

CROATIAN NATIONAL BANK

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ANNUAL REPORT

4

Payment Operations

4.1 Application of the New National Payment System Act

In 2002, the payment system reform went through its last and most demanding stage - business entities and citizens' transaction accounts held with the FINA were closed and corresponding accounts opened at banks. The implementation of the last stage of the domestic payment system reform was demanding both for payment system agents, the Croatian National Bank and banks, and payment system participants. Participants' accounts with banks were opened based on a new account structure meeting required European standards. The implementation of these activities called for the adjustment of existing primary and subordinate legislation. On 1 November 2002, the FINA was put in charge of managing the Unified Register of Business Entities' Accounts.

The National Payment System Act (official gazette *Narodne novine*, No. 117/2001), enacted in late 2001, defines the basic principles of the payment system. The Act has been applied since 1 April 2002 although participants were able, pursuant to one of its articles, to open accounts with banks as early as of 1 February 2002.

4.1.1 Enactment of Subordinate Legislation

Pursuant to the provisions of the National Payment System Act, the CNB regulated the domestic payment system (official gazette *Narodne novine*, No. 14/2002) by amending the following decisions:

- 1) Decision on the Terms and Methods of Opening an Account with a Bank;
- 2) Decision on the Content of the Register of Business Entities' Accounts with a Bank;
- 3) Decision on the Unified Register of Business Entities' Accounts;
- 4) Decision on the Execution of Payment Orders from the Funds in Payers' Accounts Held with Different Banks.

Additionally, the following decisions were enacted:

- 1) Decision on the Bank Account Number;
- 2) Decision on the Structure of an Account with a Bank;
- 3) Decision on Payment Orders;
- 4) Decision on the National Clearing System;
- 5) Decision on the Croatian Large Value Payment System and Settlement in Bank Accounts Held with the Croatian National Bank;
- 6) Decision on the Work Schedule for Settlement/Clearing through the Interbank Payment Systems.

Acting within its authority, the CNB also enacted the Instruction for the Implementation of Article 50, paragraph 1 through 4, of the National Payment System Act (official ga-

zette *Narodne novine*, No. 14/2002), which specifies the dynamics and method of closing all accounts that had been opened at the FINA. In addition, the Decision on Supplying Banks with Cash (official gazette *Narodne novine*, No. 22/2002) introduced changes to cash transactions, providing for the establishment of cash centers used by the CNB to supply banks with cash. Cash centers have been set up at 22 domestic locations in FINA operating units. Their organization is presented in the chapter dealing with currency department operations.

4.1.2 Payment System Reform

The payment system reform, implemented in the previous few years, was focused on putting into operation interbank payment systems, aimed at setting conditions for the performance of payment operations across business entities' transaction accounts at banks. In order to enable business entities to open such accounts at banks, while maintaining "financial discipline" provided for by the previous payment system, the CNB established the Unified Register of Business Entities' Accounts (URA). The Register operates as a database for all accounts of business entities' domestic operations; compiled to enable advanced data exchange among banks (via an Internet interface) as well as an insight in and use of these data. The CNB has given access to the URA database to approximately ten Croatian government institutions having public authority. The Register is kept by the FINA, which ensures the availability of data to all domestic payment system participants. The URA also provides the basic infrastructure enabling the freezing of all business entity's accounts in case any unsettled liabilities are recorded by its main account.

According to URA data, there were 249,254 business entities in the Republic of Croatia on 31 December 2002, of which 135,648 (54.4%) went to legal persons, 103,859 (41.7%) to natural persons and 9,747 (3.9%) to freelancers.

Business entities had 287,901 accounts opened with banks in that period; i.e. an average 1.16 accounts per each business entity. Out of 249,254 business entities, 80.9% (201,603) were solvent, whereas 19.12% (47,651) of business entities' accounts with banks were frozen owing to unsettled liabilities.

The part of the payment system reform related to the closing of business entities transaction accounts at the FINA and the opening of corresponding accounts with banks was implemented following a predetermined dynamics through several stages. Bank began to open and manage business entities accounts on 1 February 2002. On that date the CNB started monitoring all data related to business entities "account migration" and subsequently established co-ordination with the Ministry of Finance. About 350,000 business entities and citizens' accounts were closed at the FINA in that period, as well as several evidence accounts, and the said 287,901 accounts opened. The Croatian National Bank took charge of managing and performing payment operations across the accounts of the Republic of Croatia specified by the Minister of Finance.

