



भारतीय रिज़र्व बैंक

RESERVE BANK OF INDIA

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October 06, 2009

Chief Executive Officer

All Primary (Urban) Co-operative Banks

Dear Madam/Sir

**Review of bilateral clearing arrangements between banks – Urban Co-operative Banks**

As you are aware, for convenient, cost-effective and quick processing and settlement of clearing instruments arising out of normal business activities of banks, an elaborate Clearing House infrastructure is in place in the country. Currently operational at most locations across the length and breadth of the country, the 1139 Clearing Houses facilitate multilateral net clearing and settlement of over four million cheques everyday on a T + 1 basis. In fact, the processing cycle in India for local cheques encompasses both the presentation and return clearing legs, and compares favourably with similar systems around the world.

2. During the recent annual financial inspection of a bank, our Department of Banking Supervision had observed that the bank has entered into bilateral agreements with other banks for processing and clearing of post dated cheques (PDCs) deposited with it and payable by the other banks. Under the agreement, the bank was sending such PDCs directly to the other bank for realisation and receiving proceeds thereof by credit to its current account opened with the other bank. Similar facility was extended to the other bank for clearing PDCs drawn on this bank as well. On our enquiring with a few other banks, it is ascertained that a number of similar bilateral agreements exist between /among banks and in the process, significant volume of instruments was getting exchanged and cleared outside the Clearing House infrastructure.

3. After a detailed review we have concluded that such agreements (also styled as corresponding banking arrangements by some banks) undermine the existence and need of Clearing Houses and do not in any way contribute to the efficiency of the clearing system. In fact, the banks incur higher costs and take longer time to clear the

cheques bilaterally. The parallel clearing arrangements vitiate the Clearing House rules, standard, minimum benchmarks and uniform practices. Malpractices and disputes between banks can exacerbate into systemic concerns.

4. Further, bilateral clearing arrangements attract provisions of the Payment and Settlement Systems Act, 2007 (Act) and the regulations framed thereunder. Section 2 (i) of the Act defines a payment system as a 'system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them, but does not include a stock exchange'. Section 4 (1) of the Act stipulates that 'no person other than the Reserve Bank shall commence or operate a payment system except under and in accordance with an authorization issued by the Reserve Bank under provisions of the Act'. Operators of such payment systems are required to seek authorization under the Act, within six months of the commencement of the Act i.e. by February 12, 2009. The bilateral arrangements between banks being inter-bank in nature fall within the ambit of payment systems and require authorization from the Reserve Bank.

5. Bilateral agreements include correspondent banking arrangements, arrangements under cash management services, or any arrangement that envisages routine clearing of cheques drawn on either or both banks without routing them through the Clearing House infrastructure as also agreements for sharing of ATMs, use of electronic clearing products like ECS or any such payment system products. Continuation or commencement of bilateral clearing arrangements without authorization is violative of the provisions of the Act and would invite strict penal action as provided under the Act. Keeping in view the various risks involved, banks are advised to immediately discontinue all bilateral clearing arrangements arising out of normal banking transactions.

6. Please acknowledge receipt of the circular and confirm having noted the contents for compliance.

Yours faithfully,

(A. K. Khound)  
Chief General Manager-in-Charge