

Payment and Settlement Systems : Select issues*

Director Shri Sharma, Mr. Hollandars, Mr. O'Connor, Mr. Shigang, Ms. Christova, Mr. Beau and distinguished participants and Ladies and Gentlemen,

It is my pleasure to be with you this evening to deliver the valedictory address at the Regional Payment and Settlement Systems Workshop organised jointly by the Reserve Bank of India (RBI) and the Bank for International Settlements (BIS). Participants from the central banks of 16 countries from Africa and Asia have attended this workshop and we had the privilege of having the guest speakers from the Bank of Canada, People's Bank of China, BIS and Bank De France, apart from the speakers from the RBI. The schedule of the workshop indicates that a wide gamut of subjects relating to the management of payment systems has been deliberated upon in the workshop from different country perspectives. The association of the BIS in organising the workshop as also in providing faculty support would have certainly enriched the deliberations of the workshop.

I am thankful to the organisers for giving me this opportunity to share my thoughts with you in regard to certain issues relating to the payment and settlement systems.

A major challenge for countries like India relates to the need for achieving efficiency in situations where large-scale increases in the quantum and complexity of processing of financial transactions occur. Consider the following scenario: Today's customers are more demanding than ever before; they have access to the latest information and have a wide array of options to choose from. Each customer would yearn for the best product or service at the least possible cost. Against this backdrop, efficiency has become critical if the payment system

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has to generate a high degree of customer confidence. Hence, ensuring safe and expeditious movement of funds at an optimal cost is the key to success of all payment system reforms.

Another challenge faced by the central banks relates to the explosion of technology which has made deep inroads into payment and settlement systems. The integration of many hitherto distinct markets is taking place at an unprecedented pace due to advancements in technology. Technology implementation poses a myriad of issues and options, such as : the choice of optimal technology; the costs of its implementation; the high rate of technological obsolescence and the need for periodical updation; the advantages and risks of outsourcing; and the convergence of technologies.

The relatively late adoption of technology by us and the recent initiation of reforms in payment and settlement systems have in some way proved to be a sort of blessing in disguise by enabling us to take advantage of the experience of the innovators. However, much will depend on the capability to leap frog to the state-of-the-art payment and settlement systems. Given the high rate of technology absorption witnessed in the recent past in our region, there is reason to be optimistic that the challenges will be met successfully.

One of the recent technical advances which has had a significant positive impact on the payment systems relates to the chip-based processing. Smart card chip-impregnated cards have made their presence felt everywhere. These devices are now used for card-based access control, identity documents including driving licences, health cards, phone cards, etc., but their real potential lies in storing monetary value for settlement purposes. These cards can also be used for storing account details, especially for small customers where the cost of servicing them through branch-based banking would be rather high, as also for enabling the stored value to be used for payment for goods and services purchased by the card holder. One of the advantages of these cards is the built-

in authentication mechanism which ensures that only the authorised user is able to utilise the card or its contents. These cards can deliver services such as biometric authorisation and digital signatures while providing the convenience of usage to the card holders. Finally, the integration of these smart cards with the mobile phones, I understand, holds exciting promises for the future.

Another related issue is that with a much deeper penetration of mobile telephony across all strata of the society, whether the paper-based payment system, a legacy of the past, needs to continue in the same manner. Perhaps, the payment and settlement chain may soon witness a sea change with the bank account transaction being initiated through a mobile phone, followed, within a few seconds, by the inter-bank settlement effected in central bank money. If and when that happens, the benefits would accrue to all concerned.

Closely related to the above is the need for the benchmarks not only to measure performance but also to provide a standard for the participants in the system. In a world of inter-operability, necessitated by multiple delivery offerings, the co-existence of varied systems is already a reality. This underlines the need for standards to be evolved, based on international benchmarks, but adapted to the local requirements. Such benchmarks could also be quite useful in securing compliance with the Know Your Customer (KYC) and Anti Money Laundering (AML) norms, monitoring of intricate cross-country financial flows as also the operational efficiency of each system in a country.

