

*Retail Payment Systems – Select Issues**

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1. It is indeed an honour to be the first speaker in a gathering of Payment and Settlement System professionals who will be deliberating upon various issues that I am sure will go a long way in strengthening the payment systems fabric in individual countries as well as in a global context. In the context of an otherwise gloomy scenario in the global financial system, the presence of robust payment and settlement systems infrastructure around the world has been a matter of great solace.

2. As I can see from the agenda, fruitful deliberations on various issues concerning retail payment systems will be the focus of this Seminar, which I consider to be highly appropriate as it is an exciting and most happening area. Being the first speaker, I have an advantage - I am not constrained by what has been said or covered before. Disadvantage though is not having the benefit of a chartered path to cover. Let me make best use of the advantages. I will share not only some of my perspectives with you but also present the relative status in the Indian context.

3. The payment systems in any economy can be compared to the arteries in a human body. So long as the arteries are performing their tasks silently and efficiently, the human body remains healthy and their role is hardly noticed. Once they start clogging or malfunctioning, they can impair and impact the efficient functioning of all other parts of the body. Similarly, efficiently functioning payment and settlement systems often remain in the background, but come to lime light when an inefficient payment system or any failure in any segment of payment system causes ripple effects in the economy.

* Inaugural Address by Smt. Shyamala Gopinath, Deputy Governor, Reserve Bank of India at the Regional Seminar on Payment Systems, jointly organised by the Reserve Bank of India and Bank for International Settlements at Mamallapuram, Chennai, India on March 17, 2009.

4. Depending on the nature or type of transactions that are handled by any payment system, their importance to the larger financial system is determined which in turn influences the extent of regulatory focus that is given to the system. Besides, inter-temporal and inter-spatial developments in the context of payment systems further necessitate continuous changes to be incorporated in regulatory attention too. Thus, in the initial stages of evolution of oversight structure for regulation and supervision of payment and settlement systems, greater attention may be given to Systemically Important Payment Systems (SIPS) as compared to retail payment systems, for obvious reasons, especially as these SIPS usually handle payments of large value and settlement of inter-bank transactions emanating from financial markets pass through such systems. However, as regulatory attention on these large value payments get stabilised and simultaneously developments in retail payment mechanisms evolve, the span of oversight attention widens to encompass these systems as well. Let me briefly highlight some of the issues that merit attention in the context of retail payment systems.

5. I am not sure whether a standard definition of 'Retail Payment System' has been given anywhere, but a reference to the 'Glossary of terms used in Payment Systems' (by CPSS – Committee on Payment and Settlement Systems) shows that 'retail payments' are defined as mainly consumer payments of relatively low value and urgency. Accordingly, 'retail funds transfer system' is defined as a 'system which handles a large volume of payments of relatively low value in such forms as

cheques, credit transfers, direct debits, ATM and EFTPOS (Electronic Funds Transfer at Point of Sale) transactions. Even going by this working definition, what clearly emerges is that the user base for retail payment systems is very large as they touch every economic activity in the country and even cross-border transactions of such nature. In terms of volumes, paper-based and electronic retail payment systems far exceed the large value payment transactions, while they may be lower in terms of value.

6. Efficient retail payment systems bring in operational efficiencies for all commercial activities and greatly facilitate e-commerce. Recent developments in payment systems, aided by developments in information and communication technologies, have provided customers with a wide array of choices, demanding greater levels of efficiency and safety in their operations. Further, final settlement of transactions from many of these retail systems may also occur in one or the other large-value payment systems, increasing their systemic importance. Thus, such retail payment systems, even though they are not SIPS, can be aptly called as Systems of System-Wide Importance. Oversight arrangements of such systems should, therefore, not lose sight of this relevance of retail payment mechanisms in the larger economic context.

7. The presence of a sound legal framework greatly enhances the efficacy and efficiency of the oversight function. In India, we have recently enacted the Payment & Settlement Systems Act, 2007 - an exclusive legislation for regulating and supervising payment activities, with the

Reserve Bank of India being designated as the authority to do so. This legislation, not only empowers the Reserve Bank of India to authorise, monitor and supervise various players and infrastructural arrangements in place for payment and settlement systems, but also eliminates certain ambiguities that existed in adherence to processes and procedures related to payment and settlement activities.

