

FedNow Service: What's Coming in 2023



The FedNowSM Service is an instant payment service created by the Federal Reserve Banks to provide safe and efficient instant payment services in real-time, 24/7/365. The targeted release of the FedNow Service has been narrowed down to May-July 2023, raising many questions. In an [ICBA hosted webinar](#), community banks had the chance to hear directly from the Federal Reserve about what to expect from the FedNow Service. Joni Hopkins, Vice President, Product and Relationship Management Group at Federal Reserve Financial Services, and Mark Majeske, SVP Faster Payments at Alacriti, provided an overall update and information on how community banks can prepare for and connect to faster payments.

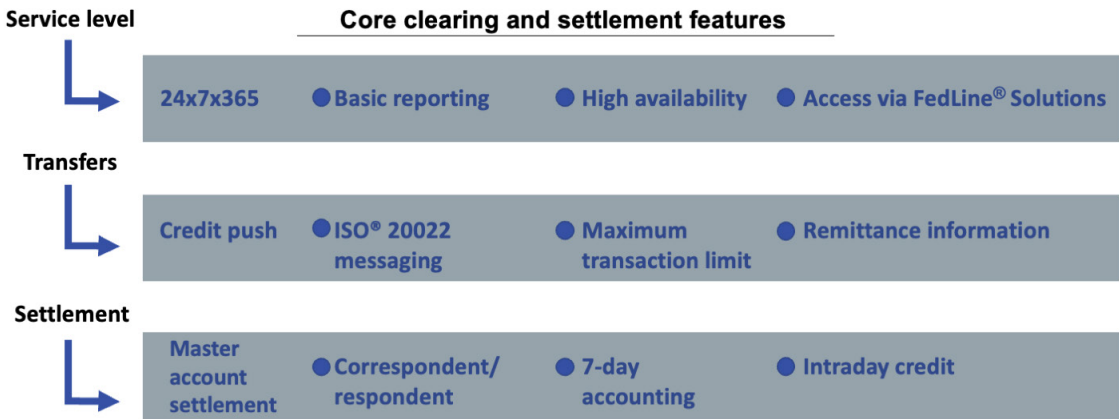
Introduction

Hopkins explained the origin of the FedNow Service. “When we think about why the Fed entered into FedNow, it is because, with our longstanding role as a payments operator, community financial institutions wanted us to help provide a new infrastructure to support instant payments in the United States. And we listened. Looking back now, it really was the right time, especially in light of the last few years. Research is telling us the same. In a Federal Reserve Survey, 90% of business respondents said that they want to be able to send or receive faster/ instant payments in the next two years. The FedNow Service is an instant payment rail that we have developed to allow every financial institution of any size in any community across the United States to be able to provide safe, efficient, instant payment services in real-time, around the clock, every day of the year to your financial institution.”

Participating in the FedNow Service provides customers of financial institutions the ability to send and receive real-time payments. It’s a rail, just as ACH payments transfer on an ACH rail, and check payments are accepted on the Fed’s Check 21 rail. It’s up to the financial institution to decide how the rail will be integrated into its organization. The FedNow Service rail has a lot of flexibility for modernization, and they have done a lot of collaboration across the ecosystem with payment service providers, end users, and other industry providers. The official pilot launched in early 2021, with over 120 participating financial institutions and processors involved.

What Will be Offered at the Beginning

Now, the advisory phase is complete, and the FedNow Service has moved to the testing phase. At launch, the Fed will release core clearing and settlement functionality to participants. These features enable use cases, enhance safety/security, and improve the customer experience. Release 1 will be as follows:



Source: 2022 The Federal Reserve

The below chart shows the value-add features that will be offered in Release 1 to support broad use cases. This includes [Request for Payment \(RfP\)](#) and final confirmation of posting on top of the core clearing and settlement features.

