

KEY MESSAGES

One of MNB's main responsibilities is to promote the reliable, efficient functioning of execution of payments as well as payment and settlement systems

The smooth functioning of the economy requires the efficient, reliable operation of financial infrastructure, including execution of payments as well as payment and securities clearing systems. This assures that if other conditions are met, real economic and financial transactions are executed as expected, in a timely, cost-effective manner. In respect of payments, efficiency primarily refers to the use of cashless payment methods, which helps to curb the shadow economy and thus increases tax revenues for the state. However, higher efficiency must not jeopardise the security of payments, as only continuous and reliable functioning can build up the trust necessary for the more wide-spread use of electronic payment instruments.

More intensive use of cashless payment methods would result in substantial savings in resources

The MNB surveys of payment habits, including public sector payments, found that cash continues to play a significant role in the Hungarian payment landscape. Based on an MNB study conducted in 2009 and published in 2011, in Hungary 3.7 billion payment transactions were executed (excluding credit transfers in VIBER), of which 84.4% occurred in cash. Hungarian society could save some HUF 106 billion annually (HUF 24 billion of which relating to public sector payments) if cash and paper based payments were replaced by electronic transactions and similar usage ratios of payment methods were reached as in the Northern European countries.

Access to payment accounts and to account-based electronic payment instruments needs to be improved

The number of payment accounts and debit cards has been increasing slowly but steadily in recent years; nevertheless, there is still room for improvement. There are two main factors hindering the spread of efficient electronic means of payment. One of them is insufficient access to basic payment services (such as payment accounts, payment cards) in some regions of the country or for certain groups of society. The other typical reason is that the choice between payment methods is not based on their relative efficiency, because the real social costs are hidden from customers. The MNB urges the introduction of a low cost, basic payment account facility, which would gradually make it possible to improve the efficiency of public sector payments as well (e.g. cashless payment of pensions and other social transfers). Access to basic payment services may also be improved by the entry of new service providers (e.g. new payment institutions, Hungarian Post), and the spread of the internet and mobile technology may result in the increased use of account-based electronic payment instruments.

Measures needed to expand the card acquiring network

The card acquiring network has expanded fairly dynamically in recent years, but in a European comparison it is still less developed than the issuer side. While in the EU there are 17,561 POS terminals per one million inhabitants on average, in Hungary the corresponding number is 7,844. The MNB considers it important to significantly increase the payment card acquiring network because today card payment is available in only 30% of retail outlets. With

the active participation of the sectoral ministries responsible, a large number of POS terminals could be installed making use of EU funds. Furthermore, even though its impact would not be quite as massive, a commercially financed POS installation programme could also have a beneficial effect on the structure of the payment card market.

In order to change payment habits, the MNB recommends the introduction of step-by-step mandatory card acceptance, gradual limitation of the use of cash and the transparent and separate pricing of payment methods

If appropriate market signals are given, the pricing of payment methods itself steers payment habits towards greater efficiency. In the case of cashless payment this mechanism generally does not work, and thus measures to overwrite distorted price signals are necessary. Simultaneously with easing the aforementioned infrastructure constraints, the MNB also recommends the transfer of regular incomes and revenues to payment accounts, the introduction of step-by-step mandatory card acceptance and gradual limitation of the use of cash. Naturally, these initiatives would also have an impact on incoming and outgoing public sector payments, and thus the dominance of cash would be eliminated in paying for public services (e.g. fees for administrative procedures) and the purchases of goods and services by the public sector. As indicated by the MNB survey of 2009, every third incoming or outgoing public sector payment is in cash. Another problem with the pricing of payment methods is their incorporation in the prices of underlying services. This hides the real cost of the payment method from customers. For example, the costs of the various payment methods are generally built into the price of the underlying service without any differentiation. Thus clients using less costly electronic transfers also pay for higher-cost postal inpayment money orders. The MNB favours the transparent pricing of payment methods separate from the price of the underlying service, where prices may be different for each payment method based on their costs. However, the implementation of such a pricing practice must not lead to a one-off price increase.

