

RECENT MODIFICATIONS TO THE DEBIT PAYMENT INSTRUMENT IN ROMANIA: A COMPARATIVE SYNOPTIC APPROACH

Socol Adela

“1 Decembrie 1918” University of Alba Iulia, Faculty of Science, Nicolae Iorga Str., No. 39, e-mail: adela_socol@yahoo.com, Phone: 0258806263, int. 198,

Turta Irina Mihaela

Ministry of Economy and Finances, Public Internal Audit Department, Bucuresti, e-mail: iryna_ela@yahoo.com

Abstract: This study is aimed to describe the actual stage and the developing opportunities for settlement of the debit payment instruments in Romania. We present the settlement system of the debit payment instruments during the period 1999 until present. We underline the actual stage of the compensation of the debit payment instruments through Transfond and comparatively with the description of the automatic process of the debit payment instruments. We examine the technical ways to preparing the debit payment instruments, especially the two proposals for operating the debit instruments through truncation – the truncation at the source and the flexible truncation method.

Key Words: Debit Payment Instruments, Automated Processing Solutions

Introduction

Among the banks' operations we identify the banking specific operations carried out directly by the banks, pertaining to the essence of the banking activity, like issuing and administering payment instruments and making payments. The operative and efficient functioning of the national banking payments system leads to a more frequent utilization of this system by the population and the economic entities.

In such an economic context, the interest of banking societies and of the national banking authority – National Bank of Romania – is to develop and maintain viable payment systems. Otherwise, National Bank of Romania carries out operations with banking companies and other credit institutions, consist of regulate and supervise payment systems, ensure services of compensation, depositing and payment. The involvement of the National Bank of Romania in building a modern national banking payment system is obvious. We affirm that relying on the structural changes at the level of banking payments, sustained by National Bank of Romania.

We chose the debit payment instruments as the object of the study, because from 2007 in Romania there is a project to automated processing of the debit payment instruments. Initially, this new system had to be operational starting at 1 April 2008, according to the agreement between national authorities and the World Bank. But this date was impossible to respect, especially because of the delays in the primary legislation adoption which modifies conditions for the debit payment instruments. From the moment of the legal framework adoption it is foreseen that it would be needed an almost 4 months transition period from the present processing way, manually towards an image processing method. In the 11-th of April 2008 were published the modifications of debit payment instruments legislation in the Official Gazette of Romania, which will be applied in 30 days from their publishing. Then in a 30 days term, the National Bank of Romania must elaborate norms for the primary legislation application.

The processing of the debit payment instruments through Transfond

The study of the settlement of the debit payment instruments did not make without the presentation of the role of Transfond society. In the year 1999 the Romanian National Bank decided to externalize the funds transfer operations and the compensation operations, and in the year 2000 is created according to the engaged settlements to the European Union, the National Company of Funds Transfer and Settlements Transfond SA, as an operator of the national payments system and the majority stockholders are the National Bank of Romania (33,33%) and the main banks that are operating in the Romanian banking system (66,67%). In the year 2001, became operational the externalizing the payments activity decided by the National Bank of Romania towards Transfond SA (excepting the funds transfers related to the State

Treasury). The Transfond SA company took the old locations of the National Bank of Romania (42 locations) where the compensation took place and the payments instruments circuit with or without cash or paper support, meaning that the payment document had to appear in physical shape at the payer, not being possible the electronic circuit of the payment documents (as well as for the less and unequal development of the banks infrastructure, as well as for not existing the needed legal settlements).

The Transfond SA Company had as main purpose for its activity financial intermediations and auxiliary activities of the financial institutions, as it follows:

- Operating the funds transfers realized as net or gross shape between the banks, State treasury and other financial institutions through settlements accounts or other types of accounts and irrevocable and no conditioned settlements of these transfers in the current accounts and the evidence accounts maintained through law by National Bank of Romania, including agent for the central bank;
- Recording and the transfer for the property over the state creations through evidence accounts of these ones opened in the name of owners recorded and maintaining its evidences, including as agent for the central bank.

