CHAPTER – III

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AN ANALYTICAL STUDY OF RESERVE BANK OF INDIA & ECO. DEV. OF INDIA

1. PRE & POST INDEPENDENCE FINANCIAL SYSTEM & ECO. DEV. OF INDIA
2. FINANCIAL REPRESSSION TO FINANCIAL LIBERALIZATION (1991 ONWARD)
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1. PRE & POST INDEPENDENCE FINANCIAL SYSTEM & ECO. DEV. OF INDIA

India has a long and chequered history of financial intermediation, particularly commercial banking. At the beginning of the 20th century, India had insurance companies (both life and general) and a functional stock exchange. Even before the setting up of the Reserve Bank of India in 1935, the country had market for money, Government securities and foreign exchange. The financial system was, however, characterized by paucity of funds and instrument, limited number of players and lack of depth and openness. It was primarily a bank-based system.

POST-INDEPENDENCE FINANCIAL SYSTEM & ECO. DEV. OF INDIA

The partition of India in 1947 adversely impacted the economies of Punjab and West Bengal, paralyzing banking activities for months. India's independence marked the end of a regime of the Laissez-faire for the Indian banking. The Government of India initiated measures to play an active role in the economic life of the nation, and the Industrial Policy Resolution adopted by the government in 1948 envisaged a mixed economy. This resulted into greater involvement of the state in different segments of the economy including banking and finance. The major steps to regulate banking included 9

In 1948, the Reserve Bank of India, India's central banking authority, was nationalized, and it became an institution owned by the Government of India.

In 1949, the Banking Regulation Act was enacted which empowered the Reserve Bank of India (RBI) "to regulate, control, and inspect the banks in India."

The Banking Regulation Act also provided that no new bank or branch of an existing bank could be opened without a license from the RBI, and no two banks could have common directors.

However, despite these provisions, control and regulations, banks in India except the State Bank of India, continued to be owned and operated by private persons. This changed with the nationalisation of major banks in India on 19th July, 1969.

At the time of Independence in 1947, India had a fairly well-developed banking system. The process of financial development in independent India has hinged effectively on the development of commercial banking, with impetus given to industrialization based on the initiatives provided in the five year plans.

Soon after Independence in 1947, Government of India followed a policy of social control of important financial institutions. The nationalization of the Reserve Banks of India (RBI) in 1948 marked the beginning of this policy. This was followed by the takeover of the then Imperial Bank of India in 1955 which was rechristened as State Bank of India. In 1956, 245 life insurance companies were nationalized and merged into the newly created Life Insurance Corporation of India (LIC). In another significant development, Government nationalized 14 major commercial banks in 1969. The year 1972 saw the nationalization of general insurance companies and the setting up of General Insurance Corporation (GIC). In 1980, 6 more commercial banks were nationalized and brought under public ownership.

Trade and industrial activities during the 1950s, and the 1960s reflected the dominance of banking as the critical source. The number of
banks and branches had gone up, notwithstanding the consolidation of small banks, and the support given to the community-operative credit movement. Functionally, banks catered to the needs of the organized industrial and trading sectors. The primary sector consisting of agriculture, forestry, and fishing had to depend largely on their own financing and on sources outside the commercial banks.

The course of development of financial institutions and markets during the post-Independence period has been largely guided by the process of planned development pursued in India with emphasis on mobilization of saving and canalizing investment to meet Plan priorities. The adoption of bank-dominated financial development strategy was aimed at meeting the spectral credit needs, particularly of agriculture and industry. Towards this end, the RBI (nationalized in 1948) concentrated on regulating and developing mechanisms for institution building. The commercial banking network was expanded to cater to the requirements of general banking and for meeting the short-term working capital requirements of industry and agriculture. Specialized development finance institutions (DFIs) with majority ownership of the RBI were set up to meet the long-term financing requirements of industry and agriculture. To facilitate the growth of these institutions, a mechanism to provide confessional finance to these institutions was also put in place by the RBI.

