Chapter III

Payment Systems of Financial Institutions: Current State and Future Prospects

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Abstract

Economic activity is always accompanied by payment. Payment systems, which are the subject of much recent discussion, are an indispensable part of the infrastructure that supports the entire economy. Progress in the field of information technology (IT) has spurred new developments in hardware and software that affect payment systems. Of recent interest are issues of increasing payment risk and the severe situation of financial institutions in some developed countries. The costs associated with setup and operation of payment systems is high, and market participants expect efficiency. Many problems are associated with bond payments. The spread of delivery vs. payment (DVP) systems and IT-based transactions are also impacting payment systems. Links between payment systems are also important and have made concerns about systemic risk if time-designated net settlements coexist with real-time gross settlements (RTGSs), which can alter outcomes or cause cancellations, thereby increasing systemic risk. If RTGSs and the net payment system are not operated by a single rule, this problem worsens. Unification of settlement systems, rules and dealings custom is critical. The complex legal frameworks that govern payment activity would benefit from structural revisions.
Introduction

The topic of payment has recently been the subject of considerable attention. Economic activities of enterprises and households are always accompanied by payment. The payment system is an indispensable infrastructure that supports the entire economy. Payment systems have been changing recently. For example, for many years paper checks were the most frequently used non-cash payment instrument in the United States. Although the check remains the predominant type of non-cash payment instrument, the number of check payments, as well as the percentage of the total payments made by this method, has declined.

Payment systems have attracted considerable recent attention. One reason for this increased interest has been new developments in hardware and software that support payment systems that have arisen as a result of progress in the IT field. Another reason for this upsurge is the issue of growing payment risk.

Recently, large numbers of financial transactions have been completed. Financial derivatives, for example, create much more risk. More, the volume of financial transactions has been far much larger than the GDP. A third concern is the difficult situation of many financial institutions.

The international financial system is also changing rapidly. The euro has come into use and a new payment system has been introduced. A real-time gross settlement system (RTGS) has been introduced in almost all developed countries. This chapter introduces the structure of the European payment system, Trans-European Automated Real-time Gross settlement Express Transfer (TARGET), which began operating on January 1, 1999. Changes to the payment system have not been limited to TARGET. This chapter also introduces the mechanism of payment systems of other than European countries, including the continuous linked settled (CLS) bank, that has come into use, and analyzes the relationship between payment systems and monetary/prudential policy. Finally, this chapter explains the structure of the new European settlement system, TARGET, and the mechanism of other payment systems.

TARGET System

This section describes the TARGET system, which now operates in Europe. This system is epoch-making in a lot of ways, and a suggestive one to for other countries. Financial alliances are well established.

Payment systems usually serve a single country. The TARGET system, the RTGS system for the euro, however, is an example of a system that links several countries by providing connection between the payment systems of various subscriber countries.

Since TARGET began operations in 1999, it has been one of the world’s largest high-value payment systems for money market, foreign exchange and securities transactions.
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