

ROMANIAN ELECTRONIC SYSTEM OF INTERBANK PAYMENTS IN THE BACKGROUND OF CREATING THE SINGLE EURO PAYMENTS AREA

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Abstract: Along with financial markets growth, the amplitude of settlements through payment systems has continuously increased. At the same time, it is necessary to be correlated with the need of streamline of noncash payments and with clients' demands to transfer sure, efficient and low-cost amounts of money. This action determined passing over to the electronic payment system functioning in real time. In this respect, we aim at drawing up a concise presentation of the electronic payment system in our country combined with assessments of this system aligned to the European Union's from the point of view of functionalities as well as respecting European and international standards and practices in the field.

Key words: interbank payments, electronic system, TARGET, Euro system, Single Market, real time payments, efficiency

1. Introduction

Since the establishment of the European Economic Community in 1958, the movement towards a more integrated European financial market has been marked by several events, the most visible of which were undoubtedly the launch of the euro in 1999 and the cash changeover in the euro area countries in 2002 in particular. Less visible, but also of great importance, was the establishment of the central banks' large-value payment system, known as TARGET, on 1 January 1999. TARGET provides the backbone of the financial system in euro, and is the implementation tool for the Euro system's single monetary policy.

The introduction of the euro as the single currency of the countries of the euro area will be completed only when the Single Euro Payments Area - SEPA - permits to individuals and corporations to make cashless payments throughout the euro area from a single payment account anywhere in the euro area using a single set of payment instruments as easily, efficiently and safely as they can make them today at the national level.

In Romania, the first steps in view of implementing this system were taken starting with the year 2005 by gradual operationalization of its three components: gross basis settlement, net basis settlement and settlement of government securities operations.

The architecture and functional characteristics of these systems were established by considering the following facts: the general policy existing in the field of payments and settlement systems of financial instrument based operations in the European Union, the main activities of interbank payments and settlements activities, standards and proposals issued by the European Central Bank, The Bank for

International Regulations and other worldwide specialized institutions and organizations. As a result, implementing an infrastructure of payments and settlements compatible with similar infrastructures in the European Union member states contributes to the Romanian system alignment to the Community requirements in the field.

2. Single Euro Payments Area role to establish the Single Market of payment services

The Single Euro Payments Area - SEPA – represents a project for the next step towards closer European integration. SEPA will imply that customers can make payments throughout the whole euro area as efficiently and safely as in the national context today. This requires, in principle, that at the end of the process, euro area customers will have the possibility of using one payment account and one set of standardized instruments.

In 2002, the banking industry took up this challenging project by creating the European Payments Council (EPC). The EPC is defining the new rules and procedures for euro payments. In doing so, it involved not only the stakeholders in the euro area, but also those in other countries of the European Union (EU), Iceland, Liechtenstein, Norway and Switzerland. Communities outside the euro area will thus have the opportunity to participate in euro payment systems, and will be able to adopt SEPA standards and practices, thereby contributing to the establishment of a single market for payment services.

SEPA consists of: the single currency; a single set of euro payment instruments – credit transfers, direct debits and card payments; efficient processing infrastructures for euro payments; common technical standards; common business practices; a harmonized legal basis and ongoing development of new customer-oriented services.

The SEPA project has two phases:

1) *Implementation phase until 2008* - the schemes for SEPA payment instruments have been developed, and banks and infrastructures will prepare their systems for roll-out;

2) *Migration phase from 2008* - customers will be offered both “old” national instruments and the “new” SEPA instruments. The European infrastructures will be able to clear payments made by both types of instruments. A critical mass of transactions will have migrated to SEPA payment instruments by 2010. Moreover, by end-2010, all euro area retail payment clearing and settlement infrastructures must be capable of processing SEPA instruments. Consequently, infrastructures must be able to address or receive, directly or indirectly, payment orders from any bank in the euro area.

The first phase, the design phase, began in 2004 and is now almost complete. This phase involves the design of the new credit transfer and direct debit schemes and the frameworks for cards and clearing and settlement infrastructures. The necessary standards and specification of security requirements have also been developed.

The second phase, the implementation phase, started in middle of 2006 and is going on until the end of 2007. This phase of the project will concentrate on preparation for the roll-out of the new SEPA instruments, standards and infrastructures. National implementation/migration bodies that have now been established in each euro area country will assist by monitoring the different stakeholders’ preparations for SEPA roll-out. These stakeholders are very diverse, consisting of a number of parties such as banks, infrastructure operators, public administrations, companies and other users.