The national payments system in the Transfond SA situation functioned in Romania until the year 2005 and during its functioning supported many changes at the procedural level. The credit payment instruments are settled into the elements of the SEP – Electronic Payments System, which function from 2005. But, in April 2008 the debit payment instruments are still settled up classically by Transfond.

In the framework of net settlements of the debit payment instruments through Transfond Company, each day of labour of the year had an imposed compensating session of the inter-banking payments, in its units in territory (41 units) and the central of Transfond (country capital city Bucharest), in special rooms prepared for this, in the morning. The compensatory session is lead by a compensation inspector. Each unit participating names an agent to represent it in the sessions, agent who has the task of preparing the compensation session and of participating as a representing of the banking unit in this session. The preparation of the compensation session is developed outside of the territorial units Transfond. The debit payment instruments are grouped on destination bank (receiving). Between the compensation agents of all banking units that participated at the session, the envelopes are exchanged, envelopes that contained the debit instruments packages and compensating centralized dispositions and their annexes, available for the debit payment instruments. After receiving of the envelopes with the packages of compensatory instruments where meant for banking units that represented them, each agent verifies them, assures them and goes back to its banking unit. The debit payments instruments are divided between the valid paying instructions and the refuses for the justified cases. These refuses are presented to the correspondents banking units in the second part of the compensatory session.

An overview on the future of the debit payment instruments

To understand the special case of the debit payment instruments in their quality of means of payment, we present the main characteristics of the debit payment instruments. *The bill of exchange* is the document through which a person, the drawer or the issuer, gives an order to another person, the drawee, to pay at maturity, an amount of money to a third person, the payee, or upon his order. *A promissory note* is a document through which the issuer undertakes to pay to the payee, or upon his order, an amount of money, at maturity, in a certain place. Consequently, the promissory note intervenes between two persons, and not three, as is the case of the bill of exchange. Unlike the bill of exchange, it does not contain the payment order addressed to another person, but only the acknowledgment of his own payment obligation. *A check* is a document through which a person, the drawer, gives an unconditional order to a bank, the drawee, in which he or she has available funds to pay, upon the presenting of the writ, an amount of money to another person, the payee. The payee can be the drawer himself (check of withdrawal). The debit payment instruments shall take the form in writing and the document shall comprise the mandatory mentions stipulated in the Law no. 58/1934 and no. 59/1034.

These mentioned regulations did not essentially modify from 1934 and their elements are inadequate to the development of the actual banking area. It is imposed the change of the national regulations. More precisely, the Romanian legislation said that the payments using debit payment instruments are conditioned by their physical transmission between the banking societies involved, so this kind of payments is not made by electronic compensation nowadays. In this circumstances there is a need to change the existing banking

regulations (which imply the physical circulation of the debit instruments) because in present the banking settlements with payment debit instruments, being intra or inter banking, are marked by the physical transmission of the debit instrument by postal circuit. In this way we have an unjustified increase of the duration of settlements with payment debit instruments. Also, there is the risk of losing the debit payment instruments.

All the time after '90 years, in Romania was very important to change the banking regulations which imply the physical circulation of the debit payment instruments. This need became acute in the last years, after 2005, because the banking settlements with payment debit instruments, being intra or inter banking, are marked by the physical transmission of the debit instrument by postal circuit. In this way we have an unjustified increase of the duration of settlements with payment debit instruments.

In December 2007, National Bank of Romania sent to European Central Bank a request for an opinion on two draft emergency ordinances amending Law No. 58/1934 on bills of exchange and promissory notes and Law No. 59/1934 on cheques. In February 2008, the European Central Bank delivered the opinion. The amendments proposed in the draft emergency ordinances are follows: to regulate truncation; to define the concept of signature on cheques, bills of exchange and promissory notes more clearly; to eliminate post-dated cheques, the *allonge* and data/references to data on the back of cheques, bills of exchange and promissory notes; and to introduce a single period for presenting a cheque for payment, regardless of whether it is payable in the city where it was issued.

