# Chapter 2

# Issues in Clearing System in People's Bank

## 2.1 Introduction

The previous chapter was about the client - People's Bank and its portion in cheque payment process. In order to present a comprehensive justification for the need of the project, first it is necessary to present a general overview of the "image clearing process" in the People's Bank. This chapter discusses information about the image clearing process as well as the roll of participating organization in the process.

## 2.2 Participants in the Clearing Process

The cheque payment settlement process among Bank/Branches is coordinated by the Central Bank of Sri Lanka – CBSL. In early 2002 Lanka Clear (Pvt) Limited – LCPL is formed [16] and assigned for the clearing process of the country. The CBSL and all commercial banks operating in Sri Lanka are the LCPL's shareholders .Before it comes to image clearing the physical cheque is circulated among Bank/Branches.



## 2.3 Overview of the cheque clearing process

When a cheque is presented to a branch for realization it can be dishonour due to various reasons. Refer the Appendix A for complete list of Return Reasons which is prescribed by the LCPL. Return reasons are categorized into to groups as Technical Returns and Account Base Returns. In the image clearing the image of the cheque is scrutinized and marked for accept or return due to Technical aspect of the cheque.

The Account base returns are generated process with the relevant banking system and should be amalgamate both returns in to a text file. The text file shall be submitted to the LCPL by burn to a CD or submit using a data line. Once a cheque is dishonored it shall be reported to the LCPL for the accordance settlements within Bank/Branches. If a particular cheque is returned by a paying bank, the payee is acknowledged by a Cheque Return Notification – CRN.

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[16] http://www.lcpl.lk/inpages/aboutus/history.shtml

In the present system of the People's Bank all the branches through out the country received an Inward data CD by the courier service in every working day of the week. Once it received the branch staff scrutinized and marked using the present system. At the cut-off time they prepare a return data CD and handed over to the courier service.

The present system is illustrated in an activity diagram in the Figure 2.1 and the diagram of overview is in Appendix B.