8. Retail payment systems are growing in terms of their reach and variety - products, delivery channels, number of service providers and diverse technological solutions. The rapid migration from paper to electronic modes can largely be attributed to the extraordinary growth in issuance and usage of cards (both debit and credit), increasing Automated Clearing Houses (ACH) transactions (for repetitive bill and utility payments), multiple delivery channels (ATMs, net-banking and core-banking solutions) and the changing appetite of the present generation of consumers. What we are witnessing is the favourable shift from the beneficiary-initiated transactions (from debit-pull in cheques) to the beneficiary-facilitated transactions (to credit-push in ACH). This, to be precise, is what makes this segment most exciting to the players and most challenging to the regulators. The responsibility of both, though, is to make it a win-win situation to the users – by ushering in products that are ‘competitive yet comparative’, ‘unique yet generic’, ‘feature-rich yet cost-effective’ and ‘comprehensive-in-coverage yet transparent-in-content’.

9. Under such a scenario, any country planning for an efficient payment system needs to put in place a roadmap, which is often called as the “Vision Document”. The

vision document lays out the future direction of the payment systems – which normally gives a reasonable description of what could be expected in a span covering the next 3-5 years in various segments, both wholesale and retail. This document is expected to represent the initial direction of the approach of a central bank from the point of transparency of its policies. Vision document would cover the aspirations and desires of the consumers, the service providers, technological capabilities, global developments and domestic requirements. All or major policy pronouncements thereafter would broadly traverse this path. In the Indian context, the aspects outlined in the ‘Payments System Vision Document’ encompassing the three-year period 2005-2008 have largely been achieved and we are now in the process of framing the vision document covering the period up to 2011.

10. Given the wider range of economic activities that impact and in turn are influenced by the presence of a safe and efficient retail payments infrastructure in the country, developments in these systems can be harnessed to widen the scope of coverage of the services particularly in the context of financial inclusion. In countries like ours, developments in retail payments and their delivery channels can be effectively dovetailed for bridging not only geographical gaps but also in terms of extension of financial activities and access to these activities to a wider section of society.

11. Payment and settlement systems in India have, and I am sure it is the case in many other jurisdictions too, players that are common across the retail and wholesale segments. Access criteria for membership

to the clearing houses that provide the retail products (cheques, ACH, *etc.*) and eligibility to offer various payment products (pre-paid instruments, mobile payments, *etc.*) should be stringent enough to permit only strong entities with better risk management practices to enter. What we should aim for is a level-playing-field with players firmly-on-the-ground. Infirmities and arbitrage opportunities in one segment should not be allowed to transcend into the other. Procedures should be in place to benchmark and lay down the expectations and roles of different stakeholders in each product-segment. The endeavour should be to correspondingly benchmark these requirements and standards with international standards, wherever they are available. A word of caution – the international standards and benchmarks, including vendor solutions operating elsewhere, have to be dovetailed and customised to suit domestic requirements and situations.

12. Deliberations in Seminars such as these also need to highlight the need for a set of standards or recommendations for best practices in the context of retail payment systems just as the prescriptions in the context of SIPS or Securities Settlement Systems, *etc.* May be a beginning could be made along the lines of the European Central Bank's "Oversight standards for euro retail payment systems" (June 2003), which seek to apply some of the Core Principles for SIPS to specific retail payment systems as well depending upon the assessment made by the central bank with respect to the systemic implications such retail systems can have. In the Indian context, we have already made our

electronic funds transfer systems such as RTGS (Real Time Gross Settlement) and NEFT (National Electronic Funds Transfer) compliant with the FATF (Financial Action Task Force) requirements on wire transfers. We have also prepared bench mark documents covering cheque clearing – both mechanical and manual, as also retail electronic products which cover the aspects of minimum standards that have to be put in practice to ensure their efficient operations. These benchmark standards are applicable to both the processing centres run by the Reserve Bank as well as other commercial banks.

13. Another issue that merits attention is that of service charges. It can be argued that the competitiveness and competition or a buyer's market would bring down costs in a near-to-medium time-frame and definitely in the longer-run. Yet, the fears of cartelisation, excessive cost-recovery in the initial years and lack of transparency in the cost-structure are concerns that need to be addressed. While the charges-framework should be remunerative to providers, they should not be prohibitive to users. The challenges lie in striking a balance between cost and cost-recovery, including the issues relating to transparency in the charges framework and rationalisation of charges across banks / service providers. In the UK, the Office of Fair Trading (OFT) has been addressing these issues. We, in India, have recently mandated the service charges that could be levied by banks for providing electronic payment products to their customers, as also for usage of shared-ATM networks by banks' customers.

