# Overview of the Federal Reserve's Payments System Risk Policy

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# Preface

The purpose of this document, the *Overview*, is to help depository institutions comply with the Federal Reserve's Policy Statement on Payments System Risk (PSR policy) issued by the Board of Governors of the Federal Reserve System. The PSR policy contains three sections. The first section addresses the risks to the Federal Reserve Banks in extending intraday credit to depository institutions. The second section establishes policies and procedures for private-sector payment systems. The third section describes the Board's support of market innovations, such as rollovers or continuing contracts, that may reduce institutions' use of Federal Reserve intraday credit.

Depository institutions that use only minimal amounts of Federal Reserve intraday credit should use the *Overview* to help determine the requirements for compliance with the PSR policy. Institutions that use Federal Reserve intraday credit more regularly and those that may be considered "special situations" because of their legal structure or payment activity should obtain a copy of the *Guide to the Federal Reserve's Payments System Risk Policy* for a more comprehensive description of the PSR policy's requirements.[1]

Users of the *Overview* should be aware that the information it contains is based on the PSR policy in effect at the time of publication. If the Board finds it necessary to modify the PSR policy, future policy statements will supersede information in the *Overview* until it can be updated accordingly.[2]

1. The *Guide to the Federal Reserve's Payments System Risk Policy* is available on line at http://www.federalreserve.gov/paymentsystems/psr/guide.pdf or from any Federal Reserve Bank.
2. The current version of the PSR policy is available on line at http://www.federalreserve.gov/paymentsystems/psr/policy.pdf

# 1 Background

An integral component of the PSR policy is a program to control the use of Federal Reserve intraday credit, commonly referred to as “daylight credit” or “daylight overdrafts.” A daylight overdraft occurs at a Reserve Bank when funds in an institution’s Federal Reserve account are insufficient to cover outgoing Fedwire funds transfers, incoming book-entry securities transfers, or other payment activity processed by a Reserve Bank, such as check or automated clearinghouse (ACH) transactions.[3]

## Policy History

In 1985, the Board published a policy statement on risks in large-dollar wire transfer systems. The policy required institutions incurring daylight overdrafts in their Federal Reserve accounts as a result of Fedwire funds transfers to establish a maximum limit, or net debit cap, on those overdrafts. In subsequent years, the Board expanded the original PSR policy to address the control of risks in activities such as ACH transactions, book-entry securities transfers, offshore dollar clearing and netting, and certain private-sector securities clearing and settlement systems. In addition, the Board has made a number of modifications to the original program, such as reductions in net debit cap levels, the creation of an exempt status for institutions that incur only minimal daylight overdrafts, and the implementation of daylight overdraft fees.

In 1992, the Board approved a policy to charge depository institutions fees for their use of Federal Reserve daylight credit, beginning in April 1994. The Board also modified how it measures daylight overdrafts in depository institutions’ Federal Reserve accounts. This measurement method incorporates specific account posting times that more closely match the processing times of banks’ transactions.

In 2001, the Board revised the PSR policy to permit certain depository institutions to obtain collateralized daylight overdraft capacity above their net debit caps and to modify the net debit cap calculation for U.S. branches and agencies of foreign banks. In addition, the Board rescinded its inter-affiliate transfer and Fedwire third-party access policies because the risks presented by these arrangements are adequately addressed through the supervisory process.

## Primary Risk Controls Included in the Policy

Like depository institutions that offer payment services to customers, Federal Reserve Banks may be exposed to risk of loss when they process payments for institutions that hold accounts with them. The Federal Reserve guarantees payment on its systems for Fedwire funds and book-entry securities transfers, Net Settlement Service (NSS) transactions, and ACH credit originations. Because the Federal Reserve guarantees payment for these transactions, it could bear any losses resulting from the failure of an institution with an overdraft in its account. The Federal Reserve’s exposure in such instances can be significant. For example, during 2001, depository institutions incurred daylight overdrafts in their Federal Reserve accounts totaling up to almost $100 billion per day.

To control daylight overdrafts, the Federal Reserve’s PSR policy establishes limits on the amount of Federal Reserve daylight credit that a depository institution may use during a single day and over a two-week reserve maintenance period. These limits are sufficiently flexible to reflect the overall financial condition and operational capacity of each institution using Federal Reserve payment services. The policy also permits Reserve Banks to protect themselves from the risk of loss by unilaterally reducing net debit caps, imposing collateralization or clearing-balance requirements, rejecting or delaying certain transactions until sufficient balances exist, or, in extreme cases, prohibiting an institution from using Fedwire.

The Board implemented daylight overdraft fees to provide a financial incentive for institutions to control their use of Federal Reserve intraday credit and to recognize explicitly the risks inherent in the provision of intraday credit. Daylight overdraft fees induce institutions to make business decisions concerning the amount of Federal Reserve intraday credit they are willing to use based on the cost of using that credit. The daylight overdraft measurement method, which incorporates a set of nearly real-time transaction posting rules, should also help institutions control their use of Federal Reserve intraday credit by providing greater certainty about how their payment activity affects their Federal Reserve account balances during the day.

The Federal Reserve also relies on depository institutions’ boards of directors to play a vital role in its efforts to control risks in the payment system. As a general matter, an institution’s board of directors is responsible for establishing and implementing policies to ensure that management follows safe and sound operating practices, complies with applicable banking laws, and prudently manages financial risks. At a minimum, an institution’s board of directors should (1) understand the institution’s practices and controls regarding risks assumed when processing large-dollar transactions for both its own account and the accounts of its customers or respon-

3. Fedwire is a registered service mark of the Federal Reserve Banks.

dents; (2) establish prudent limits on the daylight overdraft or net debit position that the institution may incur in its Federal Reserve account and on private-sector clearing and settlement systems; and (3) review periodically the institution's daylight overdraft activity to ensure that the institution operates within the guidelines established by its board of directors.

# 2 Daylight Overdraft Capacity

Under the Federal Reserve's PSR program, each depository institution that maintains a Federal Reserve account is assigned or may establish a net debit cap. A net debit cap is the maximum dollar amount of uncollateralized daylight overdrafts that an institution may incur in its Federal Reserve account. An institution must be financially healthy and have regular access to the discount window to adopt a positive net debit cap. This section discusses the types of cap categories and the methods for establishing a cap category.

