

Payment system changes in Hungary

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Historical background

The countries of Central and Eastern Europe have faced totally different kinds of challenges from countries in other regions in the last decade. These countries had not only to liberalise their economies but to transform them radically and manage the shift from the centrally planned economy model to the market economy one. From a financial point of view the centrally planned economic system assumed the single-tier banking system, where the banking sector was, practically, consolidated into two mega-banks: the central bank, which was at the same time the sole commercial bank, and the savings bank. The number of accounts kept by the central bank was limited by the rather small number of state-owned companies and cooperatives. Payments between the clients of the central bank were made exclusively in account money. The savings bank kept accounts for consumers and for private entrepreneurs. The majority of retail payments were effected in cash, while some payments between corporations and consumers took place by electronic funds transfer, which required a bilateral contract between the corporation and the savings bank for the exchange of batch files.

Hungarian economists sought ways to improve the socialist economic model from the mid-1950s within the politically tolerable limits. The economic reform process suffered several setbacks and it was not possible to reform the banking system until 1987. The banking reform meant dividing up the National Bank of Hungary by creating a true central bank and some commercial banks. The question of setting up an interbank clearing system arose soon afterwards. At the time, clearing and settlement was considered to be a merely operational matter, which had nothing to do with risk.

The need for profound change in payment systems, which has presented a great challenge even for central banks operating in long-established market economies during the last decade, was

accompanied by the task of creating the basic banking infrastructure for payments in the Central and Eastern European region, where even the commercial banking sector was non-existent ten years ago and the active generations had no previous experience in business banking. During this period the process of change accelerated in the whole economy, and the banks had to cope with the ever-growing number of accounts and payments, and also had to set up their own accounting systems. It is no wonder that in this situation the central bank has had to take a leading role and assume much of the responsibility for managing the change.

The regulatory power of the central bank

The National Bank of Hungary (NBH) is empowered and obliged to be actively involved in creating and changing the payments infrastructure not only for high-value interbank systems but for all payments.

According to the Constitution of the Republic of Hungary (Act XX of 1949): “It is the responsibility of the National Bank of Hungary ... to regulate the circulation of money”.

Under the Act on the National Bank of Hungary (Act LX of 1991) “... the framework of the national payments and clearing system shall be elaborated by the NBH ...” and “the circulation of money shall be controlled by the NBH”. It is also stated that “... within the framework of the law, the NBH may impose rules by way of central bank decrees on financial institutions and other legal entities engaging in the activities of financial institutions, or business associations which are not legal entities and pursue such activities, and private entrepreneurs conducting financial activities, to regulate ... the circulation of money. The regulations of the central bank with regard to the circulation of money extend to legal entities, economic associations other than legal entities, and also natural persons.”

Policy objectives

The primary goal of the National Bank of Hungary is, similar to that of other central banks, the reduction of risks, with special regard to credit, systemic and technical risks.

The NBH also pays particular attention to the efficiency and the smooth functioning of the whole payment system as well as the maintenance of public confidence in payment services.

Thus the central bank:

- manages the system with the lowest possible social cost;
- secures the continuous and undisturbed functioning of the payment system;
- enforces consumer protection;
- supervises the prudential operation of the system by means of oversight and licensing;
- regulates the redress procedures.

Finally, the NBH considers it equally important to achieve full compatibility of the Hungarian payment system with EU requirements.

The evolution of the payment systems and the main lessons

The interbank clearing system started operations in 1994, eight years after the reform of the banking system. The project suffered delays because the problems which arose required appropriate solutions. The main problems were:

- first, the task of separating the operations of the central bank and the “legacy banks” was a precondition for setting up a new clearing system;
- second, some of the fundamental assumptions on which investment decisions in the clearing house company were based turned out to be false (e.g. the unavailability of public telecommunication services, the lack of centralised accounting within banks, the persistence of the COCOM rules);
- third, the original system design did not take credit, liquidity, settlement and systemic risks into account.

The system which was put in place in 1994 is a deferred settlement (gross) batch clearing system which processes payment orders overnight.

Furthermore, the National Bank of Hungary successfully implemented two projects in 1995 and 1996–97. The first introduced uniform account numbering and standard paper forms, and the second the interbank

clearing system for direct debits and direct credit transfers. The introduction of the RTGS system is now at the top of the agenda.

The main lessons learnt by the central bank

- It is extremely important to design new systems carefully and realistically. For example, the simple overnight batch clearing system can better serve the interests and real needs of participants than the technologically more advanced plan that has now been abandoned.
- Without some form of pressure from the central bank commercial banks are reluctant to change payment arrangements. This does not mean that the central bank should do the whole job. On the contrary, it has to maintain continuous dialogue and cooperation with commercial banks. Otherwise the difficulty lies in finding the point where the central bank must take action.
- In the course of payment system reform the central bank must be firm and determined in setting the agenda and ensure compliance with deadlines. The central bank must find the way to push forward those banks which lag behind.
- Sometimes different interests of some large banks may imperil the success of projects. In Hungary’s case, for example, large banks tried to start exchanging payment instructions bilaterally just before the introduction of operations at the clearing house. The central bank responded by ruling that all interbank payment instructions should be forwarded to the clearing house. The central bank must understand the motives of the individual banks and let them exert their influence only to an extent which cannot be harmful.
- Cooperation with commercial banks is often difficult because the senior management is often uninterested in payment system issues and the banks tend to delegate their IT experts for discussions related to interbank payments.

Setting goals and drawing up a practicable plan to reach them

The challenges the NBH has to face are very similar to those for other central banks. The management of change in payment systems can only be

successful if the central bank has a payment systems strategy. This should be based on the analysis of the current situation and on the mission of the central bank. The most important element of this strategy is an action plan which sets out the tasks for the coming years.

The strategic action plan should be communicated to the government, the commercial banks and other major players in the payments business. Such information is very useful for banks and some corporations to support their investment decisions. Publication of the action plan is nonetheless risky, because the players have to be assured that the central bank's measures are predictable.

The central bank must cooperate with the banks. Such cooperation can take the form of project organisation or a committee. The projects and committees should have well-defined tasks and should be wound up once the work is completed.