2. FINANCIAL DOMINATION TO FINANCIAL LIBERALIZATION (SINC 1991) 10

Considering the strategic importance of the financial sector, the Government of India set up a Committee on Financial System in 1991

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under the chairmanship of Mr. M. Narasimham. It was asked to examine all aspects relating to the structure, organization function and procedures of the Indian financial system. The Committee submitted its report in November 1991. It was presented to Parliament in December 1991.

Financial sector reforms during the last decade and a half have focused on the following.

1. Elimination of segmentation across various markets in order to facilitate.
2. Easing the liquidity management process.
3. Making resource allocation more efficient across the economy.

For this purpose, restrictions on pricing of assets have been removed, new instruments have been introduced, and technological infrastructure has been strengthened. In short, liberalization of the financial sector has included, among others, the following measures.

1. Deregulation of interest rates.
2. Introduction of new products.
3. Relaxation in investment norms for financial intermediaries, especially banks.
4. Lowering of restrictions on specialization/diversification of banks.
5. Emergence of new institutions such as primary dealers and mutual funds.
6. Withdrawal of reserve requirements on inter-bank borrowings.
7. Withdrawal of credit controls and excessively high reserve requirements.
8. Deregulation and development of markets.
9. Moves toward privatization of financial services.
10. Easing of restrictions in respect of banks’ foreign currency investments.
11. Easing of restrictions on current and capital account convertibility.
12. Lowering of entry barriers/limits on participation of foreign banks.

These reforms have paved the way for integration among various segments of the financial system. It is widely accepted that reduction/removal of financial repression has enhanced the efficiency and potential growth of the Indian economy.

Reforms in the commercial banking sector had two distinct phases. The first phase of reforms introduced subsequent to the release of the Report of the Committee on Financial System (Chairman : M. Narasimham), 1992 focused mainly on enabling and strengthening measures. The second phase of reforms, introduced subsequent to the recommendations of the Committee on Banking structural measures and improvement in standards of disclosure and levels of transparency in order to align the Indian standards with international best practices. Reforms have brought about considerable improvements as reflected in various parameters relating to capital adequacy, asset quality, profitability and operational efficiency.

The key objective of reforms in the banking sector in India has been to enhance the stability and efficiency of bank. To achieve this objective, various reform measures were initiated that could be categorized broadly into three main groups : (a) enabling measures, (b) strengthening measures and (c) institutional measures.
Enabling measure were designed to create an environment where banks could respond optimally to market signals on the basis of commercial considerations. Salient among these included reduction in statutory pre-emotions so as to release greater funds for commercial lending, interest rate deregulation to enable price discovery, granting of operational autonomy to banks and liberalization of the entry norms for financial intermediaries.

The strengthening measures aimed at reducing the vulnerability of banks in the face of fluctuations in the economic environment. These included, inter alia, capital adequacy, income recognition, asset classification and provisioning norms, exposure norms, improved levels of transparency, and disclosure standards.

Institutional measures focused on reforms in the legal framework pertaining to banks and creation of new institutions.

**Nationalization of Banks and other Firms**

**Imperial Bank of India (1955):** Soon after Independence, India launched its First Five Year Plan (1951-56). The Plan accorded high priority to the development of rural India, particularly agriculture. The All India Rural Credit Survey Committee recommended the creation of a State-partnered and State-sponsored bank by taking over the Imperial Banks India and integrating with it the former State-owned or State-associated banks. Accordingly an Act was passed in the Parliament in May 1955 and the State Bank of India was constituted on July 1, 1955. Later, the State Bank of India (Subsidiary Banks) Act was passed in 1959.
enabling the State Banks of India to take over eight former State-associated banks as its subsidiaries.

**Life Insurance Business (1956)**: By the Life Insurance (Emergency Provisions) Ordinance, 1956, promulgated by the President of India on January 19, 1956, the management and control of life insurance business in India, including the foreign business of India insurers, and the Indian business of foreign insurers, vested with immediate effect in the Central Government. With this the life insurance business passed from the private sector to the public sector. This was step never before attempted anywhere in the world on such a large scale.

Though the Ordinance was promulgated in January 1956, the Life Insurance Corporation Act was passed in the next session of parliament. According to this Act the Life Insurance Corporation of India came into existence on September 1, 1956.

