

The changing landscape of Payment Systems in India- Some thoughts

Ladies and Gentlemen,

1. I am indeed privileged to be in your midst at this Second Annual Payment Systems Summit being jointly organised by IBA and Finsight Media. Let me begin by making an unimpeachable statement that a well regulated and smooth functioning payment system is very critical for the efficient functioning of the economy, be it financial sector or real sector. A well run payment system is an essential prerequisite for successful and safe running of various institutions like banks, non-banking entities and other service providers who all contribute to the economic growth and to the integration of the money, capital and forex markets. Today, even a small co-operative bank has the fear that it may face the risk of loss of reputation if a simple issue like its membership status with a clearing house is downgraded from direct to indirect. If the country's payment systems are witness to a monthly turnover that is more than equal to the entire annual GDP of the country, you can well imagine their criticality and importance.
2. This is true of any country, irrespective of whether developing or advanced. The volumes, number of players, time for settlement, the channels of delivery may vary, but not the risks, concerns and the policy focus. All the attention on payment systems performance has been justified if one looks at the recent or, so to say, the ongoing economic recession. This could have been so easily aggravated had there been any failure in the functioning of payment systems. This is a vindication of the efforts of the regulators towards ensuring that the payment systems are safe, sound, secure and efficient.
3. Given that payment systems are vital for any country, it is important not to underestimate its dynamism. While excessive regulation can stifle innovation,

inadequate competition can result in inefficiency and monopoly. While fewer players mean cartelisation, large numbers thereof can mean chaos. While free access is welcomed by all, unbridled right of entry can very well be the first sign of trouble. Therefore one has to draw a line, as a regulator, as a stakeholder, as a common man in order to enjoy the benefits of a well-functioning and widely-trusted payment system with a menu of products. If yesterday was the day of the paper, today and the future belongs to the electronic mode. It is for each one of us to steer and navigate the course of the payment systems. Of course, the word of caution is that the entire process has to be smooth, non-disruptive and concurrent with the preparedness and convenience of the users.

4. The period of time since the last summit has seen a plethora of developments. The Payment & Settlement Systems Act has been legislated which casts responsibility on the Reserve Bank of India to authorise and supervise all the payment system products operating in the country, including such activities of non-bank entities, various service providers and so on. The task is mammoth and the challenge enormous. When we talk of large value payment systems, RTGS comes to our mind first. It is a matter of great satisfaction to mention here that we had recently subjected our RTGS system to an external institution for expert analysis, especially to review compliance with the internationally accepted Core Principles as applicable to Systemically Important Payment Systems. The results are very satisfying. Our RTGS system has been found to be in full compliance with all the core principles, except in one area where we are adjudged to be partly compliant and that too because we are offering the RTGS facility free of cost to member banks! But we are fully conscious that this does not mean that we can rest on our laurels. Given the fast changing

landscape of the payment system we can always plan ahead. In RBI we are already looking at the next generation RTGS with more improved features. We have also seen the birth of the industry body that is expected to take over all activities relating to retail payment systems in the country. Turning out attention to the retail systems, the National Payments Corporation of India (NPCI) is looked upon to consolidate and launch new products to modernise the various retail payment products. NEFT, a widely used retail payment product has transcended borders with the launch of the Indo-Nepal Remittance Facility Scheme for providing a cheaper mode of sending migrant worker remittances from India to Nepal.

5. We have also set up a state of the art data centre where to the critical payment system applications like RTGS, CFMS and PDO-NDS have already been migrated. Back-up infrastructure for NEFT and NFS is also being created at the data centre which will provide the requisite redundancies to assure their uninterrupted availability at all times. We are also in the process of looking at a number of other options like, hosting the data of all MICR-CPCs at a central location which can facilitate a single point of download for the member banks be it the clearing data or reports, single window facility for member banks to view the balances held across various clearing locations by leveraging the core banking solution of the bank managing the CPC, conceptualising and implementing settlement finality with an appropriate mechanism to take care of failure-to-settle situations etc.
6. Payment systems in India have had a chequered history and traditional systems have been in vogue for many centuries, well mingling with the more recent electronic products. The initiatives of the Reserve Bank- all through a

consultative process- have always aimed at the establishment of an integrated system that would benefit all the sectors of the economy, and at the same time reduce the overall risk in the system. At the heart of all these initiatives is the role played by technology which has been the backbone of the payment system reforms and it is gratifying to note that there has been substantial expansion of the menu of technology based products and services available to the customers of banks for their payment needs.