The level of the payment card interchange fee hinders the expansion of the acquiring network; thus regulatory intervention is required for its reduction

Considering that some of the proposals explained above (e.g. paying public sector transfers to accounts, step-by-step mandatory acceptance of cards) shape payment habits without necessarily giving an option to users, it is important that once these regulatory measures are introduced, the users of such payment methods are not faced with unreasonably high costs. Merchants pay a charge to the acquiring payment service provider (merchant fee). This covers, inter alia, the costs of acceptance, most of the time also the rental of the POS terminal and the interchange fee. The latter is passed on by the acquiring payment service provider to the card issuing payment service provider. The interchange fee represents a large part of the merchant fee. The reduction in the interchange fee could substantially lower the costs incurred by merchants in accepting cards and eventually encourage the acceptance and use of payment cards. Consequently, the MNB has made a recommendation to the Ministry for National Economy concerning the regulation of the payment card interchange fee in Hungary.

In 2010, the MNB, after observing the inefficiency of

In a modern economy, the efficiency of payments depends not only on cost but also on the speed of the execution of payments. The launch of intraday

self-regulation, issued a decree requiring the launch of intraday clearing

clearing on 2 July 2012 substantially accelerated the clearing of domestic electronic credit transfers in the Interbank Clearing System (ICS). This change primarily offers benefits to companies and other institutional participants, but in the longer term it may also have favourable effects on household payments. The execution time of electronic payment orders has become one business day shorter, thus payers need not forego one day's interest income due to the overnight clearing and are able to use the received amounts on the same day. Furthermore, under the new clearing arrangement there is space for more detailed information, thus a broader range of data on the economic transaction underlying the payment can be transmitted.

The regulatory and supervisory activities of the Bank play a significant role in assuring that domestic payments occur in a predictable, efficient manner

The MNB decree lays down not only the requirement of intraday clearing, but also the rules of execution of domestic payments. Compliance with the requirements must be monitored because on an individual level the circumvention of rules may be rational. Market mechanisms are unable to discover and correct non-compliance due to information asymmetry. The credit institutions examined in 2011 were broadly observed as functioning according to the law, but the MNB ordered measures to be taken to address the deficiencies identified. In 2011, the Bank audited 16 credit institutions. Based on the findings, the MNB required 78 measures to be taken and a total of HUF 21.4 million of fines were also imposed on seven credit institutions.

Last year there were no major fraud events relating to electronic payment transactions, partially because of the spread of chip technology

In 2011, 11,595 fraud events were registered with payment cards issued in Hungary, in the total value of HUF 568.4 million, corresponding to 0.007 per cent of the total card turnover in value terms. This is low by international standards. In recent years, the use of chip technology on payment cards has enhanced the security of card payments. The chip migration of the domestic acquiring network (POS terminals and ATMs) accelerated in 2007, that of cards in the last quarter of 2010. Statistics on card fraud clearly show the beneficial effects of the application of chips.

The risks identified in the issuance of vouchers require regulatory intervention

Some estimate the annual turnover of the Hungarian voucher market to be several hundreds of billions of forints. The operation of the voucher market has its risks, but at present there is no law in Hungary to regulate the issuance and redemption of vouchers or the safeguarding requirements for the protection of client funds relating to vouchers. There are two main risks associated with vouchers. First, whether the voucher is widely accepted as a cashless means of payment. Second, when the voucher is redeemed, there is a risk as to whether its issuer will be able to pay in accordance with the predefined rules, that is, if it has the funds necessary for redemption. In light of the above risks, the MNB has come to the conclusion that there is a need for regulation of the domestic voucher issuance so that this market can work in a transparent, safe and reliable way.

In 2011 the risk of service continuity was low in all three overseen systems (VIBER, ICS

The MNB promotes the efficient, reliable operation of payment and securities settlement systems in the framework of its oversight activities. The monthly availability ratio of the core settlement service of VIBER was below the

and the securities clearing and settlement system); the system operational interdependency risk has also been reduced

required 99.7 per cent in one month only. The ICS demonstrated a high level of operational reliability. The availability of the key securities clearing and settlement services showed the decline of operational risk. The three overseen systems are linked at a number of points to assure the smooth clearing and settlement of payments and securities transactions. Furthermore, there are interdependencies between the VIBER and other systems within the MNB as well. Both inter and intra-system operational interdependency risk has declined since the previous year. At KELER, business risk is an important factor in the risk of service continuity, determined primarily by the central counterparty model based on a guarantee provided by the KELER to the KELER CCP and callable on first demand. According to the oversight recommendations addressed by the MNB to the KELER Group, this model is expected to be phased out, and subsequently the KELER CCP is to be recapitalised. The EU legislation (EMIR) to be published officially shortly supports this direction.