**Commercial Banks (1969 and 1980)**: The process of state domination of financial sector was given impetus with the adoption of the policy of social control over banks in 1967, reinforced in 1969 by the nationalization of 14 major scheduled commercial banks. In April 1980, government nationalized 6 more commercial banks. Driven largely by public sector initiative and policy activism, commercial banks have dominant share in total financial assets and are the main source of financing for the private corporate sector. They also channel a sizeable share of household savings to the public sector. Besides, in recent years, they have been performing most of the payment system function. With increased diversification in recent years, banks in both public and private sectors have been providing a wide range of financial services.
General Insurance Business (1973) : The general insurance business was nationalized with effect from January 1, 1973, through the General Insurance Business (Nationalization) Act 1972. However, as a prelude to the above Act, the Government took over the management of all the operating companies 19711 through General Insurance (Emergency Provision) Act, 1971. The emergency Act provided for the appointment of custodians who were empowered to exercise control over these companies subject to the directions of the Central Government. At the time of nationalization of these companies, there were a total of 107 companies underwriting general insurance business in India. All these companies were amalgamated and grouped into four, namely the National Insurance Company Limited, the New India Assurance Company Limited, the Oriental Insurance Company Limited, and the United India Insurance Company Limited with head offices at Kolkata, Mumbai, Delhi and Chennai respectively. The General Insurance Company (GIC) was formed as a holding company in November 1972. The GIC was constituted for the purpose of superintending, controlling and carrying out the business of general insurance. The entire capital of GIC was subscribed by the Government and that of four companies by the GIC on behalf of the Government of India. Broadly speaking, financial development in India up to the early 1990s was, by and large, a state-induced activity.

Rethinking on Government Domination of Financial Sector : Nationalization of commercial banks in 1969 and 1980 was a mixed blessing. After nationalization there was a shift of emphasis from industry to agriculture. The country witnessed rapid expansion in bank branches, even in rural areas. However, bank nationalization created its
own problems like excessive bureaucratization, red-tapism and disruptive tactics of trade unions of banks employees.

Beginning a near-monopoly of the Government, the banking sector suffered from lack of competition, low capital base, low productivity and high intermediation cost. The role of technology was minimal and the quality of service was not given adequate importance. Banks also did not follow proper risk management system and the prudential standards were weak. All these resulted in poor asset quality and low profitability.

Among non-banking financial intermediaries, development finance institutions (DFIs) operated in an over-protected environment with most of the funding coming from assured sources at confessional terms.

The mutual fund industry also suffered from lack of competition and was dominated for long by one institution, viz. the Unit Trust of India UTI.

Non-banking financial companies (NBFCs) grew rapidly, but there was no regulation regarding their asset side. Financial markets were characterized by control over pricing of financial assets, barriers to entry, high transaction costs and restrictions in movement of funds between the market segments. This, apart from inhibiting the development of the markets, also affected their efficiency.

Similarly, capital market structure in India was subject to several controls and opaque procedures. The trading and settlement system was outdated and not in tune with international practices. Raising of capital from the market was regulated by the Capital Issues (Control) Act, 1947 which was administered by the Controller of Capital Issues (CCIs) in the Ministry of Finance, Government of India. The scheme of controls under the Act required all the companies to obtain prior consent for issues of
capital to the public. Pricing as well as the features of the capital structure (such as debt-equity ratios), were controlled by the Government. The Securities Contracts (Regulation) Act was administered by the Directorate of Stock Exchanges also in the Ministry of Finance. It empowered the Government to recognize/derecognize stock exchanges, stipulate rules and bye-laws for their functioning, compel listing of securities by public companies etc. Such a system of regulation and control was fragmented and inadequate in the context of liberalization was sweeping across the world. Urgent measures were needed to relax controls and modernize the functioning of capital market.

Furthermore, state monopoly of insurance business resulted in limited availability of insurance products, lack of information technology and poor quality of insurance services. In this connection, the Committee on Reforms in Insurance Sector (Chairman : R.N. Malhotra), which was set up in April 1993 and which submitted its report in January 1944, remarked,

“Indian insurance industry lacks depth, diversity and reach, both geographically as well as in terms of insurable population, as there was immensely vast potential yet to be tapped;

It provides poor customer service in terms of pricing, adequacy and appropriateness of covers and the much needed and timely claims settlement.