7. In the light of the current global meltdown, there are anticipations of lowered spend in technology. This should lead to consolidation of investment and the probable emergence of platforms and products which are generic in nature and inter-operable. This would also result in optimum utilisation of existing infrastructure and move to new technology only after due testing and when it is absolutely necessary. In short, we should be witnessing maximum output for every rupee of investment in technology. To my mind, this should not deter investments in technology for the betterment of security. For instance, the recent directive on two-factor authentication in credit cards is being talked about as one that would entail additional investments in technology. One of the comments that I received in this regard was a gentle pointer that the number of online frauds in this country has not yet reached alarming levels. But you will surely agree that you cannot fault the regulator for being ahead of the curve on this issue! With the number of credit card issuances and usage increasing by the day, it is necessary to bring credibility to the system even at the cost of additional investments to assure security.
8. From the days of distributed products and requirements catering to the needs and aspirations of stakeholders at regional locations, we have now tuned

ourselves to products with a national character. Technological advancements by way of enabling branches with core banking solutions (CBS) will actuate the reality of a customer of a branch not just being a customer of the bank, but of the banking industry per se. National-ECS and National-EFT is expected to leverage and ride on the CBS infrastructure to extend the benefits of centralised processing across all branch locations in the country from a single processing location. While we can claim credit that more than 55,000 branches are presently RTGS and NEFT enabled, can we be truly happy if we look at the daily volume of transactions handled by these products? How many of the branches are actually initiating even a single transaction in a day? Are they in reality equipped to do so? If yes, the volumes should increase manifold. Banks have the responsibility to augment and put in place the necessary framework at the processing centres (aka service branches) for straight-through-processing, with adequate infrastructure like connectivity, access to customer accounts, network support, including assuring adequate availability of quality human resource with technical expertise to realise the advantages. What is the point in introducing products that are national in reach when the last mile is still through media mode and the branches have to be telephonically or otherwise told to open the mails containing debit or credit instructions? Migration of old customer account numbers to the requirements under CBS requires priority if the transactions are to be processed within the confines of the service branches.

9. An important issue relates to the need to pass on the benefits of such an enablement to the users by way of reasonability in charges and transparency in framework. Else, regulatory interventions will be the order of the day. How can

one expect a customer to be convinced about as to why intra-bank transactions are more expensive than inter-bank transactions? Can we ourselves be convinced that charges can still be levied on ad-valorem basis when the inputs required to be entered are the same? Should proceeds of collection continue to be remitted using drafts or paper modes if both the bank branches are enabled to send and originate electronic transactions, just because the same was not asked for? Would not the decreasing collections be more than compensated by increasing volumes? Is it not everyone's responsibility to contribute to transparency and bring repute to the system? These questions beg greater deliberations in the forum of bankers.

10. It is often argued that irrespective of the regulatory intervention the competition or a buyer's market would bring down costs in a near to medium timeframe and definitely in the longer run. However this is the classical theory of free markets and competition which has broken down around the world. Further, the fears of cartelisation, excessive cost-recovery in the initial years and lack of transparency in the cost-structure are concerns that any regulator needs to address. We have been advocating the need for transparency in framing of the cheque collection policy, the compensation policy for delays in collection and a transparent framework for levy of charges for other products as well, with as minimum sub-segments and conditionalities as possible. In cases of delay or deficiency in assured levels of service, the consumers need to be compensated in a fair manner. But what is fair? For instance, in case a bank does not adhere to the turnaround time of 12 days stipulated for refunding the failed ATM transactions, at what rate should the customer be compensated? The obvious answer I expect to hear from around the table is at SB rate. Personally I do not

concur. The regulators always expect the banks to comply with the instructions both in spirit and in letter. The penalty for non compliance has to be exemplary. This explains my views about compensation at SB rate.

11. I next come to new delivery channels like the mobile phones. The subscriber base is increasing sharply and serves over 400 million subscribers as on date, while the mobile tariffs have seen a steep decline. This has resulted in the increase in use of mobile phones with the average being 287 minutes a month. There is also a constant demand for more value added services for entertainment, information, banking, et al. The mobile phones and prepaid cards are expected to be the frontiers of developments in technology in general, and payment systems in particular, in the years to come.

12. Against the backdrop of the social objectives and the developmental role assumed by many central banks, including India, the costs to the system also merits policy intervention. Expansion of retail payment products should assist financial inclusion endeavours and reach the unbanked. Whether financial inclusion could be facilitated only by expansion of the banking channels is an on going debate around the world. There are no uniform answers. Each country has to take a well informed choice depending on the situations prevailing in that country. India has consciously gone in for a pre-dominantly bank led model. But the business correspondent model - the scope of which is currently under review - together with new delivery channels like plastic cards, mobiles and internet can easily supplement the banking channels in achieving inclusion. Retail payment products need to embrace the developmental concerns and social objectives of access and cost with support from appropriate technology. As the reach increases, so would be the demand from users for more value

added services, about unsustainable costs, increase in access points, etc. It does sometimes become difficult to explain whether technology drives payment system development or payment system initiatives stimulate technological advancements. As long as the innovations bring about faster, safer and secure products one does not worry about the order!