14. Besides other kinds of financial risks and risk mitigation measures that need to

be taken, operational risk assumes significant importance in the context of retail payments and their settlement mechanisms because of the wider scope of operations of such systems which is not limited to a few players (unlike large-value or inter-bank payment systems). While Retail payment systems need to be sized appropriately to handle substantial volumes and reduce the load on large-value payment systems, appropriate and well-tested business-continuity-plans with sufficient built-in-redundancies should also be in place to ensure availability of the retail payment systems in the eventuality of any disruption / contingency. I am sure important issues such as process innovation, outsourcing, Business Continuity Planning, *etc.* will be substantially covered during the Seminar deliberations.

15. While banks and other financial intermediaries are often the major players in any payment system arrangement, the role of non-bank operators such as technology and communication service-providers, support services for ATM networks, issuance of pre-paid payment instruments, *etc.* certainly cannot be ignored. Modern payment systems, be it wholesale or retail, depend extensively on technology and communications for their effective and efficient functioning. The role of non-banks gains more importance when e-wallets and pre-paid instruments are widely accepted as convenient channels of effecting payment; the impact of such instruments in replacing the physical needs of cash in an economy is enormous and warrants delicate policy handling.

16. Another issue that needs to be examined in retail payment systems, relates

to the role of industry organisations and self-regulatory organisations in meeting the expectations of various consumer-groups, information dissemination, building awareness of the products among the banks' operational staff, public and the like as also in promoting the usage thereof. Consolidation of infrastructure and patronising umbrella organisations is what we have been aiming at in India. Recently the National Payments Corporation of India (NPCI), an umbrella organisation set-up by banks, has been institutionalised which is expected to take over the various retail payment products operating in the country. Being an organisation with banks as stakeholders, NPCI is expected to provide uniformity in operations, standard operating procedures, and promote resiliency and efficiency of the retail payments infrastructure.

17. The Seminar would also give us the opportunity of learning from developments in various jurisdictions. The UK has recently implemented the benchmark 24x7 system (known as Faster Payments Service), wherein retail customers are in a position to transfer funds at any point of time in a day, while the related inter-bank settlements take place only during the working of hours of the RTGS system. Bank customers can initiate such transfers either through net or phone banking. I believe the speakers from the People's Bank of China would also be sharing with us their experience and success of similar systems implemented in their country. In India, the NEFT (a retail electronic funds transfer facility), has six net settlements during the day, for providing funds transfer facilities. This network handles

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transfer volumes of around three million transactions a month, while that in UK, I understand, handles as high a volume as five million a day.

18. As I said earlier, the issues are endless, and before I take your leave, let me flag a few developments which are presently being considered by us. These relate to white-labelling of ATMs (complete outsourcing of most of the ATM-related activities by banks), cash withdrawal at points-of-sale, transfer of social security benefits through electronic means, hastening the migration of paper instruments to the paper-less mode, two-factor authentication for use of cards, consolidation of infrastructure, supporting the need for a single national-id for customer identification and KYC purposes, providing low-value one-to-one transfers on a 24x7 basis, *etc.* Giving a logical direction to settlement finality in net-settlement systems by examining guaranteed settlement is yet another thought process.

19. Ladies and gentlemen, you would agree with me that the host of issues that revolve around the retail payment systems cannot be addressed in a matter of few minutes. All that I have attempted is to draw your attention to the important issues that any regulator needs to be conscious about. I am sure over the next three days some of these issues may see solutions emerging with your active participation. At the end of the Seminar, let us all hope to carry with us sufficient knowledge to steer the course of the retail payment systems not just within our jurisdictions but also strive to harmonise the efforts of retail payment activities across jurisdictions.

20. Let me conclude by quoting what Leonardo da Vinci had said – “I have been impressed with the urgency of doing. Knowing is not enough; we must apply. Being willing is not enough; we must do.” What was true then is equally applicable today.

21. I wish you all the very best and happy deliberations.