

### **3. Legal framework for payment and settlement systems**

The Negotiable Instruments Act, 1881 (N.I. Act) continues to be the predominant legal base for all cheque-based (instrument-based) payment systems in India. It has been amended time and again to accommodate new requirements and policies. The latest amendments in respect of the definition of “cheque” by inclusion of the “electronic image of a truncated cheque” and a “cheque in the electronic form” have opened up avenues for introducing new methods of processing paper-based payment instruments. Simultaneous amendment to the Information Technology Act, 2000, making it applicable to N.I. Act, has accorded legal status to the usage of electronic payment systems in Indian banking.

However, the electronic payment systems like ECS, EFT, NDS, RTGS, etc. work on the basis of a series of bi-lateral agreements made specifically for each one of them which are of contractual nature between the participant and the manager of the systems. The process of netting of payables and receivables is adopted by all payment systems except RTGS where the settlement is on gross basis. Existing legal structure does not explicitly cover ‘netting’ and ‘finality of settlement’. Some countries have legislated ‘netting’ and ‘finality of settlement’ and also built regulatory structures either within the central banks or by way of establishing quasi-judicial institutions to oversee payment systems.

The growth and proliferation of existing and new payment systems has necessitated central banks to move away from operating retail payment systems. Management and operations of payment systems are being taken over by consortium of banks, central counter parties, authorised private service providers, etc. Lack of an apposite provision in law for regulation and supervision of these entities reduces the scope of having a monitoring mechanism leading to apprehension of participants and end-users on the safety and security of the payment systems.

The 'Payment and Settlement Systems Bill' has been proposed with the view to receiving and creating legal definition of 'netting' and 'settlement finality' and also to create a regulatory framework for the payment and settlement systems.

The shift towards electronic modes of payments has revealed inadequacies in the present legal structure and consequently there is lack of legal clarity about the products designed using information technology. This issue becomes more pronounced in respect of the 'instruction' based payments, i.e. the now prominent 'credit transfer' systems. The United Nations has published an UNCITRAL Model Law on International Credit Transfers (1994) to cover payment instructions which are originated by the payer through a banking system to pay into a beneficiary's bank account. Such a law will have to be put in place in India too as current international trends indicate a bias towards the more risk-free credit transfer mode of payments.

Keeping in view the possibility of dishonour of instructions on the due date, the issue of legality of action required to be taken against the defaulters has to be addressed. Such instructions of payment are in the nature of non-negotiable standing instructions. These types of instructions, not being instruments, are not covered under the existing laws. Therefore, there is a need to examine this issue to provide desirable level of robustness.

Keeping the above in view, it is proposed to initiate the following steps towards building a sound legal base for payment systems during 2005-08:

**Action Points:**

1. The Payment and Settlement Systems Bill to be enacted;
2. Regulations for authorised payment and settlement systems to be framed
3. Finalisation of EFT Regulations
4. Initiating the process of legislation for credit transfer transactions on the lines of UNCITRAL Model Law on International Credit Transfers (1994)
5. Drafting Regulations for ECS(Debit Clearing)