## Net Debit Caps

An institution's cap category and its capital measure determine the dollar amount of its net debit cap.[4] An institution's net debit cap is calculated as its cap multiple times its capital measure:

*Net debit cap =*
*cap multiple x capital measure.*

Because an institution's net debit cap is a function of its capital measure, the dollar amount of the cap will vary over time as the institution's capital measure changes. An institution's cap category, however, is normally fixed for one year. The policy defines six cap categories, described in more detail below: high, above average, average, de minimis, exempt from filing, and zero. The high, above average, and average cap categories are referred to as "self-assessed" caps. Cap categories and their associated cap levels, set as multiples of capital, are listed in the following table.

Net Debit Cap Multiples

| Cap category | Single day | Two-week average |
|---|---|---|
| High | 2.25 | 1.50 |
| Above average | 1.875 | 1.125 |
| Average | 1.125 | 0.75 |
| De minimis | 0.40 | 0.40 |
| Exempt from filing* | $10 million or 0.20 | $10 million or 0.20 |
| Zero | 0 | 0 |

* The exempt-from-filing cap is equal to the lesser of $10 million or 0.20 multiplied by a capital measure.

4. The capital measure for domestically chartered institutions is equivalent to supervisory capital, as described in the capital adequacy guidelines of the federal financial regulatory agencies. See section 5 of this document for a discussion of the capital measure used for U.S. branches and agencies of foreign banks.

An institution with a self-assessed cap has two cap multiples, one for its maximum allowable overdraft on any day (single-day cap) and one for the maximum allowable average of its peak daily overdrafts for a two-week period (two-week average cap). The purpose of the single-day cap is to limit excessive daylight overdrafts on any day and to ensure that institutions develop internal controls that focus on their exposures each day. The two-week average cap provides flexibility, in recognition that fluctuations in payments can occur from day to day. Institutions in the zero, exempt-from-filing, and de minimis cap categories have one cap that applies to both the single-day peak overdraft and the average peak overdraft for a two-week period.

### *Self-Assessed*

Financially healthy depository institutions that regularly incur daylight overdrafts in excess of 40 percent of their capital must perform an assessment of their creditworthiness, intraday funds management and control, customer credit policies and controls, and operating controls and contingency procedures to obtain a cap level that accommodates their normal use of intraday credit. The institution's board of directors must review and approve the results of the self-assessment, and the institution must communicate its directors' approval to the Reserve Bank by submitting a board-of-directors resolution. The Reserve Bank, in conjunction with the institution's primary regulator, will review the cap resolution for appropriateness. Should the Reserve Bank determine that the cap resolution is not appropriate, the institution will be informed that it should reevaluate its self-assessment and submit another resolution. Additional information on the self-assessment process is provided in the *Guide to the Federal Reserve's Payments System Risk Policy.*

### *De Minimis*

Depository institutions that incur daylight overdrafts up to 40 percent of their capital may qualify for a de minimis net debit cap. To ease the burden of performing a self-assessment for these institutions, the PSR policy allows a financially healthy institution to incur daylight overdrafts up to 40 percent of its capital if the institution submits a board-of-directors resolution. An institution with a de minimis cap must submit to its Reserve Bank at least once each year a copy of its board-of-directors resolution (or a resolution by its holding company's board) approving the depository institution's use of daylight credit up to the de minimis level. If an institution with a de minimis cap exceeds its cap during a two-week reserve maintenance period, its Reserve Bank will counsel the institution and decide whether the de minimis cap should be maintained or whether the institution will be required to perform a self-assessment for a higher cap.

### *Exempt from Filing*

The majority of depository institutions that hold Federal Reserve accounts have an exempt-from-filing net debit cap. The exempt-from-filing cap category is granted at the discretion of the Reserve Bank and permits institutions to incur daylight overdrafts in amounts up to the smaller of $10 million or 20 percent of their capital. If a Reserve Bank determines that an institution is eligible for the exempt-from-filing status, it will assign this cap category without requiring any additional documentation. The Reserve Bank will review the status of an exempt depository institution that incurs overdrafts in its Federal Reserve account in excess of its limit on more than two days in any two consecutive two-week reserve maintenance periods. The Reserve Bank will decide if the exemption should be maintained or if the institution will be required to file for a higher cap.

### *Zero*

An institution with a zero net debit cap should not incur daylight overdrafts in its Federal Reserve account. If an institution with a zero cap incurs a daylight overdraft, the Reserve Bank will counsel the institution and may monitor the institution's activity in real time and reject or delay certain transactions that would cause an overdraft. If the institution qualifies for a positive cap, the Reserve Bank may suggest that the institution adopt an exempt-from-filing cap or file for a higher cap if the institution believes that it will continue to incur daylight overdrafts.

In certain instances, a Reserve Bank may assign a depository institution a zero net debit cap. Institutions that may pose special risks to the Reserve Banks, such as those without regular access to the discount window, those incurring daylight overdrafts in violation of the PSR policy, or those in weak financial condition, are generally assigned a zero cap. The Reserve Banks may also assign recently chartered institutions a zero cap.

## Additional Daylight Overdraft Capacity

Although net debit caps provide sufficient liquidity to most institutions, some depository institutions may still experience intraday liquidity pressures. Consequently, certain depository institutions with self-assessed net debit caps may pledge collateral to their Reserve Banks to secure daylight overdraft capacity in excess of their net debit caps, subject to Reserve Bank approval. A depository institution with a self-assessed net debit cap that wishes to expand its daylight overdraft capacity by pledging collateral should consult its Reserve Bank. The Reserve Bank will work with a depository institution that requests additional daylight overdraft capacity to decide on its maximum daylight overdraft capacity. If the Reserve Bank approves the institution's request, the depository institution must submit a board-of-directors resolution at least once in each twelve-month period. An institution's maximum daylight overdraft capacity is defined as follows:

*Maximum daylight overdraft capacity = net debit cap + Reserve Bank-approved collateralized credit.*

Institutions with exempt-from-filing and de minimis net debit caps may not obtain additional daylight overdraft capacity by pledging collateral. These institutions must first file for a self-assessed cap to obtain additional daylight overdraft capacity. Institutions with zero net debit caps also may not obtain additional daylight overdraft capacity by pledging collateral. If an institution has adopted a zero cap voluntarily but qualifies for a positive cap, it must file for a higher cap to obtain additional daylight overdraft capacity. Depository institutions that have been assigned a zero net debit cap by a Reserve Bank are not eligible to apply for additional daylight overdraft capacity.

