



SIB STUDENTS' ECONOMIC FORUM

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Theme No. 176 : CHEQUE TRUNCATION

To avoid delays in clearing and to facilitate quicker settlement of clearing cheques, Reserve Bank of India has introduced a new process called cheque truncation. It is based on the report of a working group headed by Dr. R. D. Burman, Executive Director of RBI. The group has submitted recommendations on the mode of truncation, preservation period of the physical cheques, storage location of cheque images and security requirements for the flow of cheque data images over the different banks and clearing houses network.

What is cheque Truncation?

It is a way to reduce the clearing cycle to provide faster clearance of local and intercity cheques enabling quicker payment and settlement system. This will enable banks to enjoy greater efficiency in the management of funds of its customers and to provide better customer service.

In the process of “cheque Truncation” as envisaged by RBI, instead of sending physical cheques deposited by bank customers to the clearing houses, electronic records of their contents are generated through digital image process (called Truncated cheques) and the collecting banks or clearing houses will capture the electronic information. These truncated cheques along with the MICR data available at the bottom of these cheques will be transmitted and presented to the drawee banks by electronic transmission for verification via secure, broadband data communication network as a digitally signed data packet. The cheque truncation project, which would use electronic image of the cheque for processing is a new concept in our country and the RBI has decided to implement it soon.

What is the legal basis for introducing the new system of cheque Truncation?

The legal basis for introducing the new system of “cheque truncation” has been established with the passage of the negotiable instruments (Amendment) Act 2002. This Act has brought about a significant change of the Information Technology Act 2000 thereby bringing the cheques within the purview of the Act. The amendment of Section 6 of the Negotiable Instruments Act has facilitated the inclusion of truncated cheques within the definition of a ‘cheque’. The amended Section 6 of the Negotiable Instruments Act now reads as “A Cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form”. Section 81 A of the Negotiable Instruments Act 1881 will also give legal validity to electronic cheques.

New section 6 (a) of Negotiable Instruments Act explains “cheque in the electronic form “contains the exact mirror image of a paper cheque and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signatures (with or without the use of Biometrics) and asymmetric cryptography. The electronic cheque (e-cheque) thus contains the exact mirror contents of the paper cheque in image form and like paper cheques are legally binding Promises to pay. Digital signature brings with it the required trust (authenticity, integrity, confidentiality and non-repudiation-the four vital mantras of e-security) for the transaction.

How the process of cheque Truncation would work?

The cheque in the physical form as and when tendered by the customer, the presenting banks will keep the physical cheque in their custody, giving a unique identifier to the instrument, capture the image of the instrument by using the software provided for the purpose duly certified by the

authority concerned and route the image to the clearing house. The clearing house will do the image routing and processing to send image files of cheques to the drawee bank. The drawee bank and branch will follow image based inward and outward return including verification of signature images of drawer already held in electronic form with the drawee branch. In the outward return, the returned instrument is allocated a fresh unique identifier and a return reason (image return document). This can be used by the customer to represent the cheque. The image files messaging and transmission across the banks and clearing house could be ensured through Structured Financial Messaging system (SFMS) and INFINIT of the reserve Bank of India which is public key Infrastructure (PKI) enabled.

What the commercial banks are expected to do?

The banks are expected to put in place suitable systems and procedures, and carry out stringent and rigorous tests to ensure that the system comply to the banks' and RBI requirements. The selected system should be tested and proven to seamlessly interface to clearing House interface (CHI).

The current paper based clearing will be replaced by image and data clearing for outward and inward items. Cheque data and images will be stored in image archives for outward and inward items for eight years. The paper instruments should also be retained for eight years.

What are the Hardware and Software needs?

RBI will provide only the CHI application software, to the member banks. Banks have to purchase (i) appropriate hardware, (ii) systems software, and (iii) networking infrastructure. The CHI will act as a Gateway for outward and inward MICR data and the images of the instruments to be sent to/ Received from the clearing house over the network/media. The CHI is a windows based software with server. The Gateway shall be deployed using the Public Key Infrastructure for all its communication with the clearing house. The CHI shall aggregate the images and MICR data

received from the branches for outward presentation and will deliver the inward images and MICR data, drawee bank branchwise, to the respective CHI. Banks are to ensure that the images and data sent to RBI's CHI comply with all the guidelines issued by RBI. The images may have to pass the required Image Quality Assurance (IQA) and Image Quality Usability (IQU) specifications. Failure to do so may result in rejection of such images.

How to deal with Fraudulent Transactions?

There is apprehension amongst bankers that they may not be able to distinguish between fraudulent cheques and genuine ones under the 'reserve Bank of India's plan to clear cheques using scanned images. They are in a fix as to what to do if there is any suspected fraud in the physical cheque itself, like alteration of figures, fraudulent signatures, etc. Aware of such an eventuality, it has been decided that the collecting banks or the clearing houses will retain the truncated cheques and the drawee banks will be able to examine the physical version of truncated cheques to assist them in making payment decisions in case of need – like suspicion of any fraud, forgery, tampering or destruction of the instrument under question.

Conclusion : Clearing through cheque truncation is expected to commence in metros like Delhi, by 31st March, 2007. This will help to reduce the time for the clearing process to one day. Besides, the time efficiency, the process would do away with the need for transporting millions of cheques every day. Many countries including third world countries like Botswana, Venezuela, Columbia, Malaysia, Taiwan and Thailand have already adopted truncated cheque clearing. The cheque truncation project is certain to revolutionize the payment mechanism in our country. It will also give a big jump towards the efforts of providing better and technology based customer service. 