

July1, 2004

CMDs/CEOs of all Scheduled Banks

Dear Sir

Cheque Truncation - Pilot Implementation

The Reserve Bank has been taking several reform measures to improve safety and efficiency in the payment modes. Though the thrust has been towards a move to the safer and more efficient electronic modes of payment, it is necessary that we take measures to improve efficiency in the paper based modes of payments as well.. The introduction of the Magnetic Ink Character Recognition(MICR) technology for cheque processing and the creation of imaging capabilities helped bring in efficiency improvements in handling volume and reconciliation of clearing differences. However, beyond a point the MICR technology could not speed up the collection process thanks to the logistics involved in the requirement that the cheques have to physically transported all the way from the collecting branch of a bank to the drawee bank branch. The way several countries have sought to solve this problem is by introducing a process called cheque truncation in which the movement of the physical instruments is curtailed at a point in the clearing cycle beyond which the process is completed purely based only on the electronic data and images of the cheques.

2. The question of introduction of cheque truncation in India has been engaging the attention of the Reserve Bank for quite some time. In order to provide legal basis for payment of truncated paper based instruments, we took up with the Government to amend the Negotiable Instruments Act, 1881 and accordingly the Act was suitably amended in December, 2002. A Working Group for Cheque Truncation and e-cheque was constituted by the Reserve Bank in January 2003 under the chairmanship of Dr. R. B. Barman Executive Director, Reserve Bank of India to, among other things, draw a road map for introduction of cheque truncation for the country. The Working Group recommended the suitable cheque truncation model for India. A copy of the Report of the Working Group was forwarded to you vide our letter D.O. DIT/962/09.63.36 dated 18th October, 2003. It is also available on our website www.rbi.org.in. A brief write up on the salient features of the recommendations is given in Annex 1.

3. The recommendations of the Working Group have been accepted. Accordingly, it has been decided that an Image based Cheque Truncation Pilot Project be initiated by the Reserve Bank for the Bankers Clearing House of the National Capital Region of Delhi and its nearby areas. The pilot project is

expected to be made operational in early part of 2005.

4. Several preparatory steps are required to be undertaken by both the Reserve Bank and the banks for implementation of the project. The Reserve Bank has initiated steps to procure the required hardware and software systems for the central system. The steps to be taken by the banks primarily revolve around the procurement and/or outsourcing of truncation capabilities and adopting related changes in the systems and procedures. You may also form a Policy Group, Implementation Group and nominate Nodal Officers for the purpose. The time frame within which the above tasks are required to be undertaken is given in Annex 2.

5. I request you to initiate action as described above within the prescribed timeframe to ensure launching cheque truncation in the National Capital Region smoothly. Kindly acknowledge receipt of this letter to the Chief General Manager-in-Charge, Reserve Bank of India, Department of Information Technology, Reserve Bank of India, Central Office, S B Singh Marg, Mumbai 400 001.

Yours faithfully

(Rakesh Mohan)

Deputy Governor

Encl : as above

Report of the Working Group on Cheque Truncation and e-Cheque (Part I)

Salient Features

To introduce a system of cheque truncation in India, a Working Group on Cheque Truncation and e-cheques (Chairman: Dr. R B Barman, Executive Director) was constituted by the Reserve Bank. The Working Group submitted Part I of its report in July 2003 and suggested a model for the cheque truncation in India. The major recommendations of the Working Group are as under:

- ❖ The physical cheque will be truncated within the presenting bank.
- ❖ Within the presenting bank the point of truncation could be decided by each individual member bank providing for Service Bureau models where banks can approach or set up Service Bureaux for capturing images and MICR data.
- ❖ Settlement will be generated on the basis of current MICR code line data.
- ❖ Electronic images will be used for payment processing.
- ❖ Grey scale technology will be deployed for imaging.
- ❖ Images will be preserved for eight years.
- ❖ A Centralised Agency per clearing location will act as an image warehouse for the banks. Group recommended norms for agencies to provide the service.
- ❖ Public Key Infrastructure will be deployed to protect images and data flow over the network.

Annex 2

Implementation of Cheque Truncation

- Timeframe for Preparatory Measures

1. Formation of a Cheque Truncation Implementation Policy Group within the bank at the highest level (to be headed by the Executive Director or the Chief Operating Officer or similar functionary) with due representations(at HOD level) from banking operations, systems and procedures, audit, legal, IT and other related functions to guide implementation of cheque truncation within the bank July 04
2. Formation of a Cheque Truncation Implementation Group in New Delhi July 04
3. Nomination of two Nodal Officers, one each from the Policy Group and the Implementation Group to interact with the Reserve Bank July 04
4. Deciding point/s of truncation within the bank July – Aug 04
5. Procurement or outsourcing of capabilities for MICR data capture and cheque image capture for Cheque Truncation System in the National Capital Region July – Dec 04
6. Undertaking Business Process Reengineering required for introduction of cheque truncation July – Dec 04
7. Organising Cheque Truncation Awareness Programmes within the bank to sensitise staff about the new system, its rules and procedures among other things, i) for outward and inward processing of cheques and images, and ii) changed responsibilities as a collecting and paying banker including preservation of cheques as the collecting bank and paying cheques based on images of cheques July – Dec 04