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## Payments Glossary

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### A

#### Automated Clearing House (ACH)

A type of payment system designed to allow corporations and consumers to reduce or eliminate the use of paper checks when making routine high-volume, low value payments. ACH systems process large volumes of individual payments electronically. Typical ACH payments include salaries, consumer and corporate bill payments, interest and dividend, and Social Security. Examples of private sector ACH providers in the U.S. include VISA, the New York Clearing House, and the American Clearing House.

#### Automatic Teller Machine (ATM) Card

A payment card issued to a person for activating Automated Teller Machines--computer terminals which allow consumers to make deposits and withdrawals.

### B

#### Batch Processing

The transmission or processing of a group of related payment instructions.

#### Book Entry System

An accounting system that permits the transfer of assets (such as securities) without the physical movement of paper documents or certificates. The U.S. book-entry system is called the National Book-Entry Securities system or NBES. NBES related transfers are made via Fedwire on a real-time delivery-vs-payment gross settlement basis.

### C

#### Check

A retail payment instrument consisting of a written order from one party (the drawer) to another party (the drawee, normally a bank) requiring the drawee to pay a specified sum on demand to the drawer or to a third party specified by a drawer.

#### Clearance

The process of transmitting, reconciling, and in some cases, confirming payments orders or financial instrument transfer instructions prior to settlement.

#### Clearing Corporation (aka Clearinghouse)

A central processing mechanism through which financial institutions agree to exchange payment instructions or other financial obligations (e.g. securities). The institutions settle for items exchanged at a designated time based on the rules and procedures of the clearing corporation. In some cases, the clearing corporation may assume significant counterparty, financial, or risk management responsibilities for the clearing system.

#### Clearing Account

Deposit account held by banks and thrift institutions at the Federal Reserve. Unlike reserve accounts, which institutions are required to maintain, clearing accounts are held if their required reserve balances are not large enough to cover the dollar volume of their check clearing and other transfers of funds through the Federal Reserve.

#### Confirmation

The process in which the terms of a trade are verified either by market participants directly or by some central entity.

#### Correspondent Bank

A bank that holds deposits for other banks and performs services, such as check clearing. The deposit balance is a form of payment for services.

#### Counterparty

One party to a trade.

#### Custodian

An entity, often a bank, that safekeeps securities for its customers and may provide various other services, including clearance and settlement, cash management, foreign exchange, and securities lending.

**Credit Card**

A payment card issued to a person for purchasing goods and services and obtaining cash against a line of credit established by the issuer. Credit cards may be of two types: those issued by merchants and vendor (such as a store) and those issued by banks (such as VISA and MasterCard). Cardholders may also be able to receive other bankcard services.

**D**[↑ Top](#)**Daylight Overdraft**

A negative position in an institution's Federal Reserve account.

**Default**

Failure to complete a funds or securities transfer according to its terms for reasons that are not technical or temporary, usually as a result of bankruptcy.

**Delivery-vs-Payments system (DVP)**

A system that ensures that the final transfer of one asset will simultaneously occur if, and only if, the final transfer of another asset (or other assets) occurs.

**Depository**

Facility for holding securities in either a certified or an uncertified (dematerialized) form. Allows securities transfers through book-entry. Depositories may also offer funds accounts and permit funds transfers as a means of payment. Depositories may be privately or publicly operated. The Depository Trust Company (DTC) is the largest American securities depository and holds the majority of the equity, corporate bond, and money market instruments issued in the United States.

**Depository Institution**

An institution that holds funds or marketable securities, usually under a specific agreement.

**Direct Deposit**

Electronic deposits or credit--usually via ACH--to an individual's bank account. Common uses of direct deposit include payroll payments, Social Security benefits and income from investments, such as CDs, annuities and mutual funds.

**Direct Debit**

Electronic transfer--usually via ACH--out of an individual's checking (or savings) account to pay recurring bills, such as mortgage payments, insurance premiums and utility payments.

**E**[↑ Top](#)**Electronic Benefits Transfer (EBT)**

A type of EFT (see below) system involving the transfer of public entitlement payments, such as welfare or food stamps, via direct deposit or point-of-sale technology (see POS). The recipient can be given an identification card, similar to a benefit card, and a PIN number to allow them to access the benefits through an electronic network.

**Electronic Commerce (E-Commerce)**

A broad term encompassing the remote procurement and payment by businesses or consumers of goods and services through electronic systems, such as the Internet.

**Electronic Data Interchange (EDI)**

The communication of trade-related information among business partners in a structured, standardized, machine-readable electronic form.

**Electronic Funds Transfer (EFT)**

A generic term describing any transfer of funds between parties or depository institutions via electronic data systems. Automated Clearing House (ACH) is an example of EFT.

**F**[↑ Top](#)**Finality**

An irrevocable and unconditional transfer of payment which occurs during settlement.