It lacks the global dimensions having remained in isolation too long.” 1991 was not particularly conducive for the development of deep and wide financial markets. In fact, it had resulted in segmented and underdeveloped markets characterized by paucity of institution functioned in a highly regulated environment, characterized by an
administered interest rate structure, quantitative restrictions on credit flows, fairly high reserve requirements and pre-emption of significant proportion of lend able resources for the priority and Government sector, interest rate controls led to suboptimal use of credit resulting in low levels of investment and growth. These, coupled with other factors such as the absence of proper accounting, transparency and prudential norms, resulted in a large build-up of non-performing assets in the banking system. All this led to erosion of profitability in the banking sector, besides decline in productivity and efficiency. The bank-based and highly controlled regime turned out to be inimical to financial market development.

Thus, until the early 1990s, the role of the financial system in India was primarily restricted to the function of channeling resources from surplus to deficit sectors. Whereas the financial system performed this role reasonably well, its operations came to be marked by some serious deficiencies over the years. The Indian Government determined the quantum, allocation and the price of credit, a situation referred to a financial repression by some experts.

It was in this backdrop, that wide-ranging financial sector reforms in India were introduced as a integral part of the economic reforms initiated in the early 1990s.

**Reserve Banks of India (RBI):**

Since the setting up of the Reserve Bank of India in 1935, its role in the financial sector and financial market development has undergone significant changes. Emerging primarily as a bank-based financial system, the development of financial structure in India has been to
finance the planned development efforts. To this end, institutional
development received considerable attention of the RBI. The broad-based
development of the banking sector to meet short-term financing needs
was supplemented by the setting up of specialized development finance
institutions by the RBI to cater to long-term financing needs. Since the
early 1990s, the introduction of financial sector reforms has provided a
strong impetus to the development of financial markets. The introduction
of market-based monetary policy instruments, the liberalization of capital
controls and integration of the Indian economy with global markets have
exposed the country to potentially volatile capital inflows, posing new
challenges and dilemmas for the RBI in monetary and exchange rate
management.

The RBI has been suitably reorienting the regulatory and
supervisory framework so as to meet the challenges of a new
environment. It has been the endeavour of the RBI to develop of
competitive, strong and dynamic banking system so that it plays an
effective role in supporting the growth process of the economy. The
emphasis has been on safeguarding the financial stability of the overall
system through increased emphasis on prudential guidelines and effective
monitoring, improving institutional soundness, strengthening the
regulatory and supervisory processes by aligning with international best
practices and by developing the necessary technological and legal
infrastructure. While the approach towards the reforms has essentially
been gradual and relevant to the context, consultative processes and
appropriate timing and sequencing of measures have succeeded in aiding
growth, enhancing efficiency, avoiding crises and imparting resilience to
the financial system.
The role of the RBI in the financial markets assumed significance due to the following factors.

1. The primary interest of the RBI in financial markets is because of its criticality in the transmission of monetary policy. From an operational perspective, reliance on indirect instruments and money market operations for conducting monetary policy necessitated development of the money, Government securities and foreign exchange markets.

2. Financial stability has emerged as one of the increasingly important concerns for the RBI resulting in increased attention to financial market development. The money market is the focal point for RBI intervention for equilibrating short-term liquidity flows on account of its linkages with the foreign exchange market. The Government securities market has become the focal point for the entire debt market due to several considerations: (a) the fiscal deficit of the Government, both Centre and the States, continues to be fairly high, resulting in large market borrowings by the Central and State Governments. With the corporate debt market still in its nascent stage of development, the Government securities market is the largest component of the debt market: (b) it serves as a benchmark for pricing of other debt market instruments and (c) it provides an efficient transmission channel for monetary policy.

3. Since the markets were repressed in several ways in the past by law, regulation and policies, the RBI has, therefore, been facilitating the development of markets by creating an enabling environment through legal changes, technological and institutional
development and dynamic improvements in market micro-
structure.