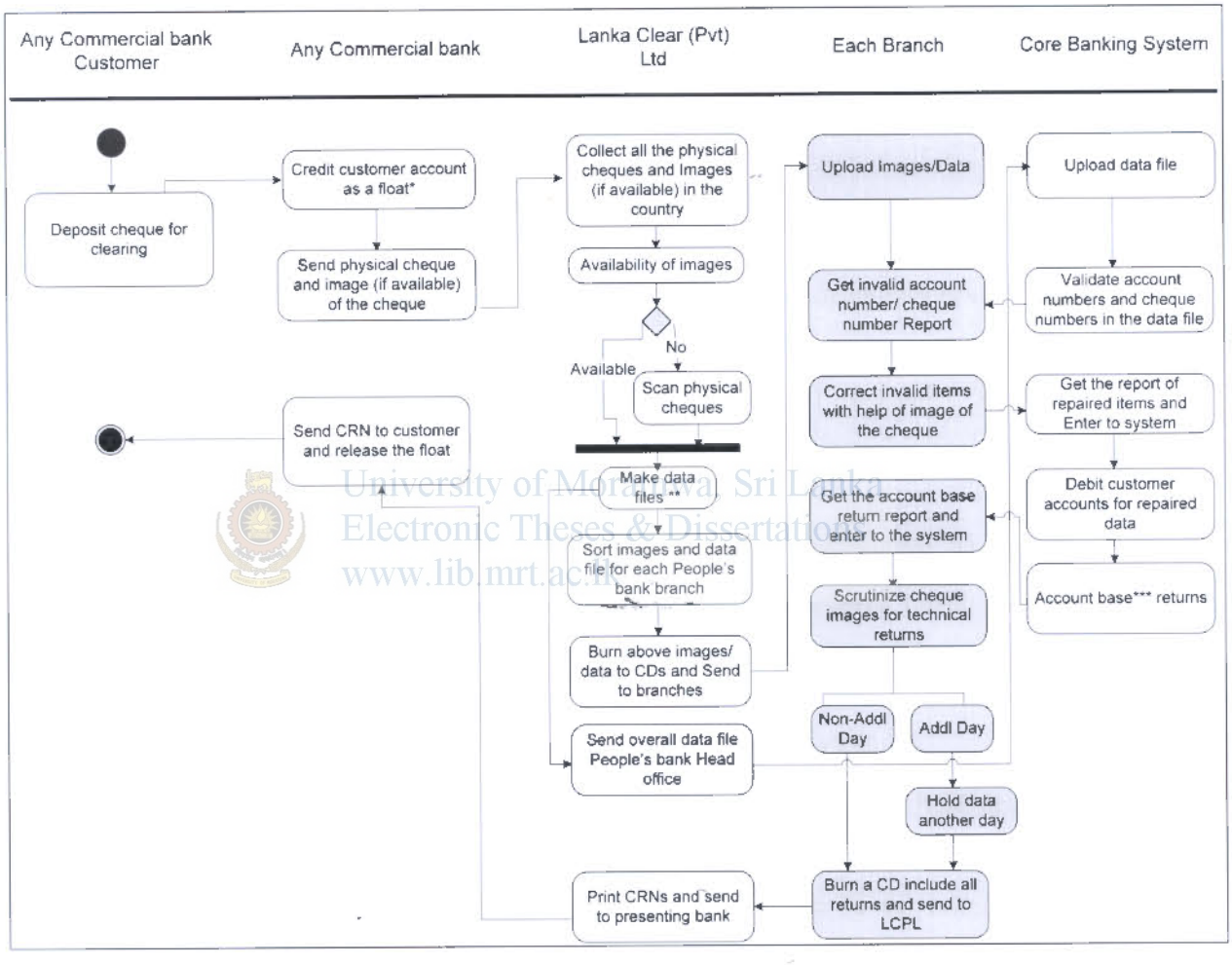




Figure 2.1 : Flow of activities of existing system

| * Float | ** Data file – include following data | *** Account base |
|---|---|---|
| Float occurs when there is a delay in the clearing of payments between banks. This delay is due to get the confirmation from the Paying Bank/Branch. Float is considered in days in the clearing process. | 1. Cheque Number<br>2. Clearing branch (People's bank)<br>3. Unique Identification Number – UI for the chque<br>4. Account number<br>5. Amount<br>6. Presenting bank/branch | 1. Insufficient funds<br>2. Account Close<br>3. Payment Stop by the Drawer<br>4. Effects Not Realized etc. |

Figure 2.2: Explanations of * marked words in the Figure 2.1

## 2.4 Drawbacks and Weaknesses of the Existing System

1. The bank/branch staffs are the people who should focus on customer services not the back office operations. In new concept of banking the back office operations are to be centralized. These operations can be assigned to specialized personnel. Cheque clearing is considered as the main banking activity in commercial banks. So it has to be highly accurate and efficient.
2. People's Bank has 300+ branch network scattered throughout the country. The Bank has no mechanism to monitor the status of its branches with regard to the cheque clearing, other than manual way. Therefore an island wide process monitoring system is needed.
3. Minimizing in frauds is another challenge in such a huge financial institute.
4. Branches have to submit there return data in a CD to a currier service. Reaching the CD to LCPL's regional centers takes considerable time. Said charges for currier service are considerable amount. Failing submitting return data in the day is subject to fine the branch by the LCPL. The cost for the bank increases in operational and administrational due to existing decentralized system of cheque clearing.
5. As far as the People's Bank is concern it has to spends 1.5 Million rupees per month for the delivering the Inward data CD to branches. Particular branch has to use two CDs per day; one for Inward Data CD and other for Outward Return Data CD. The cost for CDs in a month around 0.5 million.

6. The branch staffs have to devote 2-3 hours per day on this task and when hardware failures happen recovery time takes some times days. Then it effects the clearing cycle of the country. These delays are liable to fine (Rs. 1000 per day) the branches by the LCPL.
7. When a cheque been scrutinized the relevant signature(s) must be appear in the screen for review. Existing system has no signature verification system other than search and reviews the physical signature cards.
8. When LCPL make the data files sometimes they miss-read or find wrong information (Account Number, Cheque Number, Amount etc) in the MICR line of the cheque. These wrong readings are around 25% of the total cheque volume. When it is validate with the core banking system these items are rejected. These are called Invalid Items. Correcting of invalid items in Image Clearing System has no validation with the Core banking system that pays the way to iterative work of correcting. It takes considerable time to repairing the file in individual branches.
9. In the present practice the Core Banking System checks the "Invalid Items" and provides reports for individual branches. Then the branch staff searches for those items in the present system and correct them. And then generate a corrected items report and enter them to the Core Banking system. At this point of time the Core Banking System can be process clearing to mark return items on Account base. In the mean time individual branch scrutinize cheques and mark returns and get a return items report and enter to the Core Banking System. And each branch is provided with an account base report and enters to the present clearing system. These report entering activities can be eliminated by passing data files among two systems.
10. When it is required to refer a higher authority to honour or dishonour a cheque the system has no electronic facility convey it.
11. The drawer has no way to get to know what cheques are been presented for clearing in the day.

## 2.5 Proposed system Vs other systems

Three software vendors were made demonstration on their products to the management of the People's Bank. Comparison is represented in the Table 2.1.

| Feature | CICPS | DMS Imago | Interblocks Chq Truncation | Mariland system |
|---|---|---|---|---|
| Interface with Core Banking System | Already Done | Has to be done | Has to be done | Has to be done |
| Software Cost | Very Low | Medium | High | Low |
| Reliability of the Vendor | N/A | Medium | Medium | Low |
| Maintenance agreement | No need | Need | Need | Need |
| Usability | High | High | Medium | Medium |
| User Friendly | High | High | Medium | Medium |
| System Application | Desktop | Desktop | Web base | Desktop |

Table 2.1 : Proposed system Vs Available other systems

**Comments on this comparison and other issues:**

1. The interface with the Core Banking System and the Signature Verification System is essential as far as the proposed system is concern. As these systems are vendor software, if a third party vendor come and interface with them is very time consuming task.
2. Cost is always low when it is in-house development.
3. Some systems need user training and expertise the users.

With this comparison and past experience with software vendors the management of the People's Bank willing to in-house development.

## 2.6 Summary

This chapter provides an overview of the process of cheque clearing and participating parties in the process. The present system is described next and the drawbacks and weakness of the said system. The comparison of systems proposed to centralize clearing is discussed later. The next chapter "Technology Adopted" is going to discuss about technologies can be used for this project.