EMERGENCE OF CHEQUE TRUNCATION SYSTEM

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ABSTRACT

Clearing has been an important part of the banking system and will always remain a part of it for years to come. Clearing in banking indicates the transfer of fund from one person to another. This clearing of fund can take place in 2 ways either through cash or through cheque. There has been no major change in the cash transactions except for the changes in value of money. However the cheque clearing system has undergone lot of changes. The origin of cheque can be traced back to the first century AD, where banks in and around Persia used to issue letters of credit called "Sakks" wherein the banks used to pay the identified payees as per the instructions. This eliminated the cumbersome process of carrying money or gold which was very risky. Changes have taken place in cheque clearing over the period of time. From ordinary cheque clearing to MICR clearing and finally to the latest in clearing 'Cheque Truncation System'.

This is a conceptual paper which tries to explore the changes that have taken place in the bank clearing system in the past and speaks about the present system of cheque clearing the Cheque Truncation System.

KEY WORDS: Cheque Truncation, MICR clearing

Introduction:

Payments are an integral part of the financial system. It is the soul of any transactions that take place in the economy, let it be business to consumer or consumer to business or be it business to business. These payments are primarily done through cash, cheque payment or the electronic form. Out of which the major part of payments are done through the cheque mode. The major challenge faced by the banking sector is the efficient & speedy clearing of these instruments.

Objectives:

The main objectives of the study are to know

1. The types of cheque clearing that have evolved in the banking industry.
2. The Cheque Truncation System (CTS) in detail.

Research Methodology:

Since this is a conceptual paper, the data is collected mainly through secondary source and then analysed to meet the objectives. Also certain unstructured interviews were done with the managers of certain banks to get certain details.

Types of Cheque Clearing or Paper-Based Clearing In Banks:

1. **Traditional Clearing:**

Daily cheque clearing was initially started in 1770 wherein the bank clerks used to meet each other to exchange their cheques and settle their dues or balances if any through cash. This system was also followed in India too wherein the bank employees used to walk to other banks with the cheques provided by their customers for clearing. These cheques were presented to the respective drawee banks and the amount was collected over the counter.

2. **Manual Clearing/ Hand Sort Clearing :**

As discussed previously, with the formation of clearing houses in the metropolitans and other presidential towns the settlement in cash vanished & was replaced by new system. Here the clerks or the representatives of the various banks use to meet at a central point, known as the clearing house to exchange their cheques. Once the claims on cheques were settled, the balance amount was paid by the banks through the cheques of the presidential Banks. This settlement was later changed to the respective Clearing House bank cheques or the RBI cheques.

3. **Claim Based Settlement System:**

The first major step to be done in the process of modernisation of payment system was the computerisation of clearing operations. The claim based settlement system (CBSS) was introduced in the early eighties at Delhi, Mumbai and Chennai. This system used Microprocessor based computer system for generating the settlement reports which were based on the input statements which had the aggregate amount of claims or cheques presented by one bank over the other in the clearing house. Due to the errors in manual sorting and balancing, the settlement & balancing of clearing cheques used to take a lot of time. Hence this system of settlement was introduced.

4. **MICR Clearing:**

The Magnetic Ink Character Recognition (MICR) system or format was first developed in 1950's by Stanford Research Institute & General Electric Computer Laboratory. This is a technology wherein the cheques are processed mechanically with enhanced speed. The existing cheques were redesigned with the introduction of 9 digit MICR code line at the bottom of the cheque. These machine readable 9 digits MICR numbers identified its city, through its postal code. This also helped the clearing houses to sort the cheques based on the bank & branch wise & ultimately help the clearing house to deliver these cheques to the respective bank branches. This system was introduced in 1986 for the first time in India at Mumbai. By 1989, this MICR clearing system was fully operational in all the metropolitan cities. Subsequently by 1990's it was operational all over the country.

5. **Inter-City Clearing:**

The 4 metro cities, Mumbai, Delhi, Chennai and Calcutta were covered by this 2 way inter-city clearing. As per this system, any inter-city cheques which are drawn on any of these 4 metro cities were being processed at the MICR clearing house & sent to the drawee centre to be integrated with the clearing of the local centre. The extension of this system to all other major cities was called as "**Regional Grid Clearing**".

6. **Magnetic Media Based Clearing System (MMBCS):**

This is also known as floppy based clearing system. This is based on the in-house software of RBI, wherein the clearing data that is the funds cleared or returned are submitted in floppies to the clearing house and based on which the clearing is conducted. This was a step towards complete automation of the MICR cheque processing & clearing system. This system covers all the different types of clearings except inter-city clearing.

7. **High Value Clearing:**

This type of clearing was first introduced on April 1989 in Chennai. This system was used to settle large value based cheques in major cities especially the ones where RBI had its branches.