## Confidentiality of Net Debit Caps

The Federal Reserve considers cap categories and amounts to be confidential and will share this information only with an institution's primary supervisor. Institutions are also expected to treat their cap information as confidential. Cap information should not be shared with outside parties or mentioned in any public documents.[5]

5. See SR Letter 85-35 *Confidentiality of Sender Net Debit Caps and Self-Assessment Ratings.*

# 3 Daylight Overdraft Monitoring

The information in this section is intended to assist institutions in monitoring their Federal Reserve account balances for daylight overdraft purposes. The Federal Reserve expects institutions that maintain Federal Reserve accounts to monitor their account balances on an intraday basis in order to comply with the PSR policy. Institutions should be aware of the payments made from their accounts each day and know how those payments are funded. To monitor their Federal Reserve account balances and payment activities, institutions may use their own systems as well as the Federal Reserve's systems.

## Daylight Overdraft Measurement

The Federal Reserve uses a schedule of rules (referred to as "daylight overdraft posting rules") to determine whether a daylight overdraft has occurred in a depository institution's account. The daylight overdraft posting rules define the time of day that debits and credits for transactions processed by the Federal Reserve will post to an institution's account (appendix A). For example, Fedwire funds and book-entry securities transfers and NSS transactions are posted to accounts as they occur throughout the day, while all other transactions have fixed posting times. Although the posting rules affect the calculation of an institution's account balance for daylight overdraft monitoring and pricing purposes, the posting rules do not affect the finality or revocability of the entry to the account.

The Federal Reserve uses the Daylight Overdraft Reporting and Pricing System (DORPS) to measure on an ex-post basis an institution's overdraft activity, monitor its compliance with the PSR policy, and calculate daylight overdraft charges. DORPS captures all debits and credits resulting from an institution's payment activity and calculates end-of-minute account balances using the daylight overdraft posting rules. The daylight overdraft measurement period begins with the scheduled opening time of the Fedwire funds transfer system at 12:30 a.m. Eastern Time (ET) and continues until the scheduled closing at 6:30 p.m. ET.[6] Although DORPS records positive and negative account balances, a net positive balance from one minute does not offset a net negative balance from another minute for purposes of determining compliance with net debit caps or for calculating daylight overdraft fees. In addition, DORPS calculates daylight overdrafts on a consolidated basis for U.S. branches and agencies of the same foreign bank family and for accounts involved in a charter-level merger. In these instances, DORPS derives a single account balance by adding together the end-of-minute balances of each account.[7]

## Policy Compliance

Reserve Banks generally monitor institutions' compliance with the PSR policy over each two-week reserve maintenance period. At the end of each two-week reserve maintenance period, DORPS generates several reports that provide both Reserve Banks and depository institutions with information for monitoring daylight overdrafts, including the largest (or peak) daylight overdraft for each day during the period and daylight overdrafts in excess of an institution's approved daylight overdraft capacity. An institution incurs a cap breach when its account balance for a particular day shows one or more negative end-of-minute balances in excess of its single-day cap or when its average peak daylight overdraft over a reserve maintenance period exceeds its two-week average cap.[8]

The Federal Reserve considers all cap breaches violations of the PSR policy except in the following limited circumstances. First, the policy allows institutions in the exempt-from-filing cap category to incur up to two cap breaches in two consecutive two-week reserve maintenance periods without violating the PSR policy. Second, cap breaches incurred by institutions in the administrative counseling flexibility program are not considered policy violations.[9] Finally, a Reserve Bank has discretion to waive a

6. In cases of unscheduled extensions of Fedwire hours, the final closing account balance is recorded as if it were the balance at the standard closing time, and balances between the scheduled and actual closing times are not recorded in DORPS.

7. For institutions with accounts in more than one Federal Reserve District, an administrative Reserve Bank (ARB) is designated. The ARB coordinates the Federal Reserve's daylight overdraft monitoring activities for the consolidated accounts.

8. An institution's average peak daily overdraft is calculated by adding the largest overdraft incurred for each day during a reserve maintenance period and dividing that sum by the number of business days in the period.

For an institution with a maximum daylight overdraft capacity limit, the single-day cap is equal to an institution's net debit cap plus the amount of applicable Reserve Bank-approved collateral. The two-week average cap is equal to the two-week average net debit cap plus the amount of applicable Reserve Bank-approved collateral, averaged over a two-week reserve maintenance period.

9. The Federal Reserve's administrative counseling flexibility program is designed to assist relatively small institutions that frequently exceed their net debit caps as a result of the posting of transactions without settlement-day finality. Under administrative counseling flexibility, the Reserve Banks work with affected institutions to identify alternatives that

violation if it determines that the cap breach resulted from circumstances beyond the institution's control, such as an operational failure at a Reserve Bank.

## Consequences of Policy Violations

A policy violation may initiate a series of Reserve Bank actions aimed at deterring an institution's excessive use of Federal Reserve intraday credit. These actions depend on the institution's history of daylight overdrafts and financial condition. Initial actions taken by the Reserve Bank may include an assessment of the causes of the overdrafts and a review of account-management practices. In addition, the Reserve Bank may require an institution to submit documentation specifying actions it will take to address the overdraft problems. If policy violations continue to occur, the Reserve Bank may take additional actions. For example, if a financially healthy institution in the zero, exempt-from-filing, or de minimis cap category continues to breach its cap, the Reserve Bank may recommend that the institution file a cap resolution or perform a self-assessment to obtain a higher net debit cap.

In situations in which an institution continues to violate the PSR policy and counseling and other Reserve Bank actions have been ineffective, the Reserve Bank may assign the institution a zero cap. In addition, the Reserve Bank may impose other account controls that it deems prudent, such as requiring increased clearing balances; rejecting Fedwire funds transfers, ACH credit originations, or NSS activity in excess of the account balance; or requiring the institution to prefund certain transactions. Reserve Banks also keep institutions' primary regulators apprised of any recurring overdraft problems.

would avoid or reduce daylight overdrafts caused by transactions without settlement-day finality, but the Banks generally do not subject these institutions to escalated levels of counseling, require collateral, or assign a zero cap.

## Real-Time Monitoring

The Account Balance Monitoring System (ABMS) is a Federal Reserve automated application that provides real-time, intraday information on an institution's account balance and Federal Reserve payment activity.[10] Intraday accounting activity for Fedwire funds and securities transfers and NSS transactions are updated in real time; most other transactions are updated every five minutes. All institutions that have an electronic connection to the Federal Reserve's Fedwire funds transfer service, such as through a FedLine terminal or a computer interface connection, are able to review their intraday Federal Reserve account balances in ABMS.[11] ABMS serves as both an account-monitoring tool for depository institutions and a risk-management control for the Reserve Banks.