Let me now dwell a little on certain facets of effective payment and settlement systems. The introduction of the Real Time Gross Settlement (RTGS) System by many countries has not only resulted in compliance with the Core Principles for Systemically Important Payment Systems enumerated by the BIS, Basle but has also paved the way for risk-free, credit push-based fund transfers settled on a real time basis and in the central bank money. However, the liquidity requirements for the RTGS are relatively high. Hence, the options are being weighed as to whether the liquidity requirements can be tackled by the banks in a

cost-effective manner without losing the benefits of the RTGS. A judicious mix of netting coupled with the RTGS, or a guaranteed net settlement are some of the measures which would obviate the risks involved in the Deferred Net Settlement Systems (DNS). While the RTGS holds great promise, it is possible that the technological as well as institutional aspects may result in considerable problems during the phase of transition.

Our experience with RTGS shows that there are immense benefits but its popularity itself can give rise to some operational issues when the system is stabilising. Recently, delays in closing the books by the end of the day have been reported. I am informed that several experts are working on the system to resolve the problems. We are according highest priority to tackle these operational issues that have cropped up in the recent past.

I take this opportunity to endorse what Shri Narayana Murthy, Chairman and Chief Mentor, Infosys said while speaking at this forum. He said :

“According to the RBI, there are about 48,000 public sector bank branches in the country, of which over 63 per cent are in semi-urban and rural areas. Though over 70 per cent of the branches have attained 100 per cent computerisation, real time gross settlement (RTGS) is available only in 23,500, while the national electronic funds transfer covers less than 5,000 branches. Hence, integrating semi-urban and rural areas into the electronic clearing system was critical”.

I agree that the coverage of the RTGS undoubtedly needs to be expanded over a period. This would require upscaling of its operations in terms of capacity and speed, for which efficient and effective transition to the RTGS system and its stabilisation would be essential. It is necessary to explore all the issues in a comprehensive manner that would arise in rapid upscaling of RTGS in our country.

Further, several strategic measures may be necessary to popularise and encourage the use of the RTGS by the financial intermediaries, consistent with the efficacy and capacity of the RTGS system. We would, no doubt, be happy to gain from your experience and share our experience, in the days to come.

We have formulated a 'Payment and Settlement Systems Vision' document for the use of banks, financial institutions as well as the general public. The vision document outlines the short- and medium-term plans of the Reserve Bank for the various payment and settlement systems in the country. The broad contours outlined in the document enable the banks to plan their initiatives in tune with the perspectives laid down in the Vision for the country as a whole.

It is noted that the spread and reach of the payment services are often confined to certain sections of the society especially in the early stages of development. The provision of payment services by the banks to all and at affordable rates is an important requirement for a more balanced and equitable socio-economic development. We, in India, have been attempting an active approach towards Financial Inclusion in the recent past. Hence, access to funds transfer services at economical rates to the vast majority of the country's population would be essential for securing financial inclusion as also for reducing the dependence on non-banking channels for remittance of funds. Infact, I agree with Shri Narayana Murthy when he said :

"the retail payment systems need to be improved by developing appropriate applications and user-friendly websites with simple interfaces and local content".

Perhaps knowledge of payment systems could be an element of intensive campaign for financial education that RBI intends launching soon.

An aspect closely related to the above is the need for providing adequate legal backing for transaction processing in a high-technology environment. Most of the countries in the world have a supporting legal framework in place for the purpose, while several others are in the process of enacting statutes to meet the

requirements of a technology-driven processing environment. In view of the large-scale and rapid advances in technology, we are trying to ensure that the legal framework in our country is not lagging behind the developments in technology. While the Payment and Settlement Systems Bill, 2006 is under consideration of the Parliament, the oversight of payment and settlement system was initiated under the RBI (Board for Regulation and Supervision of Payment and Settlement Systems) Regulations, 2005, which have been framed under the statutory provisions of the RBI Act. As and when the Payment and Settlement Systems Bill is enacted in the Parliament, the enactment would provide a specified and dedicated legal foundation for the regulation and supervision of the payment and settlement systems as also legal recognition to netting procedures in the country.

Given the nature of developments in payment and settlement systems and the role played by the Information Technology, we would all stand to gain if we share our experiences amongst ourselves. While the expositions such as this seminar provide a valuable platform for exchange of views, ideas and information, it would be beneficial if we keep the communication channels going even after we return to our respective places, in the true spirit of international cooperation.

I am confident that together we would not only successfully meet the challenges before us but also implement optimal payment and settlement systems for the benefit of our countrymen.

Thank you.