4.1.3 Improvement of Interbank Payment Systems and a Presentation of Payments Executed in 2002

A part of the activities performed in 2002 was focused on the improvement of domestic payment system facilities. The Croatian Large Value Payment System (CLVPS) underwent technological modifications and conditions were set down in anticipation of new projects:

- a new version of the CLVPS program (CAS 2.60) was installed as part of its regular annual upgrade;
- SWIFT Alliance Access-Automated File Transfer (AFT) was purchased and installed – a new option for automatic recording of payment transactions made by SWIFT in CNB customers' accounts. The project is being tested.

Table 4.1 CLVPS – Payments Executed in 2002
in HRK

Month	CLVPS – total		Average amount per payment transaction
	Transaction amount	Number of transactions	
January	66,996,233,344	11,054	6,060,814
February	63,031,134,644	10,424	6,046,732
March	80,756,363,388	10,818	7,464,999
April	83,656,171,766	8,748	9,562,891
May	77,044,172,367	7,890	9,764,787
June	61,698,668,989	6,984	8,834,288
July	76,003,713,790	8,950	8,492,035
August	78,151,686,836	7,774	10,052,957
September	76,656,536,505	7,678	9,983,920
October	82,873,412,087	8,263	10,029,458
November	72,699,595,266	7,561	9,615,077
December	84,181,653,529	7,659	10,991,207
Total	903,749,342,511	103,803	8,706,389
Average	75,312,445,209	8,650	8,706,389

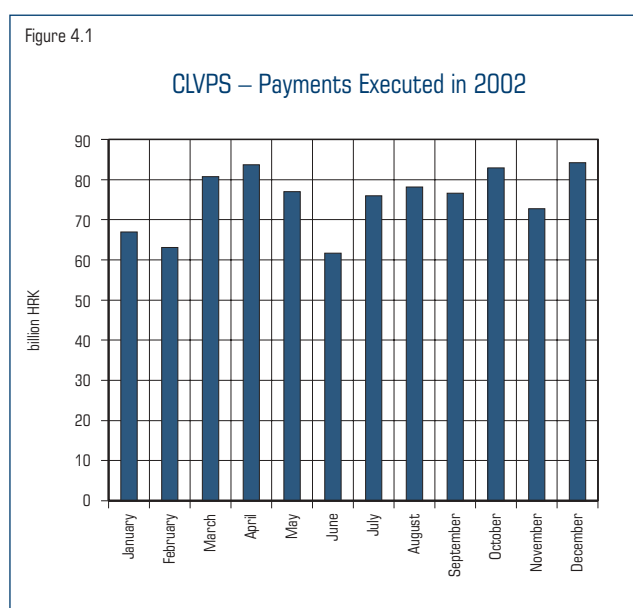
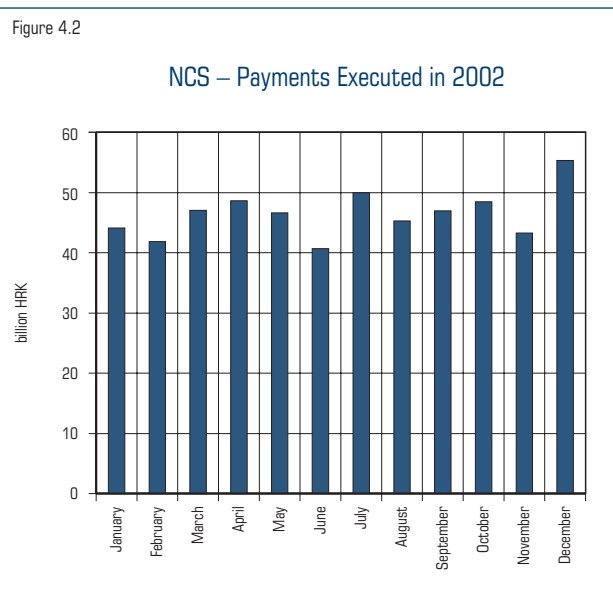


