

CROATIAN NATIONAL BANK

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4

Payment Operations

Activities focusing on the further implementation of payment system reform in the country continued in 2001. They included the enactment of the necessary legislation and regulations that regulate the reform and the pursuance of the specific operative activities connected with the reform. In addition to these core activities, supervision was conducted over the institutions authorized to perform payment operations (Financial Agency, FINA and Croatian Post).

4.1 National Clearing System (NCS)

The National Clearing System became operative on 5 February 2001. It is the second interbank payment system in the country, after the Croatian Large Value Payment System (CLVPS) introduced in April 1999. The NCS is an interbank, small payment system, or a system for the settlement of all interbank payment transactions that are not conducted through the CLVPS. Before it became operative, all accounts of banks/savings banks were transferred from the Institute for Payment Transactions (hereinafter: FINA) to the Croatian National Bank. By definition, the NCS is a system for the settlement of interbank payment transactions on the net multilateral principle. Settlement on the net multilateral principle is settlement that is performed continuously during the whole settlement day, whereby the payments debited and credited to banks' clearing accounts with the NCS are mutually cleared (netted). The result of such settlement is a corresponding net position in a bank's clearing account with the NCS. The net position in a bank's clearing account with the NCS has a cover or limit that the bank determines before the beginning of each settlement day in the NCS by transferring funds from its clearing account to its cover account.

Each bank's net position in the NCS is transferred at the end of the settlement day to its settlement account with the CNB for final settlement. Since the method for the determination of the limit (the guaranteed limit) is defined, settlement in a bank's account is ensured for all payments cleared through the NCS.

The launching of the NCS was the final step in providing the infrastructure (that includes the existing CLVPS) for the performance of interbank payment transactions in accordance with the provisions of the new Law on the National Payment System. This infrastructure, along with the formation of the Unified Register of Business Entities' Accounts, created the prerequisite for keeping business entities' accounts with banks.

This system for the settlement of interbank payment transaction is in compliance with the BIS recommendations for the development of domestic payment systems. In addition, it finally made it impossible to perform cashless payment transactions into and from clients' accounts when there is no adequate cover for their execution with the depository bank.

As a result, the banks were enabled to improve their management of daily liquidity, and the CNB was enabled to improve its management and monitoring of the daily liquidity of the banking system as a whole.

4.2 The Transfer of Payment Operations related to Business Entities' Accounts to Banks

At its meeting in July 2001, the Council of the Croatian National Bank granted approval to 9 banks for keeping accounts of business entities in private and majority private ownership. These banks were allowed to begin opening and keeping business entities' accounts as of 15 October 2001.

The precondition for obtaining these approvals by the CNB was the submission of an application form whose content was determined by the CNB decision. By submitting it, banks demonstrated their ability to perform payment operations in accordance with the provisions of the Law on the National Payment System and the regulations enacted on the basis thereof. To date, 31 banks have been granted approval for keeping accounts of business entities.

Although the approvals were based on the provisions of the old Law on the National Payment System, they should be viewed in the context of preparations for the implementation of the new Law on the National Payment System. That is, they gave the banks to opportunity, before the enactment of the new Law, to meet the demanding technical and operative preconditions for the performance of payment operations. However, it should be noted that only about 2000 accounts of business entities were opened with banks by 1 February 2001, i.e. before the implementation of the provisions of particular articles of the new Law on the National Payment System.

4.3 Unified Register of Business Entities' Accounts (URBEA)

The Unified Register of Business Entities' Accounts keeps a record of all accounts that business entities open with banks and the CNB for their regular operations. Each business entity is assigned an identification number by the CBS, so it is possible to locate every account opened by one business entity with banks.

The URBEA became operative on 15 October 2001. All banks, savings banks and the FINA were required to submit data on the business entities' accounts kept with them. Communication with the database in the URBEA is performed via Internet interface. The formation of the URBEA in the CNB created a unique database on all business entities in the country. It enabled the implementation of the Decision that regulates the execution of payment orders from the funds in payer's accounts kept with different banks. In addition, the procedures are in place for blocking all the business entity's accounts in the case that there are registered arrears.

4.4 Enforcement of Regulations related to the Payment System Reform

The changes that took place in 2001 necessitated the preparation of new legislation and regulations.