13. The various measures initiated by the Reserve Bank in recent times are well calibrated and intended to hasten the progress of migration of paper to the electronic mode. It is true that our local clearing cycle is one of the most efficient in the world. In an ideal scenario, it is not difficult to withdraw funds within 30 hours of deposit of a cheque. We can also boast that the mechanised cheque processing activities would shortly be in excess of 90% of the total volumes handled in the country, both in terms of volume and value. More than 98% of the 1115 Clearing Houses in the country are computerised. It is now possible to visualise collection of outstation cheques within the local clearing cycle of T+1 in as many as 54 major centres in the country if the cheques are drawn on core-banking enabled branches, thanks to the concept of Speed Clearing. The clearing and settlement infrastructure for paper processing is time-tested with adequate redundancies both for processing and settlement requirements at large centres. But the risks are inherent in a paper based system. It is time that we retain paper for low value and retail transactions and migrate all large value and wholesale transactions to the electronic mode. The recent initiative to increase the threshold for High Value Clearing is a step in this direction. This, however, has been misunderstood in some quarters to mean that paper based instruments below the threshold cannot be cleared. This is not so. Such instruments can well get presented and cleared through

the alternate system of MICR clearing. In this connection, it may be of interest to know that in UK where cheque volumes account for less than 10% share, the National Payments Plan outlined in May 2008, suggests that an active management of the decline of the cheque will be required, even to consider a possible closure of cheque clearing in 2018, i.e., after ten years. India is still far from reaching this zone!

14. One needs to realise that paper still accounts for almost 68% of the daily transactions in the payment and settlement systems. While this share has been decreasing slowly and gradually, we need to appreciate that paper would continue to be used in the near foreseeable future. What we can do is to minimise the need for paper to move. World over, studies have revealed that more than half the costs incurred in paper-based clearing is towards transportation and movement of the cheques. Cheque truncation is what has been successfully attempted in the National Capital Region of the country to migrate cheque clearing to an electronic platform by moving to image based cheque processing. Presently, the cheque truncation system (CTS) handles more than 90% of the daily cheque volumes at New Delhi. It is necessary to extend the benefits of cheque truncation across more centres. It is our intention to extend CTS to Chennai which would then also act as a DR site for the solution at New Delhi and vice versa.

15. Many locations across the globe with cheque volumes that are significantly more than India as also countries with much smaller volumes, have successfully implemented truncation. The problem in accepting images for processing is more of a mindset. Internally, if banks can use images for passing a cheque, why not use cheque images for settlement purposes?

Cheque features can be further standardised to address concerns of security and fraud in image-based processing. I do not envisage a manifold increase in the cost of a cheque leaf if addition of a security feature or two can be considered. Standardisation can also facilitate OCR capture of critical information and avoid data-entry and mistakes related thereto, thereby facilitating STP even in cheque clearing. There could always be a cut-off only within which can cheques participate in CTS.

16. But as one looks at various developments that expect a change in mindset, one is also presented with a wish list that would revolutionise the manner in which banking would be conducted and customer requirements enabled. For example, the demand for a more liberal policy on ATMs, the suggestion that RTGS business hours can extend to more than 16-20 hours a day, the anticipation that funds transfer instructions can be emanated and settled real time on a 24x7 basis, the concept of 'outstation' cheques as a thing of the past, etc.

17. As a central banker we do face a number of challenges. The myriad of service providers, plethora of services already in existence (guaranteed or non-guaranteed), the presence of non-banking entities, the impact of systems where geographical boundaries are virtually non-existent, the multiple roles expected of a central banker (development-oriented, growth-facilitating, system-operating, efficiency-assuring and customer protection), the responsibilities to co-operate with international jurisdictions and other regulators, the need to set and follow minimum benchmarks, the responsibility of ensuring uniform operating standards are but a few. To add to this, the list is growing by the day and becoming more complex.

18. Kudos once again to the organisers for providing a platform to discuss the ways and means in which the payment systems can be relied to deliver in an environment that is ever changing and, against the backdrop of demands that are ever increasing. I am really glad to share my thoughts at such an event. As part of the regulatory set up that has been the driving force of innovations in payment systems, I can justifiably claim that our efforts are on track and in sync with what the situation requires. I am equally sure that in the years to come, if America can be enthused by slogan 'Yes, we can', we can very well set ourselves the slogan 'Yes, we have' for our payment systems. We should be able to proudly proclaim, 'Yes", our payment systems have embraced the best of technology, have practices that compare with the best in the world, have resilience to upscale and be inter-operable, have enabled financial inclusion, have done all that was expected of it. Can we? We can! Will we? We will! We are all equal partners in this endeavour. Let us look forward to the day when this becomes a reality. To quote Walt Disney, 'All our dreams can come true – if we have the courage to pursue them'.
19. A look at the agenda and the impressive list of participants gives me the assurance that many contemporary concerns would be discussed and all stakeholders can expect innovative ideas to emerge that can nurture future initiatives in payment systems in the country.
20. I wish the summit all success.

Inaugural address by Sri G Padmanabhan, Chief General Manager, Department of Payment and Settlement Systems, Reserve Bank of India, Central Office, Mumbai at the Second Payment Systems Summit organised by IBA and Finsight Media at Hotel Taj President on June 5, 2009.