The Reserve Banks may use ABMS to intercept or reject certain transactions from posting to an institution's account, a capability known as "real-time monitoring." Real-time monitoring allows the Reserve Banks to prevent an institution from transferring funds from its account if there are insufficient funds to cover the payment(s). If an institution's account is monitored in "reject" in ABMS, any outgoing Fedwire funds transfer, NSS transaction, or ACH credit origination that would cause an overdraft above a specified threshold, such as the institution's net debit cap, will be rejected. The Reserve Banks generally notify institutions before monitoring their accounts in real time.

10. For more information, please see the Account Management Guide at http://www.frbservices.org/Accounting/CustomerReferenceGuide.cfm.

11. Institutions may also access information through Fedline for the web. (Fedline is a registered service mark of the Federal Reserve Banks.) The Account Management Information (AMI) application provides depository institutions with real-time access to their intraday account balances, detailed transaction information, a variety of reports, and inquiry capabilities. Institutions can obtain information on accessing ABMS and AMI from any Federal Reserve Bank.

# 4 DAYLIGHT OVERDRAFT FEES

The Reserve Banks charge institutions a fee for daylight overdrafts incurred in their Federal Reserve accounts, subject to the deductible and waiver provisions discussed below. This section describes how daylight overdraft fees are calculated and assessed. It is important to note that the calculation of daylight overdraft fees is not related to institutions' net debit caps.

## Calculation of Charges

For each two-week reserve maintenance period, the Reserve Banks calculate and assess daylight overdraft fees, which are equal to the sum of any daily daylight overdraft charges during the period. For each day, an institution's daylight overdraft charge is equal to the effective daily rate charged for daylight overdrafts multiplied by the average daylight overdraft for the day minus a deductible valued at an effective daily rate.

## Key Components of Daylight Overdraft Pricing

*Annual rate* charged on daylight overdrafts equals 36 basis points.

*Effective annual rate* charged on daylight overdrafts is based on scheduled Fedwire operating hours and equals 27 basis points (36 x 18/24).

*Effective daily rate* charged on daylight overdrafts is the effective annual rate divided by 360.

*Average daylight overdraft* is calculated by adding together any negative end-of-minute balances incurred during the standard operating day of the Fedwire funds transfer system and dividing this amount by the number of minutes in the standard Fedwire operating day.[12]

*Deductible* equals 10 percent of an institution's capital measure and represents a threshold average level of overdrafts that an institution may incur without being charged a fee.

*Gross overdraft charge* equals the effective daily rate charged on daylight overdrafts multiplied by the average daylight overdraft for the day.

*Daily overdraft charge* equals the gross overdraft charge minus a deductible valued at an effective daily rate.

The following equations are the basis for the charge calculation below:

*Gross overdraft charge* =
*effective daily rate x average daylight overdraft.*

*Daily charge* =
*gross overdraft charge – value of the deductible.*

## Example of Daylight Overdraft Charge Calculation

*Policy parameters:*

- Scheduled Fedwire day = 18 hours
- Deductible percentage of capital = 10%
- Rate charged for overdrafts = 36 basis points (annual rate).

*Institution's parameters:*

- Capital measure = $50 million
- Sum of end-of-minute overdrafts for one day = $4 billion.

*Daily charge calculation:*

Effective daily rate = .0036 x (18/24) x (1/360) = .0000075
Average overdraft = $4,000,000,000 / 1,081 minutes = $3,700,278
Gross overdraft charge = $3,700,278 x .0000075 = $27.75
Value of the deductible = .10 x $50,000,000 x .0000042* = $21.00
Overdraft charge = $27.75 – $21.00 = $6.75.

Similar daylight overdraft activity for each day of the reserve maintenance period (generally ten business days) would result in a two-week overdraft charge of $67.50.

* Deductible daily effective rate = .0036 x (10/24) x (1/360) = .0000042.

12. All end-of-minute overdrafts incurred during the Fedwire day, including those not exceeding an institution's net debit cap, are included in this calculation. Positive account balances on a given day are effectively set to zero and do not offset any overdrafts incurred that day in computing the average daylight overdraft amount. The occasional extensions of Fedwire beyond the standard eighteen-hour day do not affect the number of minutes used in computing the average overdraft.

## Billing and Adjustments

At the end of each reserve maintenance period, a statement of preliminary daylight overdraft charges is sent to each institution that incurred charges in that period. At the end of the following reserve maintenance period, DORPS calculates final charges, which include any adjustments, and an assessment to the institution's Federal Reserve account is made. All two-week charges of $25 or less are generally waived.[13] In addition, depository institutions should be aware that earnings credits from the holding of clearing balances cannot be used to offset daylight overdraft charges.

Adjustments to daylight overdraft charges may be appropriate in limited circumstances, such as to recognize Reserve Bank errors or incorrect accounting entries. The Reserve Banks will consider adjustments, if requested by an institution, in cases when the adjustment would reduce the fee charged to the institution.

13. Daylight overdraft fees of $25 or less are not waived for Edge Act and agreement corporations, bankers' banks that have not waived their exemption from reserve requirements, and limited-purpose trust companies. These types of institutions do not have regular access to the discount window and, therefore, should not incur daylight overdrafts in their Federal Reserve accounts. The Federal Reserve charges a daylight-overdraft penalty fee against the average daily daylight overdraft incurred by such institutions.

# 5 Special Situations

Special rules or procedures, not detailed in this document, may apply to certain institutions. Institutions that fall into any of the categories discussed below should obtain a copy of the *Guide to the Federal Reserve's Payments System Risk Policy* for more information on compliance with the PSR policy.

## U.S. Branches and Agencies of Foreign Banks

For U.S. branches and agencies of foreign banks, the PSR policy includes separate procedures for determining the U.S. capital equivalency measure used in calculating net debit caps. The U.S. capital equivalency measure for these institutions is generally based on the foreign banking organization's capital and its strength of support assessment ranking or financial holding company status.

Each foreign bank "family"—consisting of all the U.S. branches and agencies of a particular foreign bank—has a single daylight overdraft cap that may be allocated among its U.S. offices. For purposes of measuring daylight overdrafts, the intraday account balances of all the branches and agencies in the family are consolidated, as described in section 3. In addition, an ARB is designated to coordinate the Federal Reserve's daylight overdraft monitoring activities for the foreign family.