The following regulations were introduced in 2001:

- 1) Decision on the Unified Register of Business Entities' Accounts (official gazette *Narodne novine*, Nos. 68/2001 and 74/2001),
- 2) Decision on the Terms and Conditions for Opening Business Entities' Accounts with Authorized Institutions (official gazette *Narodne novine*, No. 68/2001),
- 3) Decision on the Keeping and the Content of the Register of Business Entities' Accounts with Authorized Institutions (official gazette *Narodne novine*, No. 68/2001), and
- 4) Decision on the Execution of Payment Orders from the Funds in the Payer's Accounts Kept with Different Authorized Institutions (official gazette *Narodne novine*, Nos. 68/2001 and 74/2001).

4.5 The New Law on the National Payment System

The enactment of the new Law on the National Payment System at the end of 2001 was the final step in providing the legal framework for the reform of the payment system in the country. Its basic characteristics are:

- the CNB and banks are the payment transaction agents,
- the accounts of the participants in the payment system are opened and kept by banks,
- the accounts of banks and the accounts of the Republic of Croatia are opened and managed by the CNB,
- a business entity may open an account with any bank but it must specify the main account,
- a bank may not open an account for a blocked business entity,
- as of 1 February 2001, all banks may open and manage the accounts of juridical persons in the country (prior approval by the CNB is not required),
- with the exception of a few articles, the Law on the National Payment System is applied as of 1 April 2002.

4.6 Operating Activities and Procedures related to the Payment System Reform in the Country

The introduction of the NCS and URBEA required an integral technological framework, linkage with all payment system participants and the creation of the necessary test environment before running live.

During the year, supervision was exercised over the institutions authorized to perform payment operations (FINA and Croatian Post); it included direct oversight and numerous contacts with these institutions.

Direct oversight was performed in six operating units of the FINA and ten operating units of Croatian Post.

4.6.1 Improvement of Existing Systems

The activities carried out in 2001 included the improvement of existing solutions in the national payment system. Several technological modifications were made in the CLVPS:

- ❑ CAS 2.50, the new version of CAS, was installed in the CLVPS within the regular annual program upgrade,
- ❑ the option to use the new payment message MT 103 in the CLVPS was introduced,
- ❑ following the NCS launching, the application of the File Account Transfer (FAT) option began, which enables the partial automatization of CLVPS operations,
- ❑ SWIFT Alliance Access 4.1, the new version of the SWIFT application, was installed.

Developments at the Beginning of 2002

These changes in the payment system had been carried out within the framework of the old Law on the National Payment System, and the CNB was obliged to adjust the existing regulations to the new Law on the National Payment System. Acting in accordance with its authorities, the CNB passed numerous regulations (official gazette *Narodne novine*, No. 14/2002) with the aim of adjusting the performance of the new payment system operations to the new Law. The application of these regulations was set for 1 April 2002.

The new Law prescribes the terms and methods of cash payments whereby cash is supplied by the CNB to banks and by banks to their clients. In accordance with this, the

CNB passed the Decision on Supplying Banks with Cash (official gazette *Narodne novine*, No. 22/2002).

This Decision set forth the establishment of cash centers in the existing operating units of the FINA for supplying banks with cash. Their number is to be reduced by the end of the current year (probably 22). The transfer of funds from the settlement account with the CLVPS to the cash account is a condition that the bank has to meet in order to withdraw the cash in the cash center. The funds kept in this account are an integral part of the bank settlement account.

At the same time, Croatian Post was deprived of the right to build cash reserves in the case that there is no cover in the account, and the obligation to finance Croatian Post with cash reserves was taken over by Hrvatska poštanska banka.

This phase of the payment system reform was considered the most challenging for both the payment transaction agents (banks and the CNB) and the payments system participants. The numerous changes that were introduced include:

- ❑ payment system participants' accounts with the FINA were closed and corresponding accounts were opened with banks. More than 300,000 payment system participants had their accounts with the FINA.
- ❑ a new method of designing the giro account in the payment system was introduced within the procedure of opening business entities' accounts with banks. All deposit accounts for government budget revenues, obligatory contributions and revenues for financing other public needs were changed accordingly.

Finally, we would like to note that all the activities carried out in the course of national payment system reform can be considered very satisfactory, especially with respect to the time-limits for the implementation of the new Law on the National Payment System.

Some problems arose, mostly related to the closing of participants' accounts held with the FINA and the transfer of the funds in these accounts to a bank account, so the CNB supplied each bank with recommendations on how to overcome these problems. These recommendations enabled the banks to quickly solve the problem transactions.

In addition, it was considered that the closure of such a large number of accounts of business entities would pose a certain risk to the functioning of the whole system. Therefore, the time-limit for closing accounts held with the FINA was extended in consultation with the Ministry of Finance. This also reduced the pressure on the banks.

Although the course of payment system reform has been judged satisfactory so far, one should bear in mind that this is the first time that banks perform payment operations and they need time to adjust.

