the inspection of the compliance with the Decree on payment accounts switching; the inspection revealed inadequate practices of some institutions.

During the regulatory payment inspections in 2017, the MNB found that credit institutions refused the termination of accounts, which is related to and the last step of the process of switching accounts, on several occasions even in cases when it is not allowed by law. The most frequent reason for the refusal was when payment card and/or other service(s) (Internet bank, texting service) also belonged to the customer's payment account. A further deficiency was that most of the inspected institutions did not meet the obligation to provide information for easing the cross-border switching of accounts.

The regulation of instant payments was ready at end-2017, and the new service, which is innovative by international standards as well, is planned to be available in Hungary starting from 1 July 2019.

The setting up of the instant payment system is the common interest of all the parties concerned; the services relying upon the system will allow the electrification of a significant amount of cash transactions. Payments that are becoming instant for a wide range at international level as well in the medium term allow the modernisation of a number of economic processes. In 2017, GIRO Zrt. started to set up the central infrastructure that processes instant payments and other systems that support the additional services, and, in parallel with that, developments also started at payment service providers that were to join. At the end of the year, the MNB adopted and published the

statutory provisions concerning instant payments, and the rulebooks describing the details of the functioning of the system also became public. The liquidity management framework that supports the safe and reliable operation of the system is also being finalised.

The MNB and GIRO support the development of modern and customer-friendly services based on instant payment with the introduction of innovative technologies.

Real-time payments implemented with the instant payment system make the operation of the financial sector more efficient and increase the competitiveness of the economy. In order to attain the most favourable effects on the national economy, widely usable payment solutions are needed that allow instant payment in the vast majority of payment situations. The functions of the central system (e.g. mobile phone numbers and email addresses that can be used as account identifiers as well as request to pay messages) support the development of modern payment services. It is the common interest of the MNB and the market that these services should be made cheap for customers and the structure of pricing should stimulate a significant increase in the number of transactions. Return on the necessary investment should be ensured by the new transaction turnover and not by high prices. It is the MNB's definite expectation that already at the start market participants should have instant payment solutions available that are based on open standards, are interoperable, simple to use and safe.

The payment brand covering the basic instant payment service may contribute to the spreading of instant payments and facilitates the appearance of innovative payment solutions relying upon the basic service.

The objective of the payment brand strategy is to make the basic services known widely by customers that use or potentially use the payment service. It is important that the payment brand should intervene in the development of the additional services only to the minimum extent necessary. This ensures wide opportunities for competition and the spreading of innovation in this field, allowing the emergence of a number of new additional service brands. Although not necessarily parts of the payment brand but may be related to it are the descriptions of data entry standards and basic payment processes that ensure the standardisation of payment services; these descriptions are elaborated by the stakeholders in cooperation with one another or individually. Interoperability between payment services can be

implemented by making the standards and processes open.

As the medium-term strategic objective of the development of payments, the MNB envisaged the consolidation of the Hungarian clearing systems.

With the introduction of the instant payment system in Hungary an up-to-date and flexible infrastructure will become available for the participants in domestic payment transactions, and theoretically this infrastructure may also be used for the handling of transactions that do not fall under the obligation of instant processing. As economies of scale is of basic importance in payments, medium-term consolidation of some of the currently existing elements of infrastructure (intraday clearing, overnight clearing) is worth considering. However, it is possible to decide on the consolidation of individual system elements only if the functions of the instant payment system as well as the costs and possibilities of diverting certain types of transactions are known. Taking them into account, during 2018 the MNB is preparing a detailed medium-term infrastructure strategy.

The possible advantages and risks of digital central bank money are subject to examination by central banks, including the MNB, all over the world.

As a result of recent years' technological innovation, it has become theoretically possible for central banks to create widely available central bank money in digital form as well. The introduction of digital central bank money would fundamentally change the operation of the financial intermediary sector, affecting central banks' scope of duties in various respects. Central bank areas affected include payments, whose efficiency may increase with the putting of the new central bank money into circulation, because in lieu of the costly manufacturing and handling of cash, the digital format may result in savings at the level of the society. Nevertheless, various challenges and risks also arise, not only in respect of payments, but concerning monetary policy and financial stability as well. In line with, inter alia, the analytical works of the English, Danish and Swedish central banks as well as the European Central Bank, from a professional aspect the MNB considers the well-founded examination of this issue important.

The MNB continuously monitors the role of virtual currencies in the payment system,

Recent years have seen an increase in the number of virtual currencies, which, without a central issuing and operating institution, using the blockchain technology, offer services that are independent of the present financial sector. At the

although no major increase in turnover is expected in this field at present.

same time the role of these types of currencies is very limited in payments, mainly as a result of the fact that due to their decentralised nature and the ensuing characteristics (e.g. significant exchange rate volatility or inflexible money supply) they are unable to adequately fulfil money functions. Nevertheless, in cooperation with other state institutions and following the international trends, the MNB continuously examines whether it is necessary to regulate the functioning of virtual currencies, and if yes, how.

With the transposition of the new Payment Services Directive, the operation of non-bank innovative players may enhance competition and increase the quality and safety of services provided to customers in Hungary as well.

With the observance of strict security rules, the new Payment Services Directive, which entered into force in January 2018, allows customers to employ innovative third-party service providers for carrying out their payment transactions. These measures are determined by the regulatory technical standards on secure communication and strong customer authentication. Certain supplementary rules facilitating the application of the provisions of the directive have not entered into force yet; therefore, in the transitional period until they enter into force, payment service providers do not have to comply with some provisions of the directive or have to comply with them differently. The MNB's inspection practice also needs to be changed due to the new technical and security requirements.