4. Technological infrastructure has become an indispensable part of
the reform of the financial markets, with the gradual development
of sophisticated instruments and innovations in market practices.
The RBI has, therefore, taken active interest in development
appropriate technological infrastructure to facilitate market
development in areas such as payment and settlement systems,
Delivery versus Payment (DVP) and Electronic Funds Transfer
(EFT).

5. Modern financial markets are complex. The RBI, therefore, needs
to equip and continuously update itself to perform its development
and regulatory roles effectively. The process involves constant
interaction with the global counterparts in order to identify best
practices, benchmark existing practices in the Indian markets,
identify gaps and take measures to move towards international
standards, within the framework of India’s unique country
circumstances.

4. RECENT INITIATIVES TO STRENGTHEN FINANCIAL
SYSTEM\textsuperscript{11}

The financial sector in India currently comprises financial
institutions, financial markets and financial instruments. The various
segments of the financial market in India are the money market, the

\textsuperscript{11} Strengthening Indian Banking and Finance : Progress and Prospects, Speech
delivered at the Bank Economists’ Conference at Bangalore, December 27\textsuperscript{th}, 2002
Government securities market, the foreign exchange market, the capital market and the insurance market. While the money, Government securities and foreign exchange markets are regulated by the Reserve Banks of India (RBI), the capital market falls within the purview of Securities and Exchange Board of India (SEBI) and the insurance market is regulated by the Insurance Regulatory and Development Authority (IRDA).

The importance of developing appropriate financial institutions and financial markets in promoting economic growth can be hardly overemphasized. Central banks in emerging markets have made conscious efforts towards developing efficient markets and institutions in recent years, especially after some weaknesses in the system were revealed during several financial crises that reoccurred in the 1990s in different parts of the world. There is a growing recognition among central bankers around the world that a well functioning financial market enables efficient use of market-based instruments of monetary policy by improving interest rate signals in the economy. Apart from enhancing the efficiency of monetary policy, deep and well functioning financial markets promote mobilization of domestic savings and improve the allocative efficiency of financial intermediation, and foster the necessary conditions to emerge as an international or a regional financial centre. Strong domestic financial markets also act as a buffer against external disturbances and help in absorbing shocks to the domestic banking system during crises. Further, they provide incentives for development of hedging instruments, and lower macroeconomic volatility and financial instability. Efficient financial markets also have several indirect benefits
such as rapid accumulation of physical and human capital, more stable investment financing, and faster technological progress.

Financial market development is a complex and time-consuming process. There are no short cuts for developing well-functioning markets with depth and liquidity. Some of the preconditions for financial market reform are the following.

1. Macroeconomic stability.
2. Sound and efficient financial institutions and structure.
3. Prudential regulation and supervision.
4. Strong creditor rights.

Several measures have been taken by these regulatory authorities to develop and strengthen India’s financial system in order to make it compatible with best international practices.

**Payment and Settlement System**: The payment and settlement systems are at the core of financial infrastructure in a country. A well-functioning payment and settlement system is crucial for the successful implementation of monetary policy and maintaining the financial stability. Central banks have, therefore, always maintained a keen interest in the development of payment and settlement system as part of their responsibilities for monetary and financial stability. In India, the development of a safe, secure and sound payment and settlement system has been they key policy objective. IN this direction, the RBI, apart from performing the regulatory and supervisory functions, has also been making efforts to promote functionality and modernization of the payment and settlement system on an on-going basis.
A. Importance of a Sound Payment and Settlement System: A safe and efficient payment system is prerequisite for smooth functioning of the financial markets. The conduct of monetary policy in an effective manner requires safe and efficient payment and settlement systems to facilitate transfer of funds and securities between the central banks and other participants in the financial system. An efficient and stable payment and settlement system is also a pre-condition for inter-banks money markets and other short-term credit markets through which monetary policy is transmitted. In addition, developments in the payment and settlement systems that affect the speed and realization/availability of funds for further deployment can influence the overall demand for money in the economy.