Table 4.2 NCS – Payments Executed in 2002
in HRK

Month	NCS – total		Average amount per payment transaction
	Transaction amount	Transaction number	
January	44,075,049,315.78	5,702,363	7,729
February	41,815,358,097.94	5,563,289	7,516
March	47,030,972,934.03	6,108,027	7,700
April	48,603,402,680.63	8,954,811	5,428
May	46,620,427,246.54	8,773,821	5,314
June	40,685,140,079.16	8,378,939	4,856
July	49,997,909,953.30	9,917,332	5,041
August	45,230,792,608.54	8,739,996	5,175
September	46,914,921,361.31	8,939,893	5,248
October	48,416,144,158.69	9,444,752	5,126
November	43,299,761,418.96	8,829,168	4,904
December	55,285,969,416.88	9,735,165	5,679
Total	557,975,849,272.00	99,087,556	5,631
Average	46,497,987,439.00	8,257,296	5,631



4.1.4 Enactment of Subordinate Legislation and Special Regulations under New Conditions

An analysis of intervals in which the NCS receives transactions within the new payment system showed that they need to be prolonged and the daily work schedule for clearing in the interbank payment system was modified (official gazette *Narodne novine*, No. 50/2002).

The CNB also enacted the Decision on Performing Payment Operations in a Bank Following a Merger or Acquisition of Bank (official gazette *Narodne novine*, No. 75/2002).

This Decision regulates bank mergers or acquisitions in the domestic banking market and prescribes the terms and methods of performing payment transactions in interbank systems.

The Decision on the Terms and Methods of Conducting Payment Operations in Savings and Loan Co-Operatives (official gazette *Narodne novine*, No. 150/2002) introduces participants settling interbank payments through a bank into the payment system. A license granted by the CNB allows a savings and loan co-operative to conduct payment operations on behalf of its members while having the same rights and responsibilities as a bank, with the exception of operations related to clearing in the interbank payment system.

4.2 Further Development of the Domestic Payment System

The National Payment System Committee was established on CNB's initiative to fill the need for correlating and co-ordinating factors influencing the development of the domestic payment system. The Committee consists of the representatives of the Ministry of Finance, Croatian National Bank, Croatian Chamber of Commerce and Croatian Banking Association. Its purpose is to address various issues related to the domestic payment system; e.g. making proposals for new payment system services, agreeing on a common approach within the payment system to enable a uniform implementation of legal provisions from various areas, establishing co-operation between legislative authorities, etc.

The structure of citizens' accounts with banks needs to be adjusted by 30 June 2003, following the adjustment of domestic business entities' account structure, which has already been made. The structure of business entities and citizens' accounts has been brought into compliance with the standards prescribed by the European Committee for Banking Standards and international standards, i.e. BBAN - Basic Bank Account Number and IBAN - International Bank Account Number.

In addition, the National Clearing System remains to be institutionalized as an independent business entity pursuant to the provisions of the Financial Agency Act.

Transaction settlement risk, existing before the enactment of the new National Payment System Act, was completely removed from the system by the establishment of the new payment system in 2002. Banks, as the main domestic payment system agents, are now able to manage their own liquidity by managing business entities' accounts and performing transactions across these accounts. Being in charge of payment operations, which are basic banking operations, banks are able to monitor customers operations in their entirety and thus lay the ground for an open bank-customer relationship.

The domestic payment system reform has set preconditions for the further development of a market oriented payment system. The range of services banks offer to their customers has markedly grown (electronic payments, ATMs for business entities, pre-paid cards, debit cards). This especially concerns the increasing share of electronic banking in total domestic payments, both in terms of its value and the number of transactions. The maintenance of business entities' accounts with banks has considerably contributed to the further strengthening of "financial discipline" in the period when a payer's accounts are frozen. In other words, under new legal provisions, not only kuna accounts of an insolvent business entity are frozen but all its foreign exchange accounts as well. In addition, a business entity whose accounts are frozen is not allowed to extend its fixed-term depositing agreement concluded with a bank. Instead, following the expiry of such an agreement, the funds are used for covering unsettled liabilities.

The domestic payment system reform, a very sensitive and demanding project, has been implemented successfully and, most importantly, without interruptions in regular operations. Some difficulties were experienced during the transfer of funds from the accounts with the FINA to newly opened accounts at banks. The CNB reacted promptly and instructed banks how to resolve certain problems. In conclusion, the newly established domestic payment system satisfies European standards and thus fulfils part of the requirements for EU accession.