## Nonbank Banks and Industrial Banks

Nonbank banks grandfathered under the Competitive Equality Banking Act of 1987 (CEBA), industrial banks, or industrial loan companies may not incur daylight overdrafts on behalf of affiliates, except in three circumstances. First, the prohibition does not extend to overdrafts that result from inadvertent computer or accounting errors beyond the control of the nonbank, industrial bank, or industrial loan company. Second, nonbank banks are permitted to incur overdrafts on behalf of affiliates that are primary U.S. government securities dealers, provided such overdrafts are fully collateralized. Third, overdrafts incurred in connection with an activity that is financial in nature are also permitted.[14] A nonbank bank, industrial bank, or industrial loan company loses its exemption from the definition of bank under the Bank Holding Company Act if it incurs prohibited overdrafts. In enforcing these restrictions, the Federal Reserve uses a separate formula for calculating intraday Federal Reserve account positions for these institutions.

## Other Special Situations

Special rules and procedures also apply to certain bankers' banks, limited-purpose trust companies, and Edge Act and agreement corporations. These institutions do not have regular access to the discount window and therefore should not incur daylight overdrafts in their Federal Reserve accounts.[15] Bankers' banks, limited-purpose trust companies, and Edge Act and agreement corporations are assigned a zero net debit cap for daylight overdraft purposes, and any daylight overdrafts incurred by such institutions must be fully collateralized.

14. See Federal Reserve Regulation Y § 225.52 and 225.86.

15. A bankers' bank that waives its exemption from reserve requirements may be eligible for a positive net debit cap.

# 6 Privately Operated Multilateral Settlement Systems

Section II of the PSR policy sets forth a flexible, risk-based approach to risk management in multilateral settlement arrangements. This approach recognizes that such arrangements differ widely in terms of form, function, scale, and scope of activities. Multilateral settlement systems subject to the policy must identify and analyze their key risks and exposures and adopt risk-management measures commensurate with the nature and magnitude of the risks involved. Multilateral settlement arrangements that are not subject to the PSR policy are still encouraged to identify and address their risks.

In the clearing and settlement process, institutions must manage the variety of credit, liquidity, and other risks that can arise in the normal course of business, regardless of the method of clearing and settlement. The use of multilateral settlement systems introduces the risk that a failure of one participant in the system to settle its obligations when due could have credit or liquidity effects on participants that have not dealt with the defaulting participant. Multilateral settlement may, in some cases, also have the effect of altering the underlying bilateral relationships that arise between institutions during the clearing and settlement process. As a result, the incentives for, or ability of, institutions to manage and limit their risk exposures to other institutions may be reduced. In addition, there may be no timely or feasible alternative to settlement through the multilateral system in the event that the system fails to complete settlement. These factors may create added risks to participants in certain multilateral settlement systems relative to other settlement methods.

An institution participating in a privately operated multilateral settlement arrangement, such as the Clearing House Inter-Bank Payments System, a local check clearinghouse, or a privately operated ACH system is exposed to the risk that one or more members of the arrangement will be unable to fund their settlement obligations. Participants in such arrangements should review the rules of the arrangement and determine the credit and liquidity risks to which they are exposed. For example, if a participant in a local check-clearing arrangement were to default on its settlement obligation, the settlement for that arrangement could be recast, and each of the other participants in the arrangement could experience a change in its obligations and net settlement position. In this situation, the institution's management should ensure that it has appropriate sources of backup liquidity and contingency procedures for settlement.

# 7 Rollovers and Continuing Contracts

Section III of the PSR policy describes the Board's support of market innovations, such as federal funds or Eurodollar rollovers or continuing contracts, in reducing daylight overdrafts in Federal Reserve accounts and privately operated settlement systems. The Board urges market participants to consider using such innovations for these and other financial instruments when feasible. In doing so, participants should be mindful that implementing changes of this type may involve incremental costs, at least transitionally, and modified risk positions. Accordingly, participants should evaluate these factors and take them into account when selecting and negotiating with counterparties.

# 8 Controlling Risks in the Provision of Payment Services

This section presents an overview of risks in providing payment services and methods for controlling those risks. Depository institutions, including those with negligible daylight overdrafts, should be familiar with the risks associated with the various payment types and ways to mitigate those risks to better control their exposures. Any time an institution extends credit to a customer or permits a customer to use provisional funds to make a payment, the institution is exposed to the risk that the customer will not be able to meet its payment obligation. If the customer is unable or unwilling to repay the credit extension, the institution could incur a financial loss. An institution is encouraged to establish internal risk controls that reflect the creditworthiness of customers that use its payment services.

## Overview of Risks in Major Payment Systems

For an institution to control its risk from processing payments for its own account or for its customers' accounts, the institution must understand the types of risks that arise in using different payment systems. The following discussion identifies risks in several payment services and suggests some controls that might be used to protect an institution.

### *Funds Transfers*

Funds transfers made over the Federal Reserve's Fedwire funds transfer system are immediate and final transactions. The party sending the funds over Fedwire originates the transfer, and the funds are debited from the sender's account and credited to the receiver's account at the same time. Because an institution sending Fedwire funds transfers is obligated to settle those payments, the institution should ensure that a customer has funds in its account before originating a funds transfer on its behalf. Otherwise, the institution must be willing to extend credit to the customer for the amount of funds transferred in excess of the available funds in the customer's account. Institutions should perform real-time verification of customers' account balances, including credit limits that have been established, before initiating a payment on behalf of a customer. Such account-balance verifications may be performed manually by an institution that processes a very low volume of large-dollar payments or automatically through systems that incorporate intraday customer balances.

### *Book-Entry Securities Transfers*

Securities transfers made over the Federal Reserve's Fedwire securities system are also immediate and final transactions. The party sending book-entry securities over Fedwire originates the transfer, and the securities and funds payments are exchanged simultaneously. Thus, the sender's funds account is credited with the payment, and its securities account is debited for the securities; at the same time, the receiving institution's funds account is debited for the payment, and its securities account is credited for the securities.

Institutions that settle Fedwire book-entry securities for customers could be exposed to the risk of loss if a customer were to fail before settling a securities transaction. To mitigate the risk associated with settling book-entry securities transfers, an institution should assess its customer's creditworthiness to ensure that the customer can consistently fund its daily securities activity. Depending upon the customer's creditworthiness and the nature of its activity, an institution might require the customer either (1) to advise it of anticipated incoming transfers, prefund all such anticipated transfers, and return any securities not prefunded; or (2) to collateralize all intraday overdrafts.