By linking financial institutions together for the purpose of transferring monetary claims and settling payment obligations, payment and settlement system becomes a channel through which financial risks are transmitted across financial institutions and markets. Well-designed and efficiently managed systems, therefore, help in maintaining financial stability by reducing uncertainty of settlement. Settlement failures which spread to other payment and settlement systems through the contagion effect not only undermine the smooth functioning of the financial markets, but can also adversely affect the public confidence in money and efficacy of the instruments used to transfer money.

B. Role of RBI in Payment and Settlement System: Central banks world-wide are involved in payment and settlement system in a number of ways. They provide settlement accounts, oversee core payment arrangements, and operate, provide and use various payment services.
In India, RBI regulates and supervises payment and settlement system with the objective of promoting safety and efficiency by monitoring the existing and planned systems, assessing them against the stated objectives and, where necessary, inducing change. The oversight of payment and settlement systems has become more distinct and formal in recent years as part of a growing concern with financial stability as also with the increasing role of private participants in financial transactions. The increasing attention by the RBI also reflects the large increase in the value of transactions. The increasing attention by the RBI also reflects the large increase in the value of transfers cleared and settled, the increasing centralization of transactions around a small number of key systems and the growing technological complexity.

C. Board for Regulation and Supervision of Payment and Settlement System (BPSS) : In order to provide focused attention to the payment and settlement systems, the RBI constituted the BPSS as a Committee of its Central Board. The Reserve Bank of India (Board for Regulation and Supervision of Payment and Settlement Systems) Regulations, 2005 were notified in the Gazette of India on February 18, 2005. The BPSS is headed by the Governor of the RBI with the Deputy Governor in-charge of Payment and Settlement Systems as the Vice-Chairman and the other Deputy Governors and two members of the Central Board of the RBI as members. The Executive Directors in-Charge of the Department of Payments and Settlement System (DPSS) and Financial Market Committee and Legal Adviser-in-Charge are permitting invitees. The Board also has an external expert as a permanent invitee. Functions and powers of the BPSS include the following.
1. Formulating policies relating to the regulation and supervision of all types of payment and settlement systems.
2. Setting standards for existing and future systems.
3. Authorizing the payment and settlement systems.
4. Determining criteria for membership.

The National Payments Council, which was set up in 1999, has been designated as a Technical Advisory Committee of the BPSS. To assist the BPSS in performing its functions, a new department, the Department of Payments and Settlement Systems (DPSS), was set up in the RBI in March 2005.

The PBSS has met three times since its constitution in March 2005. The Board at its meetings has emphasized, *inter alia*, the following.

1. Payment system services in India should be taken to a level comparable with the best in the world.
2. Appropriate legal infrastructure may be created as early as possible.
3. A plain be drawn up to “leapfrog” from cash to electronic modes of payment, wherever possible.
4. Cheque clearing system would have to be made more efficient through cheque truncation system.
5. Usage of the Real Time Gross Settlement (RTGS) System Be increased both in terms of opening additional branch outlets and more number of transactions being put through.

**D. Modernization of Payment and Settlement System** : For modernizing the payment and settlement systems in India, a three-pronged approach has been adopted with due emphasis on consolidation, development and integration. The consolidation of the existing payment
system involves the strengthening of computerized cheque clearing and expanding the reach of Electronic Clearing Services (ECS) and Electronic Funds Transfer (EFT). The retail payment system was given an impetus with the introduction of a new facility, viz. Special Electronic Funds Transfer (SEFT) System covering about 169 centers of the country. The critical elements of the development strategy involve opening of new clearing houses, interconnection of clearing houses through the Indian Financial Network (INFINET), development of RTGS system, Centralized Funds Management System (CFMS), Negotiated Dealing System (NDS) and the Structured Financial Messaging System (SFMS).

Integration of various payment products with the system of individual banks has been another thrust area. The focus has been on a high degree of standardization within a bank and seamless interface across banks.

