

RTGS: Ways to mitigate risks

Real time gross settlement (RTGS) system guarantees final and irrevocable settlement at the central bank. It mitigates the significant credit risk associated with a high-value payment if one party defaults, writes **Iffat Zahan**

REAL time gross settlement (RTGS) system is defined as an advanced technology for ensuring faster and secured inter-bank transactions. The system is scheduled to be initiated in Bangladesh from October 08, 2015. Industry insiders are hoping to have a smoother operation of the monetary market if this system is pressed into operation.

The essential feature of this service is that it will ensure transactions (cash or security) instantaneously (on a real time) on one-to-one basis without bundling or netting with any other transaction (gross basis). It has been announced that this service will enable high-value local currency transaction along with government securities and foreign currency-based transaction.

Since the emergence of the RTGS system in 1990, it has been considered to be a crucial process for money markets. It has its advantages but there are also some risks associated with it. So, it is essential that some risk mitigation plans are chalked out before the RTGS system comes into full-fledged operation.

The most useful part of this service is the way it is able to mitigate 'counterparty credit risk'. In general, credit risk is reduced as cash is transferred between banks in 'real time', transaction by transaction settling payment finally and irrevocably in central bank money. As the system guarantees final and irrevocable settlement at the central bank, it mitigates the significant credit risk associated with a high-value payment if one party

defaults.

One should also note that the monetary policy has its important tool known as reserve. For maintaining the stability of a financial system, RTGS is an essential tool for every central bank as it is also a tool to inject or withdraw liquidity. In this regard, reserves are the cash balances that the banks are required to keep at the central bank; so in order to clear trade, all banks must hold necessary cash in the central bank or post high quality securities at the central bank. This system holds its importance for any economy seeking to secure the confidence of international and domestic investors regarding fast transaction under extreme circumstances.

In a number of large emerging economies, RTGS payments were worth an average of just over 24 times GDP (Gross Domestic Product) in 2012. Hence we should expect it would be an essential component of financial structure for an emerging economy like Bangladesh's.

On the contrary, this system has a regulatory pressure for resilience. Along with systemic importance and contribution to a stable financial market, it has the risk that the integrity and security might be compromised. Therefore, for Bangladesh, maintenance and assurance of liquidity will be a great challenge initially. For that reason, many officials from the banking sector had voiced their concerns about the quality of transaction, as they feared at the outset the system will limit timeline for each transaction.

RTGS system is not free from risks.

Like any other physical infrastructure, the system is vulnerable in the face of natural disaster and failure of essential services like power grid, telecommunications or water. Further, terrorist attack, cyber attack, data corruption, and software failure too may disrupt smooth operation of the system.

A disruption in RTGS system is very costly as not only the transfers would be disrupted but also the monetary system of the country could be slowed down. Hence the system requires a resiliency plan: a plan to recover or adjust to any vulnerability or difficult situation within a shortest possible time.

There are many popular resilience plans for RTGS in developed countries around the world which are also proposed by SWIFT (Society for Worldwide Interbank Financial Telecommunication). However, these resiliency systems could turn out to be very expensive for a developing country like Bangladesh.

However, a second site back-up could be a lesser expensive option compared to having a third operational site in a different region or a country. In this scenario, the secondary site has to have accurate information about balances in order to defy the immediate setback. Another option could be using independent data storage system for restarting the payment in case of the failure of the primary site.

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