European Central Bank approved an opinion - advice of payment - on two draft emergency ordinances amending Law No. 58/1934 on bills of exchange and promissory notes and Law No. 59/1934 on cheques. Based on opinion gift by the European Central Bank, were elaborated two law projects, which are on the order list of the Romanian parliament starting with the year 2008. The legislation modification on the cheques, bills of exchange and the promissory notes was necessary for the implementation of the new project of automatic process of the debit payments instruments.

After the first components of the SEP since 2005 (ReGIS, SENT and SaFIR), at the level of the National Bank of Romania of the Romanian Association of Banks and TransFonD began the project named PAID 07-The Automatic Process of the Debit Instruments (Palade, 2007). The project will assure the transition to the un-centralized way of processing characterized by the physic exchange of the debit payment instruments to a centralized way, based on the transmissions of the electronic payment imagines and messages and the electronic compensation of the last ones thought the SENT system.

So, after lot of years of primary changes, in March 2008, the two Government Emergency Ordinances No. 38 and No. 39 amending the debit payment instruments framework – Law No. 58/1934 on bills of exchange and promissory notes and Law No. 59/1934 on cheques. Until now, in Romania the debit payment instruments – the cheques, bills of exchange and promissory notes - are still settled up classically on paper support in the daily compensation meeting at Transfond. The technical aspects of the reimbursements based on the debit payment instruments must make the object of the second legislation given by National Bank of Romania this thing being foreseen for the first part of the year 2008.

The automatic process of the debit payment instruments is supposed to immobilize and un-materialize the instrument at the unit of the beneficiary where is presented for the first time for the settlement. The un-materialization means to capture and transfer all the information's owned by the physical instrument, together with the scanned picture of this, in a standard electronic message, which is given by the beneficiary bank in the SENT system and then to the bank unit of the payer for checking and compensation. The electronic message process is realized based to a procedure similar applied to the direct debit instructions in the SENT system. The electronic message scurred by the electronic signature, has the same legal value as the physic instrument. The solution assures the process automation creating the possibility of the integrated process of those instruments and assures a low process time. In order to apply such a solution is necessary the legal frame modification regarding the cheque the bill and the order ticket which foresees the compulsory to present the physical instrument of payment.

Changing the debit instruments' processing implies the removal of paper support circulation by truncating the debit instruments at the beneficiary's bank, the electronic transmission of the debit payment instruction and of the image, the payment's validation based on the debit instrument's scanned image protected by using the digital signature techniques and the guarantee of a high security and automation degree for operating the debit instruments, with low costs and quicker processing.

The truncation of a payment instrument consists of catching the payment information on electronic support and stopping the paper support circulation, the further operating of the payment instruction-taking place only in electronic field. The new image processing technologies allow the payment validation using the digital image of the payment instrument. The automatic operation of the debit payment instruments through the Electronic Payment System would mean:

- The truncation of the debit instruments takes place at the beneficiary's bank where the debit instrument is firstly presented for payment;
- The payment instruments are caught on electronic support using specialized machines and will be sent to ACH in MT104 folders, XML format, similar to the direct debit messages;
- The both sides image of the debit instrument is obtained by its scanning either with machines specialized for catching the payment instruments or with usual scanners. The banks will use digital signature techniques for certifying the accordance between the electronic image and the paper support original of the debit instrument and for the further image's legalization;
- The paper support payment instruments won't be sent on interbanking circuit, they will be archived at the entrance in the banking system where the truncation operation takes place, at the beneficiary's bank;
- The debit instruments will be electronically presented for payment through the automatic compensation house SENT as follows: the debit payment instrument and the digital image of the payment instrument are sent from the beneficiary's bank to the central of the bank, from there to SENT where they are registered and sent further on at the payer's bank through his central bank
- The validation of the payment is realized on the debit payment instrument's scanned image at the payer's bank;
- The compensation of the debit payment instruments will take place through SENT similarly to the direct debit operating - the "exception" method, through which the payment confirmation is implicit (the system considers to be accepted for payment all the debit instruments for which it wasn't received a denial from the payer's central bank);
- The debit instruments' images will be kept in three locations: the beneficiary's bank where the truncation took place, the payer's bank and Transfond as a trusted party, so the possible disputes would be quickly solved;
- The participants at the debit instruments operation through truncation will obey the rules referring to the compulsive maximum durations of settlement for debit instruments which will be imposed by regulations.