**Financial EDI (FEDI)**

An instrument for settling invoices by initiating payments, processing remittance data and automating reconciliation, via the exchange of electronic messages.

**Foreign Exchange Settlement Risk (aka Herstatt Risk)**

The potential loss of principal associated with settling transactions sequentially instead of simultaneously.

**H**[↑ Top](#)**Hybrid Settlement System**

A combination of a real-time gross settlement system and a multilateral net settlement system. Some deferred net settlement systems have incorporated mechanisms for making irrevocable and unconditional funds transfers during the day rather than only at the end of the day. In some cases this has resulted in hybrid systems which combine features, including risk control measures, of gross and net

settlement systems.

## L

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### Large-Value Transfer System

A type of wholesale payment system used primarily by financial institutions in which large values of funds are transferred between parties. Fedwire and CHIPS are the two large-value transfer systems in the U.S.

## M

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### Multilateral Netting

Multilateral netting is an arrangement among three or more parties to net their obligations. In settlement systems of this type transfers are irrevocable, but are only final after the completion of end-of-day-settlement.

## N

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### Net Debit Cap

The maximum dollar amount of daylight overdrafts an institution is permitted to incur in its Federal Reserve account. The exact dollar amount is a multiple--determined by the Federal Reserve--of an institution's capital. Under current policy, institutions are subject to two caps: a daily cap and a 2-week average cap. Net debit caps help reduce the credit risk to the Federal Reserve and taxpayers by limiting losses should an institution fail. In April 1994, as a supplement to the existing net debit cap policy, Federal Reserve Banks began charging fees to depository institutions for average daylight overdrafts in deposit accounts with the Federal Reserve.

### Net Settlement Systems

(Also referred to as Deferred Net Settlement Systems). A category of payments system. A system in which banks continually send payment instructions over a period of time, with final transfer occurring at the end of the processing cycle. During the period, a record is kept of net debits and credits.

## P

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### Payment

A transfer of value.

### Payment System

The mechanism--the rules, institutions, people, markets, and agreements--that make the exchange of payments possible.

### Payment vs. Payment

A mechanism in a foreign exchange settlement system which ensures that a final transfer of one currency occurs if and only if a final transfer of the other currency or currencies takes place

### Point-of-Sale (POS) Network

A network of banks, debit cardholders, and merchants that permit consumers to electronically make direct payment at the place of purchase. The funds transfer directly from the account of the cardholder to the account of the merchant.

### Point-of-Sale (POS) Card

A payment card issued to a person for purchasing goods and services that substitutes an electronic transfer of funds for cash, checks, or drafts.

## R

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### Real-Time Gross Settlement (RTGS) System

A category of payments system. A system is said to operate in real-time if each payment is processed as it is initiated--which provides immediate finality--rather than in batch. This serves to reduce Herstatt Risk. Gross settlement refers to the settlement of each transfer individually rather than netting. Fedwire uses a real-time gross settlement system.

### Reserve Account

A non-interest earning balance that depository institutions maintain with the Federal Reserve Bank or with a correspondent bank to satisfy the Fed's reserve requirements. Reserve account balances play a central role in the exchange of funds between depository institutions.

### Reserve Requirements

The percentage of deposits that a bank or other depository institution may not lend out or invest and must hold either as vault cash or on deposit at a Federal Reserve Bank. Reserve requirements affect the potential of the banking system to create transaction deposits.

### Retail Payments

Small-dollar payments made in the goods and services market.

## S

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### Securities Settlement System

The full set of institutional arrangements for confirmation, clearance, and settlement of securities trades and safekeeping of securities.

**Settlement**

The final step in the transfer of ownership involving the physical exchange of securities or payment. In a banking transaction, settlement is the process of recording the debit and credit positions of the parties involved in a transfer of funds; in a financial instrument transaction, settlement includes both the transfer of securities by the seller and the payment by the buyer. Settlements can be "gross" or "net." Gross settlement means each transaction is settled individually. Net settlement means that parties exchanging payments will offset mutual obligations to deliver identical items, at a specified time, after which only one net amount of each item is exchanged.

**Settlement date**

The date on which the parties to a transaction agree that settlement is to take place.

**Smart-Card**

A card-based payment system that stores values for transactions on a computer chip instead of a magnetic stripe. As the card is used for transactions, the amounts are subtracted from a balance on the chip. As the balance approaches zero, the chip can be "reloaded" through a number of methods. These cards are often used in closed-systems for specific types of purchases but do not have to be so restricted. The chip also allows the owner to keep a variety of information with them at all times.

**W**[↑ Top](#)**Wholesale Payments**

Large-value payments used primarily in the financial markets.

**For a more comprehensive glossary, please see:**

[A Glossary of Terms Used in Payments and Settlement Systems](#)  OFFSITE  PDF

*Bank for International Settlements, March 2003, 53 pages / 349 kb*

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