Clearing and settlement risk was low in VIBER; several participants with high turnover made use of the optional reserve requirement ratio regime

VIBER participants continued to maintain their intraday credit lines, which have been substantially increased since 2008; as a result, intraday liquidity has remained ample both at the aggregate and individual levels. The sufficiency of liquidity was also promoted by the optional reserve requirement ratio regime introduced in November 2010. Several of the 10 VIBER members with the largest turnover made use of the option to freely vary the reserve requirement ratio from time to time. In general, VIBER members with relatively high turnover compared to the low reserve balances resulting from the former fixed ratio increased their reserve ratios above the minimum 2 per cent in one step or gradually. Some participants did utilise a high percentage of their intraday credit line on particularly high-turnover days. However, this did not result in crystallisation of clearing and settlement risk in the system.

Liquidity remained abundant in the Interbank Clearing System; the occasional queues were not caused by liquidity problems

Considering that clearing members essentially use the same liquidity for clearing in the ICS as in the VIBER, liquidity in the ICS has also been sufficient. Unfunded queues in the ICS have become less frequent than in previous years, and no gridlock has emerged. The ratio of uncovered amount of queued batches to total turnover remained insignificant. Liquidity occasionally proved to be insufficient in the ICS due to the maturity of securities pledged as collateral backing up the central bank intraday credit line, the optimisation of current account balances following the regular behaviour to fulfil the reserve requirement or sometimes their intention to avoid reserve surpluses at the end of the reserve requirement period. In other instances, the outgoing ICS transactions of clearing members included items that the member was unable to take into account due to their unexpected nature or their arrival and acceptance in the late hours. Members would have been able to fill in the liquidity gaps from eligible and not yet pledged collateral available in their balance sheets. After the introduction of intraday clearing, the liquidity link between the ICS and VIBER will become more complex. If the clearing members adapt their intraday transaction and liquidity management and strengthen their coordination with one another, the launch of intraday clearing is expected to cause no major changes in the

clearing and settlement risk of the ICS.

The frequency and value of settlement fails in the spot market guaranteed by KELER CCP has increased; this indicated increasing clearing and settlement risk over the previous year level, but fails were finally settled on the intended settlement date (ISD) or one day after the ISD

In the securities clearing and settlement system no clearing or settlement risk crystallised due to the insolvency of participants. However, in the guaranteed capital markets additional financial collateral requirements had to be imposed more frequently. Furthermore, the frequency and value of settlement fails in the guaranteed spot market showed an increase of clearing and settlement risk over the previous year's levels. Almost half of the settlement fails extended beyond the intended settlement day. Settlement fails occurred in the guaranteed spot market on 22 occasions with a total value of HUF 5.2 billion; in each case, the reason was the lack of the security. Settlement fails were highly concentrated both in terms of frequency and value. Settlement fails may indicate that the relatively early settlement deadline of the spot markets (11:30 a.m.) leaves little time for arranging the OTC transaction which would provide the coverage. As of 4 June 2012, the settlement deadline of the spot market was moved to 2:00 p.m., which is expected to reduce the probability of settlement fails.

The clearing and settlement risk in the energy markets increased temporarily; a non-performing gas market clearing member finally settled its obligation, although with a significant delay

Since mid-2010 the KELER CCP has been guaranteeing transactions concluded in the gas and power markets as well. At the end of 2010, EMFESZ Kft., a clearing member of the gas market, repeatedly failed to meet its collateral and financial obligations. To manage the settlement fails, first the collateral of EMFESZ, and then the collective guarantee funds were used several times. The case ended with the institution meeting its obligations with a significant delay, but in full; its clearing membership was terminated and its operating license was suspended by the Hungarian Energy Office. Because the KELER CCP simultaneously guarantees the capital and energy markets, the securities clearing and settlement system is also exposed to the spillover risk of the energy market. Consequently, it is vital that the KELER CCP prevents the pass-through of the risk of the energy market to the clearing and settlement of the guaranteed capital market. In connection with the aforementioned settlement failure, the MNB put forth recommendations to the KELER CCP respecting the clearing arrangement in the gas market. One of the key recommendations was that the CCP should look for solutions ensuring the (legal) separation of the central counterparty of the energy market, that is, the separation of the financial resources backing the CCP clearing of various guaranteed markets.