The final phase will be a migration period, in which national payment schemes will coexist with the new SEPA schemes. Customers will be offered both “old” national and new SEPA instruments, and the clearing and settlement infrastructures will be able to process payments made using both types of instruments. The goal is to achieve a gradual market driven migration to SEPA, so that by end of 2010, a critical mass of transactions has migrated.

Thus, by 1 January 2008, the Euro system expects that the standard SEPA Credit Transfer defined by the EPC and the priority credit transfer will be made available to customers, in parallel with the national instruments, to be used in both a national and a cross-border context. Customer-to-bank and bank-to-customer standards will also have been developed and made available to customers.

By the end of 2010, the Euro system expects that public administrations, corporations and perhaps individuals will use exclusively SEPA credit transfers.

It is expected that, on 1 January 2008, the basic SEPA Direct Debit scheme will be fully operational, and be made available for business-to-consumer and for business-to-business transactions. Possible additional options, which are currently being investigated, should be made available in 2008 (European Central Bank, „Towards a Single Euro Payments Area”, February 2006, Objectives and Deadlines Fourth Progress Report).

3. Electronic system of interbank payments in Romania

The payment system in Romania experienced significant structural changes in 2005 by completing the process of implementing the electronic payment system and gradual operationalization of its three components that is (BNR Annual Report 2005, Chapter 4, Payment system, pg. 67):

- RTGS system - *Real Time Gross Settlement system* – a real time gross settlement system that entered into force on April 8, 2005;
- ACH - *Automated Clearing House* - managed by TRANSFOND SA – an automated clearing house that became effective on May 13, 2005;
- GSRS - *Government Securities Registration and Settlement system* - registration and settlement system of government securities operations that entered into force on October 3, 2005.

3.1. Interbank discount system on gross basis

In Romania, gross basis settlement system – RTGS – is a real time gross settlement system ensuring the exchange of payment instructions between participants and final (definite) settlement of interbank funds transfers on a continuous, transaction by transaction basis, as well as final (definite) settlement of net positions resulted from net basis settlement systems and funds transfers afferent to financial instruments based operations (RTGS system regulations 3rd version of October 10, 2006, BNR, pg. 5).

This system represents *the first component of the Romanian electronic payment system*, entered into force on April 8, 2005 (according to Regulation no 1 of February 23, 2005 on payment systems ensuring funds clearing, published in the Official Monitor no. 265/March 31, 2005, annulled by Regulation no 9 of September 23, 2005 on modifying and completion of the National Bank of Romania Regulation no 1/2005 on payment systems ensuring funds clearing, published in the Official Monitor no. 881/Sep. 30, 2005), ensuring high-value settlements (over 50.000 RON) and urgent interbank payments by payment order as well as great value and urgent payments

between credit institutions and State Treasury initiated by payment orders for the Treasury. At the same time, RTGS system accepts and processes the instructions from BNR authorized clearing houses or from systems ensuring transaction settlement by means of financial instruments for participants' net or gross positions settlement.

In view of fulfilling safety, security and availability conditions used internationally in projecting RTGS system in Romania there have been implemented *Straight Through Processing* - STP – systems in order to ensure efficiency increase through cutting down on operational risks and settlement time.

RTGS system was conceived in such a manner so as, along with the European Union accession, to make possible connecting to the platform of high-value payments settlements in the euro zone – TARGET ensuring the process of cross border payments in euro as well as changing the settlement currency from the actual national currency into euro.

3.2. Interbank multilateral net settlement system

According to *the definition of clearing house given by the Governors Committee of EU member states Central Banks*, “the clearing system represents a range of measures based on which, in a sole place (the clearing house), financial institutions present and change data and/or acts concerning funds transfer towards other financial institutions”.

In Romania, since 1995, there has been the Interbank Clearing House belonging to the National Bank of Romania. This entity allowed passing over from an intermediary settlement system (on a bilateral net basis) of interbank payments to a settlement system through multilateral clearing after a cessation of more than 50 years. Starting with the year 2001, multilateral clearing of interbank payments has been taken over by another operator - TransFonD – a trade company created by the banking community that carries out its activity as a BNR authorized agent.

When setting out, Funds transfer and Settlements Company - STFD TRANSFOND Ltd had BNR and 28 trade banks as shareholders. Presently, due to fusions and activity cessation in the payment system, TransFonD Ltd shareholders are BNR with 33.33% from the share capital and 24 commercial banks holding 66.67% of its share capital. As a BNR authorized agent, TransFonD sets up, by means of its 42 subsidiaries, clearing of debit payment instruments on paper (checks, bills of exchange and promissory notes) and RTGS net settlements.