Liquidity risk is also a concern for institutions that participate in Fedwire book-entry securities transfers. Because the institution sending securities controls the timing of the transfer, it may be difficult for institutions receiving such securities transfers to anticipate their funding needs and, thus, to control daylight overdrafts. Therefore, institutions must understand the intraday flows of their customers' book-entry activity to have a good understanding of their peak intraday funding needs.

### *ACH Originations and Check Transactions*

Risks in processing ACH transactions arise for both the receiving and the originating institution.[16] Institutions originating payments on behalf of customers have a commitment to make the payments when they deposit the file with an ACH processor. Because the ACH is a value-dated mechanism and transactions may be originated one or two days before settlement day, the originating institution is exposed to temporal credit risk that can extend from one to three business days,

16. Additional information about risk-management controls for the ACH payment mechanism may be obtained from NACHA—The Electronic Payments Association at http://pubs.nacha.org/risk.html.

depending upon when a customer funds the payments it originates. If the customer fails to fund the payments by the settlement day, the originating institution could suffer a loss.

To address these risks, institutions should perform credit assessments and establish intraday credit or exposure limits on customers originating large dollar volumes of ACH credit transactions. Institutions should also monitor compliance with these limits across all processing cycles for a given settlement date. If a customer's financial condition deteriorates, the originating institution should require the customer to prefund its account, provide collateral, or deposit the ACH file on the night preceding the settlement day.

The major risk in originating ACH debit transactions and collecting checks for customers is return-item risk. Return-item risk extends from the day funds are made available to customers until the individual items can no longer legally be returned. The receiver of ACH debit transactions, or the payor of checks, has the right to return transactions for various reasons, including insufficient funds in its customer's account. To minimize its exposure, an institution should perform credit assessments of all customers that originate large dollar volumes of ACH debit transactions and all customers for which the institution collects large volumes of checks; such assessments ensure that if ACH or check items are returned after the customer has been granted use of funds, the customer will be able to return the funds to the institution.

## Operational Risk and Contingency Procedures

An institution providing electronic payment services should employ a comprehensive set of controls to ensure the integrity of the processing system, to limit access to devices and systems to authorized personnel, and to ensure that fraudulent or erroneous messages or payments are not entered into the system. Institutions should strictly limit the ability to initiate transactions to authorized bank employees and customers. Most attempts at electronic payment fraud result from poor controls over payment instructions made via telephone, letter, or facsimile. An institution must ensure that payment messages come from authorized parties and are delivered to authorized parties. Additionally, the accuracy and validity of payments created by authorized staff should be monitored regularly.

Operational disruptions resulting from temporary loss of telecommunications or computer-processing ability or outages of longer duration, such as those caused by fire, flood, or earthquakes, create significant risk for an institution and its customers. In these situations, customer account balances may be frozen or unavailable, and the ability to complete transactions and make payments may be seriously impaired. For an institution processing low volumes of electronic payments, it may be practical to develop manual backup procedures or to acquire an extra Fedline terminal for backup. An institution processing higher volumes of payments should develop contingency plans that include the availability of equipment such as terminals, personal computers, and data communications equipment, including encryption devices and telephones. An institution also should consider installing backup telecommunications lines to the Federal Reserve and to its major customers. Finally, consideration should be given to establishing a complete or partial disaster recovery site that is capable of accommodating relocated operations staff.

# A Daylight Overdraft Posting Rules

### Opening Balance (Previous Day's Closing Balance)

*Post throughout Business Day:*

+/– Fedwire funds transfers
+/– Fedwire book-entry securities transfers
+/– Net settlement entries.

*Post at 8:30 a.m. Eastern Time (ET):*
+/– Government and commercial ACH credit transactions[17]
The two sides of the ACH credit transaction—the credit to the receiver and the debit to the originator—are posted simultaneously
\+ Treasury Electronic Federal Tax Payment System (EFTPS) investments from ACH credit transactions
\+ Advance-notice Treasury investments
These include direct and special direct Treasury investments for which notification was given a day earlier.
\+ Treasury checks, postal money orders, local Federal Reserve Bank checks, and EZ-Clear savings bond redemptions in separately sorted deposits
These items must be deposited by 12:01 a.m. or later local time.
– Penalty assessments for tax payments from the Treasury Investment Program (TIP).[18]

*Post at 8:30 a.m. ET and Hourly, on the Half-Hour, Thereafter:*
+/– Main-account administrative investments or withdrawals from TIP
+/– SDI (special direct investment) administrative investments or withdrawals from TIP
\+ 31 CFR Part 202 account deposits from TIP
– Uninvested PATAX tax deposits from TIP
– Main-account-balance-limit withdrawals from TIP
– Collateral-deficiency withdrawals from TIP
– 31 CFR Part 202 deficiency withdrawals from TIP.

*Post at 8:30 a.m., 1:00 p.m., and 6:30 p.m. ET:*
– Main-account Treasury withdrawals from TIP.[19]

*Post by 9:15 a.m. ET:*
\+ U.S. Treasury and government-agency book-entry interest and redemption payments
\+ U.S. Treasury and government-agency matured coupons and definitive securities received before the maturity date.

*Post Beginning at 9:15 a.m. ET:*
– Original issues of Treasury securities.
Original issues of government agency securities are delivered as book-entry securities transfers and will be posted when the securities are delivered to the purchasing institutions.

*Post at 9:30 a.m. ET and Hourly, on the Half-Hour, Thereafter:*
\+ FR–ETA Value Fedwire Investments from TIP.

*Post at 11:00 a.m. ET:*
+/– ACH debit transactions
The two sides of the ACH debit transaction—the debit to the receiver and the credit to the originator—are posted simultaneously.
\+ EFTPS investments from ACH debit transactions.

*Post at 11:00 a.m. ET and Hourly Thereafter:*
+/– Commercial check transactions, including returned checks

Note. This schedule of posting rules does not affect the overdraft restrictions and overdraft-measurement provisions for nonbank banks established by the Competitive Equality Banking Act of 1987 and the Board's Regulation Y (12 CFR 225.52)

17. Depository institutions that are monitored in real time must fund the total amount of their commercial ACH credit originations when the transactions are processed. If the Federal Reserve receives commercial ACH credit transactions from depository institutions monitored in real time after the scheduled close of the Fedwire funds transfer system, these transactions will be processed when the Federal Reserve's Account Balance Monitoring System (ABMS) reopens or by the ACH deposit deadline, whichever is earlier. The ABMS provides intraday account information to the Reserve Banks and depository institutions and is used primarily to give authorized Reserve Bank personnel a mechanism to control and monitor account activity for selected institutions. For more information on ACH transaction processing, refer to the "ACH Settlement Day Finality Guide" available through the Federal Reserve Financial Services web site at http://www.frbservices.org.