The banks within a certain geographical area of the clearing house used to present cheques of large value, especially above 1 lakh within a certain cut-off time to the clearing house. The return clearing is held through floppy based clearing by the close of the banking hours on the same day. With the introduction of RTGS & other electronic payment system it lost its charm & finally in March 2010, this clearing was discontinued.

8. Speed Clearing:

This clearing refers to the processing of the outstation cheques through local clearing. Usually the outstation cheques are sent for collection to the respective bank branches through post or courier. This cheque may take 7 to 21 days to clear and also may incur certain clearing charges. This system was introduced in June 2008. This is a part of the existing MICR Clearing, the only difference is that we can clear cheques that are drawn on core banking branches which have a branch in that city.

9. Express Cheque Clearing System (ECCS):

Apart from the 66 centres which used the MICR system, there were yet another 1,093 locations which were known as non-MICR centres. These centres were using the Magnetic Media Based Clearing Software (MMBCS) which helped these centres in automating the manual process of running these clearing houses. With the growing need for improved technology along with the core banking & graphic interface created pressure on RBI to go for something new. Hence in 2011 State Bank of India (SBI) under the advice of RBI along with the help of Software Company developed Express Cheque Clearing System (ECCS). This system helped the non-MICR centres to have a better control on the clearing activities.

10. Cheque Truncation System (CTS):

This is a logical progression of MICR clearing because the main problem with MICR system was the physical movement of cheques. With the main objective of increasing the efficiency and reducing the cheque processing time, the cheque truncation system (CTS) was introduced. CTS is an electronic process wherein the physical cheque is stopped at the presenting bank itself and only the electronic image of the check is passed on to the paying bank. The physical cheque remains with the presenting bank itself. The paying bank cheques the image & clears the funds based on the information provided to them by the presenting bank in the form of electronic media. This system was first introduced on February 1, 2008 at NCR (National Capital Region), New Delhi, which was later rolled out in other major regions all over India through the Grid system.

The Cheque Truncation System:

Concept:

Cheque Truncation System is a process by which the receiving bank (which receives the cheque for outward clearing) will not send the physical cheque to the clearing house as per the regular clearing system. Instead it converts this physical cheque into an electronic form by scanning the cheque and then it sends to the clearing house with some more additional details such as the MICR fields, presenting banks, date of presentation etc.

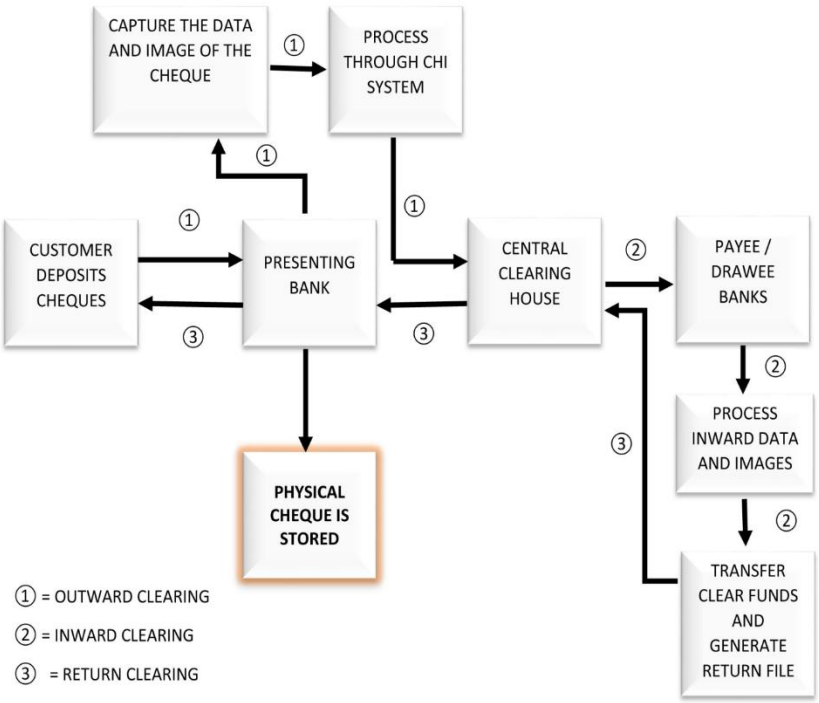
The clearing house receives this truncated cheque image and it segregates them based on the MICR codes. These electronic cheque images are then sent across to the respective Paying banks for clearance.

These Paying banks will check for the details of the cheques like date, amount in words and in figures, account number and matches the signatures for the same.

Once these things are in order, the paying bank releases the funds to the clearing house which in turn release it to the receiving bank. Else it will return the cheque as unpaid with an electronic image and advice.

Hence the cheque clearance gets completed with these above procedures or steps within a short span of time.