The net settlement Electronic System managed by TransFonD Ltd – ACH system – represents the second component of the electronic payment system in Romania that entered into force on May 13, 2005 (BNR Regulation no. 1 of February 3, 2005 on payment systems ensuring funds clearing and Regulation no3/23.02.2005 on direct debiting made through automated clearing house, Official Monitor no. 265/31.03.2005).

ACH is an electronic system of multilateral payments clearing ensuring the exchange of payment instructions between participants, calculates participants' net positions through multilateral clearing and initiates, in RTGS system, a settlement of a net settlement instruction (ACH system regulations, version 5 TransFonD, July 7, 2005, pg. 7).

The administrator and operator of ACH system is TransFonD too, ensuring clearing small value payments (respectively transfer-credit type and direct debit under 50.000 RON) between credit institutions (except for institutions issuing electronic

currency) and between these and State Treasury, respectively calculating participants' multilateral net positions in the system and transmitting these positions to final settlement in RTGS system.

Payment instructions of transfer-credit type are initiated by participants to ACH system under packages form (folders) representing groups of payments instructions of the same type, with a single initiator participant, a single addressee participant and a single settlement date sent and processed within ACH system framework. Just like the RTGS system, ACH settlement system implies *a single national circuit* at the level of bank units' headquarters participating at the settlement through TransFonD headquarters.

By implementing some distinct settlement procedures according to the individual value of funds transfers and considering operating costs, we aim at *preventing the settlement risk* that is the situations where *interbank payments could not be completed on account of funds insufficiency of one or more credit institutions participating* at the system of interbank discount.

Within the electronic system of interbank payments in Romania, in order to prevent net settlement risk, it is implemented a unilateral guarantee procedure with blocked funds in the system reserve and with guarantee eligible assets, in principle, interbank deposits and government securities that is compulsory for all credit institutions participating.

4. Conclusion

The efficiency of interbank real time settlement system is appreciated through operational performances and facilities that it offers by liquidity supplying in a definite time (a bank day), the mechanism of waiting at queue as well as real time monitoring its own liquidities during the day.

In Romania, RTGS system can process and deduct a number of at least 30,000 day payment instructions and may ensure processing without interrupting payment instructions during the peak hours of a working day of at least 40% of the daily volume during an hour interval (RTGS system rules, ver. 3 of October 1, 2006, BNR, pg. 73). ACH system has certain specific characteristics such as great volume of processed instructions – between 150,000 and 300,000 instructions per day (TransFonD Annual Report 2005, pg. 14) – but of small value, as well as the fact that there are many clearing sessions on the same day, each session being followed by obligations settlement between participating members in the RTGS system. Thus, just like the RTGS system, ACH system may ensure normal processing during peak hours of at least 40% of the daily operations volume in an hour interval.

Another criterion in assessing the system efficiency consists of the commissioning policy set out by BNR in its quality of system manager that may apply commissions' deduction on each type of instruction according to the volume of instructions processed and deducted in RTGS. Likewise, along with the system that is in operation, the commissions level was reduced by 25% compared to the one practiced until that moment in the system of great value payments on paper support.

The main *advantages that credit institutions clients benefit from as a result of implementing the electronic payment system* are the improvement of payment services quality by reducing the period from the moment of issuing the payment invoice and receiving funds of the payment beneficiary, the increase of funds circulating flow, efficiency increase, their safe transmission as well as cut down in costs afferent to

payment operations.

Moreover, perspectives foresee also *implementing a model that would ensure electronic processing of small value payments afferent to instruments of written debit payment* (checks, bills of exchange, promissory notes). This represents the last component of the classic payment system in operation. Thus, starting with May 13, 2005, the clearing system managed by BNR ensures only processing and clearing debit payment instruments on paper.

In view of further development of payment electronic system that would ensure an automated and quick processing of debit payment instruments, BNR, in its quality of regulatory and authorization agency in the field of payment systems as well as manager of clearing paper-based system, decided upon a project whose aim consisted of an electronic processing of debit payment instruments as well as modifying the legal framework in order to allow its implementation.

Interbank real time settlement system in Romania is structured in order to be compatible with similar infrastructures in the European Union member states, Single Euro Payments Area. Payments handling will be simplified as all incoming and outgoing payments will use the same format. By providing new payment instruments and common interoperable infrastructures, SEPA will bring about further European integration and market efficiency. This consolidation of infrastructures will spur competition and banks can then negotiate better clearing prices.

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