18. The Reserve Banks will identify and notify depository institutions with Treasury-authorized penalties on Thursdays. In the event that Thursday is a holiday, the Reserve Banks will identify and notify depository institutions with Treasury-authorized penalties on the following business day. Penalties will then be posted on the business day following notification.

19. On rare occasions, the Treasury may announce withdrawals in advance that are based on depository institutions' closing balances on the withdrawal date. The Federal Reserve will post these withdrawals after the close of Fedwire.

– Check debits

Check debits are posted on the hour at least one hour after presentment. Checks presented before 10:01 a.m. ET will be posted at 11:00 a.m. ET. Presentment times will be based on surveys of endpoints' scheduled courier deliveries and so will occur at the same time each day for a particular institution.

\+ Check credits

Institutions must choose one of two check-credit posting options: (1) all credits posted at a single, float-weighted posting time, or (2) fractional credits posted throughout the day. The first option allows an institution to receive all of its check credits at one time for each type of cash letter. This time may not necessarily fall on a clock hour. The second option lets the institution receive a portion of its available check credits on the clock hours between 11 a.m. and 6 p.m. ET. The option selected applies to all of an institution's check deposits, including those for its respondents. Reserve Banks will calculate crediting fractions and float-weighted posting times for each time zone based on surveys. Credits for mixed cash letters and other Fed cash letters are posted using the crediting fractions or the float-weighted posting times for the time zone of the Reserve Bank servicing the depositing institution. For separately sorted deposits, credits are posted using the posting times for the time zone of the Reserve Bank servicing the payor institution.

+/– Check corrections amounting to $1 million or more

\+ Currency and coin deposits

\+ Credit adjustments amounting to $1 million or more.

*Post at 12:30 p.m. ET and Hourly, on the Half-Hour, Thereafter:*

\+ Dynamic Investments from TIP.

*Post by 1:00 p.m. ET*

\+ Same-day Treasury investments

These transactions represent direct and special direct Treasury investments for which notification is given on the same day.

*Post at 1:00 p.m. Local Time and Hourly Thereafter:*

– Electronic check presentments.[20]

*Post at 5:00 p.m. ET:*

\+ Treasury checks, postal money orders, and EZ-Clear savings bond redemptions in separately sorted deposits

These items must be presented by 4:00 p.m. ET.

\+ Local Federal Reserve Bank checks

These items must be presented before 3:00 p.m. ET.

+/– Same-day ACH transactions

These transactions include ACH return items, check-truncation items, and flexible-settlement items.

*Post at 6:30 p.m. ET:*[21]

\+ Penalty abatements from TIP.

*Post after the Close of Fedwire Funds Transfer System:*

+/– All other transactions

These transactions include the following: local Federal Reserve Bank checks presented after 3:00 p.m. ET but before 3:00 p.m. local time, noncash collection, credits for U.S. Treasury and government agency definitive security interest and redemption payments if the coupons or securities are received on or after the maturity date, currency and coin shipments, small-dollar credit adjustments, and all debit adjustments. Discount window loans and repayments are normally posted after the close of Fedwire as well; however, in unusual circumstances a discount window loan may be posted earlier in the day with repayment twenty-four hours later, or a loan may be repaid before it would otherwise become due.

## Equals: Closing Balance.

20. The Federal Reserve Banks will post debits to depository institutions' accounts for electronic check presentments made before 12:00 p.m. local time at 1:00 p.m. local time. The Reserve Banks will post presentments made after 12:00 p.m. local time on the next clock hour that is at least one hour after presentment takes place but no later than 3:00 p.m. local time.

21. The Federal Reserve Banks will process and post Treasury-authorized penalty abatements on Thursdays. In the event that Thursday is a holiday, the Federal Reserve Banks will process and post Treasury-authorized penalty abatements on the following business day.

# B Glossary of Terms

*Above average cap*—The cap category that permits an institution to incur daylight overdrafts on a single day up to 1.875 times its capital measure and an average of its peak daily overdrafts during any two-week reserve maintenance period up to 1.125 times its capital measure.

*Account Balance Monitoring System (ABMS)*—The Federal Reserve's computer system that provides account information to the Federal Reserve Banks and depository institutions on an intraday basis. ABMS serves as both an informational source and a monitoring tool. This information includes opening balances, funds and security transfers, nonwire accounting activity, and depository institutions' cap and collateral limits.

*ACH*—Automated clearinghouse. An electronic batch-processing service used to disburse or collect funds.

*Administrative Reserve Bank (ARB)*—The administrative Reserve Bank is responsible for the administration of Federal Reserve credit, reserves, and risk-management policies for a given depository institution or other legal entity.

*Affiliate*—Any company that controls, is controlled by, or is under common control with, a bank or nonbank bank (according to Federal Reserve Regulation Y).

*Agreement corporation*—A corporate subsidiary of a federally chartered or state-chartered bank having an agreement or undertaking with the Board of Governors, under section 25 of the Federal Reserve Act, to engage in international banking and investments.

*Average cap*—The cap category that permits an institution to incur daylight overdrafts on a single day up to 1.125 times its capital measure and an average of its peak daily overdrafts during any two-week reserve maintenance period up to 0.75 times its capital measure.

*Average daily daylight overdraft*—An institution's average daily daylight overdraft is calculated by dividing the sum of its negative Federal Reserve account balances at the end of each minute of the scheduled Fedwire operating day (with positive balances set to zero) by the total number of minutes in the scheduled Fedwire operating day.

*Bankers' bank*—An institution organized and chartered solely to do business with other banks and primarily owned by the banks that it services. Bankers' banks do not take deposits or make loans to the public and are not eligible for discount window access unless they waive their exemption from reserve requirements.

*Board-of-directors resolution*—A statement of intention to follow a course of action that is approved by a majority vote of a quorum of the board of directors of a corporation. In the context of the PSR policy, a board-of-directors resolution would be adopted to convey approval to a Reserve Bank of a net debit cap category.

*Board of Governors (Board)*—The Board of Governors of the Federal Reserve System.

*Book-entry securities transfer*—Generally, an electronic transfer of a U.S. Treasury or government agency security over the Fedwire system.

