

**REMOTE DISBURSEMENT ACTIVITIES  
AND ZERO-BALANCE ACCOUNTS**

In an effort to establish and/or maintain customer relationships, banks often provide cash management services to corporate accounts. Two of the more common services are remote disbursement services and zero-balance accounts. Remote disbursement is a technique that enables a customer to delay settlement of a financial transaction by taking advantage of the "float" possibilities in the check clearing system. The process occurs when the maker of a check draws the instrument payable at a bank remotely located ("remote bank") from the payee named in the instrument. Remote disbursement is often used in conjunction with zero-balance accounts that permit depositors to draw checks against accounts maintained at or near a zero-balance. A corporate customer utilizing this cash management approach generally maintains a primary deposit account relationship at a bank where the principal borrowing arrangements are maintained. This bank may be referred to as a "concentration bank" and through it the customer consolidates receipts and makes general disbursements.

Zero-balance accounts obviously cannot be considered funding sources for the remote bank. More importantly, they present a credit risk due to the fact that checks are paid on accounts with insufficient collected balances on the expectation that covering funds will be provided by the customer prior to the close of the business day. The intraday exposure to the remote bank, in the form of unsecured lending against uncollected funds, is not reflected in the bank's financial statement. However, the amounts involved may be sizeable and even exceed the bank's capital.

Examiners should analyze the bank's cash management services. If a concentration bank is involved, the focus should be on the potential volatility presented by using corporate deposits as funding sources. If a remote bank is involved, the supervisory interest centers on the exposure resulting from the practice of routinely paying checks against uncollected funds. The absence of prudent safeguards and full knowledge of the creditworthiness of the customer may expose the remote bank to large and unnecessary risks and warrants comment in the examination report and the initiation of remedial measures.

**FUNDS TRANSFER SYSTEM RISK**

Growth of the commercial banking industry, accompanied by greater customer demand for services, has increased the importance of wire transfer activity. Wire transfer has

evolved from the use of elementary Morse code to sophisticated automated switching operations linking the Federal Reserve System with various governmental agencies and commercial banks. Functions of the wire transfer operation include daily funds transfers, securities transactions and the general communication of information.

Banks may effect transfers or related messages by mail, telephone and direct access to several telecommunications systems. The size and complexity of the operation will determine which method the bank uses. Since speed is the primary reason for many wire transfers, mail requests are infrequent. The majority of banks make transfers and execute Federal funds transactions over the telephone or teletype since their size and volume does not justify maintaining automated systems. However, the tendency to automate the operation is increasing with the advent of inexpensive computer technology.

The large-dollar networks are now an integral part of the payments and clearing mechanism. A variety of networks have been established to provide funds transfer services. They include the Federal Reserve Communications System (FedWire), the Clearing House Payments System (CHIPS) and Automated Clearing House (ACH).

The volume of funds which change hands daily in the U.S. through the electronic funds transfer environment is staggering. Present estimates place this volume at over one trillion dollars. It is therefore readily apparent why the financial institutions involved in those transactions and the regulatory authorities who supervise them are concerned with the quality of internal controls and management's awareness of the inherent risks associated with the various systems.

**Risk Management**

Errors and omissions and fraudulent alteration of the amount or account number to which funds are to be deposited could result in a loss to the bank. Costs can include loss of funds, loss of availability of funds, interest charges, and administrative expenses associated with recovering funds and correcting problems.

Banks are exposed to settlement risk whenever provisional funds are transferred. Provisional funds are irrevocable payments that are subject to final settlement at a later time. Two levels of risk are present:

- Credit risk to participating banks whose overdraft payments for customers (including nonsettling respondents) are not covered.

- Systemic risk to network participants when other participants fail to settle. There is no settlement risk to the recipient of a FedWire transfer. However, payments received through CHIPS are provisional and expose the recipients to settlement risk if funds are released prior to final settlement.

Intraday (or daylight) overdraft risk occurs when payments are released in expectation of the future receipt of covering funds. By definition, they represent credit exposures of a very short duration, usually a few hours. Overnight overdrafts result from failure to receive covering funds or intentional extensions of credit. In either case, a bank is exposed to risks resulting from payments made against insufficient funds or credit extensions.

The examination of funds transfer activities is designed to disclose deficiencies in the internal credit and operational controls of participating institutions and to assess the adequacy of the supervision of such activities by senior management and the boards of directors of those institutions.

Management is responsible for assessing the inherent risks in the system, establishing policies and controls to protect the institution against unreasonable exposures, and monitoring the effectiveness of such safeguards. Bank supervisors have the responsibility to ensure that the financial institutions have evaluated their own risks realistically and have provided for accounting records and internal controls which are adequate to keep the exposures within acceptable limits.

Effective risk management requires that:

- An adequate accounting system be in place to determine the extent of any intraday overdrafts and potential overnight overdrafts before releasing payments;
- Payments be within established credit limits and amounts in excess of such limits involving significant credit risk be properly approved by appropriate lending authorities; and
- Institutions responsible for settling the positions of others assign responsibility for monitoring respondents' accounts at an appropriate supervisory level.

To assure that prudent practices are being followed by banking institutions in their funds transfer activities, examinations should focus, with equal emphasis, on the evaluation of credit risks and operational controls. Deficiencies disclosed in either of these areas and suggestions for improvement should be discussed with

management and listed in the Report of Examination. Constructive criticism by the examiners should help the institutions strengthen procedures to minimize the risks associated with funds transfer activities. Refer to the Electronic Funds Transfer (EFT) Examination Documentation module for further guidance.