

PRUDENTIAL CHALLENGES IN FINANCIAL INFRASTRUCTURE DEVELOPMENT IN HUNGARY

Financial infrastructure development needs are determined by information technology development and changes in financial and business needs. Accordingly, a need for completely new systems and regulatory frameworks emerges every ten to fifteen years. The payments and settlements framework is provided by BIS recommendations, including the relevant CPSS publications and the Principles for Financial Market Infrastructures report published in 2011. Efficiency is the ultimate driving force for development and this holds true for the project for intraday settlements in Hungary. The most tangible change in this respect is standardisation, now a basic requirement both nationally and internationally. Adoption of the BIS recommendations will result in efficiency improvement in payment services also in countries outside the eurozone, thereby promoting economic development and international relations.

In relation to the renewal of the financial infrastructure, here we will focus on the development of Automated Clearing Houses.

In the United States and in Western Europe, the extension of bank account services to households en masse took place in the 1950s and 1960s. In Hungary, this happened in the late 1980s and the 1990s. Salary payments in cash were abolished at most workplaces. The transfer of salaries to bank accounts en masse posed new challenges for banks. This happened at a time when information technology had already started to be commonly used by businesses, while there were no telecommunications services or any commonly accepted message standards to support data transmission and processing. In the United States as well as in several countries in Western Europe, the interbank clearing of salary transfers was performed by Automated Clearing Houses (ACHs) already in the 1970s. Automated Clearing Houses were set up to carry out the electronic processing of credit transfers and collections. With today's advanced telecommunications networks and information technology systems, banks can receive and process customers' payment orders with no difficulty. Today, most payment orders are received by the Automated Clearing Houses from banks and the clearing information returned to banks. At the same time, Automated Clearing Houses have preserved their basic function of performing the interbank clearing of payment transactions of the real economy.

In parallel with this, international standards have been developed, as a natural prerequisite for automation. Driven by international banking houses and international cooperation, global standardisation has become a general

requirement, which in the European Union is also accelerated by a political will. Accordingly, it is not only the elements of the central infrastructure that need to be restructured, but the systems of the individual banks need to be redesigned as well. These changes are primarily motivated by efficiency issues and regulated by international standards. Particular mention should be made of low-value payments, which are becoming increasingly important and their importance is further increased by consumer protection endeavours.

The clearing and settlement infrastructure is a basic payments infrastructure, a well-designed, controlled and standardised national service in every country. Apart from the well-known CPSS (Committee on Payment and Settlement Systems) publications, there were three basic international standards to regulate this activity: the Core Principles for Systematically Important Payment Systems (2001), the Recommendations for Securities Settlement Systems (2001) and the Recommendations for Central Counterparties (2004). There were some needs to harmonise the principles, appropriately structure them, extend them to cover all types of institutions and use all the fresh knowledge and experience gathered since their they were published. The new standards have been integrated in a single paper titled “Principles for financial market infrastructures”, published by the Bank for International Settlements in 2011. This paper contains new and more demanding international standards for payment, clearing and settlement systems. The paper provides a single, comprehensive set of 24 principles designed to apply to all systemically important payment systems, central securities depositories, securities settlement systems, central counterparties and trade repositories. (Principles for Financial Market Infrastructure, BIS Basel 2011, ISBN 92-9197-868-X). The new principles will replace the previously mentioned, existing sets. The following chart shows the structure of the new principles.

<p style="text-align: center;">General organization</p> <p>1. Legal basis 2. Governance 3. Framework for the comprehensive management of risk</p>	<p style="text-align: center;">Credit and liquidity risk management</p> <p>4. Credit risk 5. Collateral 6. Margin 7. Liquidity risk</p>	<p style="text-align: center;">Settlement</p> <p>8. Settlement finality 9. Money settlement 10. Physical deliveries</p>
<p style="text-align: center;">Central securities depositories and exchange-of-value settlement systems</p> <p>11. Central securities depositories 12. Exchange-of-value settlement systems</p>	<p style="text-align: center;">Default management</p> <p>13. Participant-default rules and procedures 14. Segregation and portability</p>	<p style="text-align: center;">General business and operational risk management</p> <p>15. General business risk 16. Custody and investment risk 17. Operational risk</p>
<p style="text-align: center;">Access</p> <p>18. Access and participation Requirements 19. Tiered participation arrangements 20. FMI Links</p>	<p style="text-align: center;">Efficiency</p> <p>21. Efficiency and effectiveness 22. Communications procedures and standards</p>	<p style="text-align: center;">Transparency</p> <p>23. Disclosure of rules and key procedures 24. Disclosure of market data</p>

Fig. 1. The new principles

Source: Emma Bäcke, BIS (Int. Conf. Ohrid, 14. Oct. 2011).

The BIS's related publications and reports have contributed to the set of standards, codes and best practices that are deemed essential for strengthening the financial architecture worldwide.

The history of the national Automated Clearing House and financial infrastructure in Hungary dates back to the 1980s, more precisely, to the time of preparations for the reinstatement of the two-tier banking system in Hungary. The initial plan was to use the French SG2-BULL system. This was not implemented due to the high cost of the upgrades needed. To meet the new concept, GIRO created an own software, which, mindful of the Lamfalussy report and uncertainties in the Hungarian banking sector, was capable of eliminating the credit risks related to clearing members. This software and its enhancements served the Hungarian payments system between 1994 and 2009. A full renewal of the financial infrastructure took place under the InterGIRO project. Under this, a new, flexible, transparent and predictable system, allowing business risk minimisation, availability definition and efficient service provision was implemented. The InterGIRO system has also served as a basis for the InterGIRO2 system to be launched on July 2, 2012. Both projects were developed by GIRO in cooperation with the U.S.-based Montran Ltd. The InterGIRO2 project was enforced by the increased quality needs of businesses and households, the objective to promote competition, the market's need for intraday settlements, and efficiency challenges. The best way to meet these challenges seemed to be to adopt the internationally accepted principles. The InterGIRO2 project is primarily aimed at introducing intraday settlements for all clearing members and implementing the SEPA standards in Hungary by June 1, 2012.

The key financial infrastructure development projects in Hungary (the self-developed clearing system, the introduction of multiple payment transactions, the Real Time Gross Settlement System) were all implemented under national projects. In each case, the individual projects set up by the institutions involved (the national clearing house, GIRO, the Hungarian central bank, MNB, and the clearing member banks) were coordinated under a comprehensive national project. Experiences of these projects showed that to ensure implementation by the set date, the InterGIRO2 project should also be managed under a national project. With InterGIRO2, the Hungarian payments system will be able to develop in step with the eurozone. This is also expected to facilitate a smooth introduction of the euro to the Hungarian payments system. Developing the Hungarian payments system independent of the euro target date will allow the optimal scheduling of the projects and

the management of international euro payments and domestic forint payments within the same account management system. Promoting cashless payments and adjusting electronic message standards to the European and global standards (including extending the data contents of the messages) will help promote the implementation of electronic processes in the purchasing/production/marketing value chain and, thus, improve the competitiveness of the Hungarian economy as a whole. The adoption of European and global standards and guidelines will further strengthen the integration of the Hungarian economy with the European Union. (InterGIRO2 Business Manual).

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