With the implementation of RTGS, the paper-based inter-bank clearing has been discontinued in a phased manner beginning with the closure of inter-bank clearing at Mumbai in November 2004. All RTGS member banks have now been settling their inter-bank transactions only through RTGS. Non-RTGS member banks have been asked to make use of the electronic platform as customers of some RTGS participants. At present, there are 109 direct participants (the RBI, 94 scheduled banks and 14 Primary Dealers) of which 84 banks are offering RGGS-based customer services at more than 11,280 branches in 508 towns/cities across the country. The target is to have RTGS-based customer services in 15,000 bank branches by March 2006.
Electronic Clearing Service for bulk and repetitive credit-push payments such as salary, pension, dividend and interest, and credit-pull transactions such as payment of utility bills, insurance premier and installment repayment of loans is already available at 45 centers across the country. In order to make available ECS at more centers, bank-operated cheque processing centers (CPCs) have been advised by the RBI to commence ECS operations at the earliest. Banks already operating ECS services have also been advised to have a uniform two-day processing cycle at all the centers and also adhere to the return clearing on the same day as the presentation. In order to encourage electronic funds transfer systems, the processing charges for all the electronic funds transfer services were waived till March 31, 2006. The Maximum cap on value per transaction has been removed for ECS, EFT and SEFT.

With the operational lastion of the cheque processing system at Ranchi, Guwahati, Thiruchirapalli, the number of centers with automated cheque clearing system has gone up to 43. Magnetic Ink Character Recognition (MICR) technology being used at these centers for automatic listing and sorting of cheques and arriving at the settlement position of member banks now covers 86 per cent in volume and 87 per cent in value of the total clearing turnover in the country. Plans for setting up of MICR processing centers at 17 more cities/towns have been approved. This would take the total number of cities with MICR clearing to 60 and coverage of MICR to over 90 per cent in terms of both value and volume. The transition period from moving over to MICR-based clearing from a non-MICR-based cheque system generally takes two years in a city because member banks continue to issue the available stock of non-MICR cheques. In order to give a lead time, banks have
been advised to issue MICR cheques irrespective of whether cheque clearing centers use MICR cheque format or not. The use of MICR cheques would help in capturing cheque data in a standardized manner on computing platform. It would also facilitate introduction of a nation-wide cheque truncation system.

**Technological Developments**: Most of the initiatives regarding technology are aimed at providing better and more efficient customer service by offering multiple options to the customer. The death of distance, which is a by-product of technology, has become a reality in the banking sector. Technology is also playing a key role in banks’ strategy for gaining a competitive edge.

Many banks have commenced the process of setting up core banking solutions, which are at various stages of implementation. While such systems are already in place in respect of new private sector banks, a few old private sector banks and public sector banks are also quickly moving to set up such processes. This would benefit the customer in the banking sector. Computerization of the business of banks has been receiving high importance. The public sector banks have already crossed the 70 per cent level of computerization of their business. The directive from the Central Vigilance Commission (CVC) to achieve 100 per cent computerization has resulted in renewed vigour towards computerization of branches.

Networking has been receiving focused attention by banks. This activity is also being monitored by the RBI. Most banks have their own corporate networks to facilitate inter-branch and branch-communication takes place through the Indian Financial Network (INFINET). As part of the INFINET, the terrestrial nines have been augmented to provide for
increased data transfer capabilities. All these have resulted in the dependence of banks on network-based computing which has benefited the customer.

INFINET also provides for safe and secure transmission of electronic messages with the use of Public Key Infrastructure (PKI) which has the legal backing of Information Technology Act, 2000. It also provides for messages to flow in a structured environment, using the Structured Financial Messaging Solutions (SFMS), which provides for inter-operability of messages so that straight through processing (STP) is achieved.

Another major development witnessed in recent years is the growth in multiple delivery channels to customers such as internet-based banking, mobile banking and anywhere banking. This has benefited the customers and the banks alike. While customers have now a wide variety of options to choose from, banks have been able to reduce costs which have had a positive impact on their profitability.

These developments have, however, also posed certain challenges. In a world where geographical barriers are losing significance, it is essential that security is given prime importance in a trans-national scenario where large sums of money are at stake. While the challenges relating to physical security could be confronted with relative ease, the position is much more complicated in respect of IT security. The RBI has, therefore, provided guidelines on information system (IS) security as also IS audit which banks can use for their benefit. These are generic in nature and do not have any prescriptive tones.