There are two proposals for operating the debit instruments through truncation the truncation at the source and the flexible truncation variant. In the first way, the truncation will take place at the beneficiary's bank using specialized technology for catching the payment information and the images; the process has been previously briefly described.

The flexible truncation method is the same as the other one, the distinction being that both the location for truncation in the beneficiary's banking structure and the level of specialization for the technology used is decided by each bank, according to the volume of debit instruments operated in the territorial units and to the amount of investment that the bank wants to realize for this purpose. The banks can make a technological mix using less specialized machines for reading the bare code and usual machines for scanning the debit instruments. The truncation flexibility does not imply derogations from the maximum terms of operation, which will be mentioned in regulations.

Conclusions

For the automatic operation of the debit payment instruments there was a need for some changes in this domain, both at the regulation level and at the territorial network level of each bank. The regulations regarding the debit payment instruments had to be adapted to permit the debit instruments' electronic presentation for payment. National Bank of Romania will elaborate the technical norms regarding the debit payment instruments. Banks must adopt a bare code for the debit payment instruments, which would be personalized by the issuer's bank (drawer or subscriber) by completing the codes' line. For this purpose,

when delivering the notebook with debit instruments the bank would imprint a bare code on the white band of each leaf of debit instrument with the following information: the issuer customer's IBAN, the number and series of the debit instrument and the transaction code (payment instrument type). There is also necessary the numbering, giving series and keeping the promissory notes and bills of exchange' evidence in the same way as for the cheques' issuing in order to uniquely identify each debit instrument.

For facilitating the automatic processing of the debit instruments and for increasing the accuracy degree of the beneficiary's dates taken from the electronic support at the bank's counter there is recommended the encashment note's personalization by the bank, writing the IBAN code of the name of the account on the encashment note which will be used when he is in the position of beneficiary.

The increase in the volume of data to be transmitted on the internal communication network of each bank especially determined by the transmission of folders with scanned images of the debit instruments brings the need for adapting this increase to the volume of debit instruments, which are truncated by each territorial unit. The machines and the software for imprinting and reading the bare code, for catching and operating the images are another investment decision depending also on the encoding standard which will be adopted (one-dimensional or bi-dimensional bare code) and on the truncation variant chosen by each bank, truncation at the source or flexible truncation.

References

1. Palade, M. (2007) "The project PAID 07 The automatic process of the debit instruments", TransFonD, Presentation to the 6th Edition of Cards and New Banking Technologies, organized by Finmedia, on 6 and 7 March 2007, available at <http://www.cardsforum.ro/images/upload/presentations/10.ppt>, accessed 15.04.2008
2. Government Emergency Ordinances no. 38 amending the debit payment instruments framework – Law no. 58/1934 on bills of exchange and promissory notes, published in the Official Gazette no. 284/2008.
3. Government Emergency Ordinances no. 39 amending the debit payment instruments framework – Law no. 59/1934 on cheques, published in the Official Gazette no. 284/2008.
4. Law no. 59/1934 on cheques, published in the Official Gazette no. 100/1934.
5. Law no. 58/1934 on bills of exchange and promissory notes, published in the Official Gazette no. 100/1934.