*Cap*—See *Net debit cap.*

*Cap breach*—A single-day cap breach occurs whenever the peak negative end-of-minute balance in an institution's Federal Reserve account on any day exceeds its single-day net debit cap. A two-week average cap breach occurs whenever an institution's average peak daily overdraft over a reserve-maintenance period is greater than its two-week average net debit cap.

*Capital measure*—For depository institutions chartered in the United States, net debit caps are multiples of "qualifying" or similar capital measures that consist of those capital instruments that can be used to satisfy risk-based capital standards, as set forth in the capital adequacy guidelines of the federal financial regulatory agencies. The U.S. capital equivalency measures for branches and agencies of foreign banks are based on capital, supervisory rating, and financial holding company status.

*Cap category*—An institution's category or class for purposes of determining its daylight overdraft net debit cap. There are six cap categories: zero, exempt from filing, de minimis, average, above average, and high.

*Cap multiple*—The factor associated with each cap category for purposes of calculating the net debit cap.

*Competitive Equality Banking Act (CEBA)*—A federal law enacted August 10, 1987, that, among other things, prohibits nonbank banks, industrial banks, industrial loan companies, or similar institutions from incurring daylight overdrafts in their Federal Reserve accounts on behalf of affiliates, except in limited circumstances.

*Daylight overdraft*—A negative balance in an institution's Federal Reserve account at any time during the Fedwire operating day.

*Peak daily overdraft*—The maximum end-of-minute negative account balance held by an institution on a particular day.

*Two-week average overdraft*—The sum of the peak daily overdrafts over a two-week reserve maintenance period divided by the number of business days in the period.

*Daylight Overdraft Reporting and Pricing System (DORPS)*—The computer system used by the Federal Reserve to measure and assess fees for daylight overdrafts in Federal Reserve accounts.

*Deductible*—The percentage of an institution's capital that is used to determine the amount deducted from the gross overdraft charge for a day.

*De minimis cap*—The cap category that permits an institution to incur daylight overdrafts up to 40 percent of its capital measure.

*Edge Act corporation*—A corporate subsidiary of a domestic or foreign bank, established under section 25(a) of the Federal Reserve Act to engage in international banking and investments.

*Effective daily rate*—The annual rate charged for daylight overdrafts divided by 360 days, adjusted for the portion of the day during which the Fedwire funds transfer system is officially operating.

*End-of-minute balance*—The balance in an institution's Federal Reserve account at the end of each minute as measured by DORPS for purposes of daylight overdraft reporting and pricing.

*Exempt-from-filing cap*—The cap category that permits an institution to incur daylight overdrafts up to the lesser of $10 million or 20 percent of its capital measure.

*Fedwire*—The Federal Reserve funds and book-entry government securities transfer system.

*Fractional posting times*—The clock hours from 11:00 a.m. through 6:00 p.m. ET, when a portion of check credits are posted for separately sorted cash letters drawn on a particular time zone or for mixed and other Fed cash letters deposited in a particular time zone. The percentage of check credits, by cash letter type, for each hour is determined by Reserve Banks based on surveys of check presentment times and applies only to those institutions choosing the fractional posting time option for their check credits.

*Float-weighted posting time*—The float-neutral time at which check credits are posted for separately sorted cash letters containing checks drawn on a particular time zone or for mixed and other Fed cash letters deposited in a particular time zone. Float-weighted posting times are determined by Reserve Banks based on surveys of check presentment times and apply only to those institutions choosing the float-weighted posting time option for their check credits.

*Gross overdraft charge*—The daylight overdraft charge calculated, based on average overdrafts, before being reduced by the deductible valued at the effective daily rate charged for overdrafts.

*High cap*—The cap category that permits an institution to incur daylight overdrafts on a single day up to 2.25 times its capital measure and an average of its peak daily overdrafts during any two-week reserve maintenance period up to 1.5 times its capital measure.

*Industrial bank*—An institution as defined in section 2(c)(2)(H) of the Bank Holding Company Act. In general, an industrial bank is a state-chartered finance company that makes loans and raises funds by selling investment certificates or investment shares to the public.

*Liquidity*—The ability to make payments as they become due in readily available funds.

*Maximum daylight overdraft capacity*—An institution's net debit cap plus Reserve Bank-approved collateralized credit. Only institutions with self-assessed net debit caps are eligible for maximum daylight overdraft capacity.

*Net debit cap*—The maximum dollar amount of daylight overdrafts an institution is permitted to incur in its Federal Reserve account at any point in the day, or on average over a two-week period. The net debit cap is generally equal to an institution's capital measure times the cap multiple for its cap category.

*Nonbank bank*—In general, an institution that accepts deposits or makes commercial loans but does not engage in both activities. Any institution that became a bank as a result of the enactment of CEBA and was not controlled by a bank holding company on the day before CEBA was enacted.

*Overnight overdraft*—A negative position in a Federal Reserve account at the Reserve Bank's close of business. Overnight overdrafts are subject to a penalty fee.

*Posting rules*—A schedule used for determining the timing of debits and credits to an institution's Federal Reserve account for various transactions processed by the Reserve Banks.

*PSR policy*—The Federal Reserve's Policy Statement on Payments System Risk.

*Real-time monitoring*—The ABMS function that provides the ability to monitor an institution's Federal Reserve account balance as transactions occur throughout the day and to reject or intercept outgoing funds transfers when they would cause an overdraft in an institution's Federal Reserve account.

*Reserve maintenance period*—A two-week period beginning on a Thursday and ending on a Wednesday over which most depository institutions must maintain required reserves and over which daylight overdrafts are monitored and charges may be assessed.

*Risk-based capital*—The “qualifying” or similar capital measure used to satisfy risk-based capital standards, as set forth in the capital adequacy guidelines of the federal financial regulatory agencies.

*Self-assessment*—A process by which a depository institution assesses its creditworthiness, intraday funds management, operational controls, contingency procedures, and credit policies to determine its appropriate cap category for daylight overdraft purposes.

*Self-assessed cap*—One of three cap categories for which institutions are required to complete a self-assessment. The self-assessment cap categories are average, above average, or high.

*Systemic risk*—In the context of payment systems, the risk that liquidity or payment problems at one financial institution will be transmitted to other institutions.

*U.S. capital equivalency*—Capital measure applied to U.S. branches and agencies of foreign banks for purposes of calculating net debit caps and the deductible used to calculate daylight overdraft charges.

*Zero cap*—The cap category associated with a cap multiple of zero and resulting in a net debit cap of zero. A depository institution may voluntarily adopt this cap category, or a Reserve Bank may assign a zero cap to certain institutions.