

4. Risk Mitigation in Payment Systems

Safe, secure and efficient payment systems are critical to the effective functioning of the financial systems. Payment Systems face various risks like credit, liquidity, legal, operational and settlement risks. However, systemic risks by far outweigh other types of risks. In case of systemically important payment systems, failure of one or more participants could have a domino effect, leading to settlement failures in other payment systems, thereby threatening stability of the entire financial system. Over the past few years an international consensus has developed on the need to strengthen the payment systems by promoting and adopting internationally accepted standards and practices. The Committee on Payment and Settlement Systems of the G-10 countries (CPSS) set up under the auspices of the Bank

for International Settlements (BIS) has formulated best practices in the form of Core Principles for Systemically Important Payment Systems (SIPS). The CPSS has also specified the responsibilities of the central banks with regard to the payment systems in their respective countries.

India has, by March 2004, made all the systemically important payment systems (SIPS) compliant with the Core Principles, except the Inter-bank Clearings at places other than Mumbai and the High Value Clearing Systems. There is a need to complete this process in the near future.

Keeping the above in view, it is proposed to initiate the following steps towards risk mitigation in payment systems during 2005-08:

Action Points:

To address Systemic Risks:

1. Interbank transactions at all places to be migrated to RTGS System
2. High Value Clearing Systems to be made secured netting systems by introduction of guarantee funds

To address Liquidity Risks:

1. Implementation of National Settlement System for posting the net position of the clearing participants in all clearing houses in the country.

To address Operational and Legal Risks:

1. For enhanced security of messages, PKI based digital signatures to be introduced.
2. Credit transfers to be encouraged and in electronic mode
3. Provide for high availability of all systems