Process:



Requirements:

1. INFRASTRUCTURE:

The following are the infrastructures required for the smooth functioning of Cheque Truncation System (CTS) at the banking branch level.

- Connectivity from the bank gateway to the clearing house.
- Hardware & software system to support the CHI provided by RBI
- Hardware should be based on the volume of the cheques processed by the banks
- The band width requirement of the banks should be based on factors such as peak inward cheques, peak outward cheques, efficiency of the network, average size of an image & future requirements.

2. REQIREMENTS FOR BANKS TO PARTICIPATE IN CTS CLEARING:

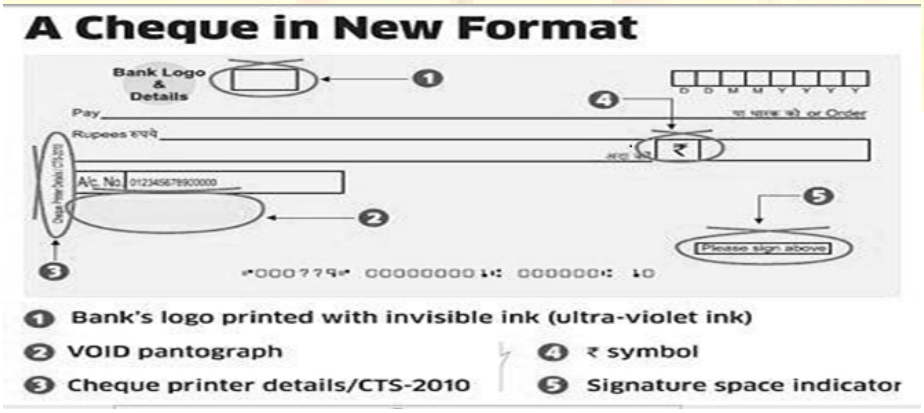
The criteria for the banks to participate in the CTS clearing are

- They should be the members of the Clearing House of the respective Grids.
- They should be members of the Indian Financial Network (INFINET).

If the banks are not the members of the INFINET, they can still be a part of the CTS clearing if;

- They become the sub-members of the direct members.
- The banks may use the infrastructures of other banks who have INFINET membership without being the INFINET members themselves.

Unique Features in the Cheque:



The following are the changes that are incorporated in the latest CTS compiled cheques.

- Each cheque will have a common phrase "Please sign above this line" at the bottom right corner which is known as the signature space indicator.
- A watermark "CTS INDIA" can be seen against the light in all the CTS 2010 cheques
- A bank logo with ultra violet ink would be present on the cheque which can be viewed through UV Scanners.
- There cannot be an alteration done in the CTS 2010 enabled cheques. If any changes are to be made, the cheque has to be replaced by another.
- All the cheques will have "payable at par at all branches of the bank" printed at the bottom of the cheque.
- There will be MICR & IFSC code of their respective banks printed on the cheques.
- The cheques need to be signed with some darker colour pens so that they are visible under scanning.
- Every cheque has a Void Pantograph printed on it, which helps in avoiding the fraudsters in tampering & photocopying the cheques.

Benefits:

- It Speeds up & improves the efficiency of the cheque clearing cycle
- Reconciliation in done better in terms of receivables & payables
- The transaction costs related to cheque clearing are reduced
- Since its faster it saves time.
- Operational risk is reduced
- Reduces paper wastage, as most of the reports and manual paper work is done away with.
- More secured when compared to other clearing systems
- Enhances the customer service and thereby reducing complaints.
- Reduces frauds.

- It improves the operational efficiency of the bank.
- Minimises the cost of cheque collections & other related costs.
- It eliminates the problem of logistics.
- Timely and better control over the payments.
- Elimination of cheque clearing float.
- The Geographical dependence is eliminated.

Conclusion:

In this paper we have seen the various types of cheque clearing systems that has evolved over time. From the traditional clearing system where the clerks use to go to various banks to clear and settle the dues to Hand-sorted system, where bank people use to meet at a central point and settle the difference through cash or central bank cheque. As the volumes increased along with technology the MICR system came into limelight which helped the processing of cheques at a faster pace and hence increased the efficiency of the cheque clearing system. In spite of all these changes the physical cheques were still moving from the presenting banker to the clearing house and finally to the settling banker. In order to avoid this and also to reduce the cost and time wasted with this activity a new system called Cheque Truncation System (CTS) is introduced. Presently this CTS system is in existence and is working on a grid clearing system. With CTS cheques from any core banking branch can be cleared at one go as a local clearing cheque.

The paper also discusses the various requirements for a smooth functioning of the cheque truncation system (CTS) of clearing. It also helps us to understand the benefits available and how it is better than the other cheque clearing systems. Hence we conclude the paper by saying that CTS is an efficient system which is here to stay.

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