To ensure the safety and security of the service, the Fed will offer:

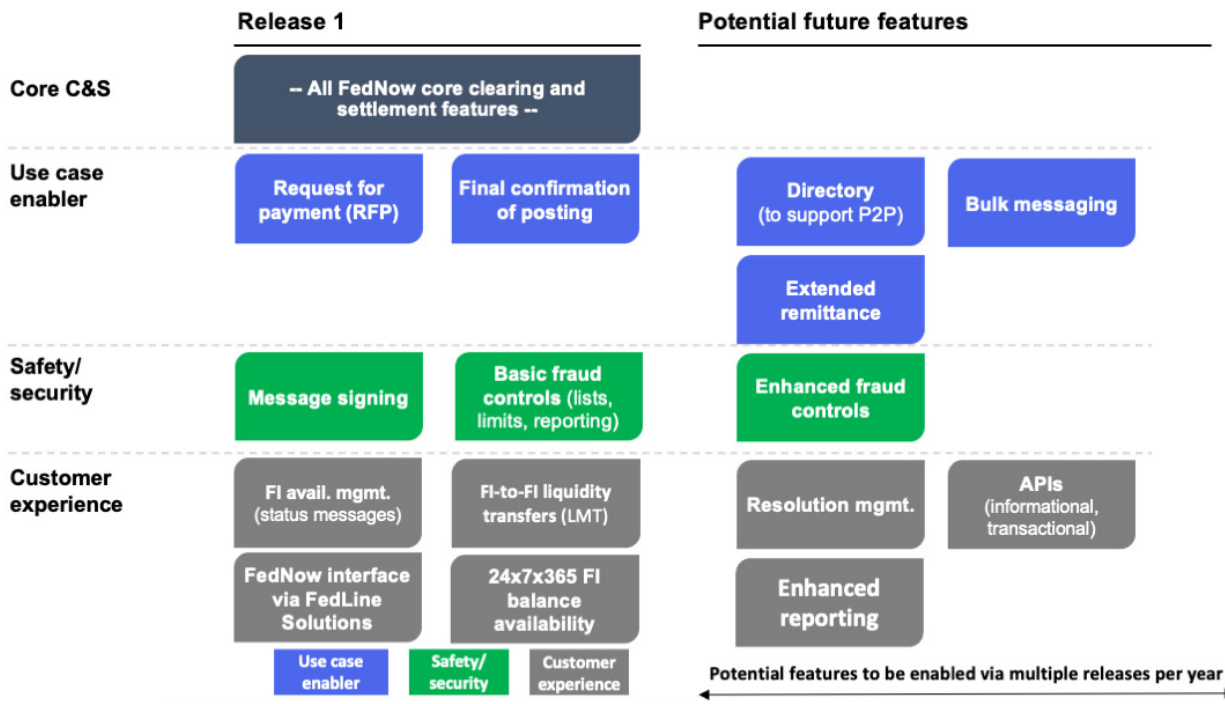
- Message signing: A digital signing of messages to ensure authentication and validity of message content.
- Enhanced fraud controls: These will be transaction-level controls to mitigate fraud risks by allowing FIs to set a transaction limit lower than the maximum credit transfer limit, supporting negative lists, and reporting of fraud in the network and to FedNow.

To support customer experience:

- The service will allow participants to broadcast when they go offline and come back online so that participants know which FIs cannot receive payments.
- Participants will be able to send liquidity transfers in support of liquidity needs for instant payments—transferring money between master accounts (or master account and joint account for private sector system) will be supported through an ISO 20022 message.
- There will be a participant portal, or user interface, to support setting configurations or retrieving reports.
- Participants will be able to obtain their account balance 24/7/365.

Future considerations:

- The FedNow Service endeavors to offer additional features in the initial period following launch to support alias-based payments such as directories. And also fraud prevention, error resolution, or case management tools. Other features may include support for bulk payments or enhanced remittance information.
- The Federal Reserve will continue to engage with stakeholders on these and other more complex considerations, such as cross-border capability.



Source: 2022 The Federal Reserve

Key Considerations for the Instant Payment Journey

Hopkins listed some key considerations that every financial institution should be mindful of when starting their instant payment journey. The first key consideration is the offerings that could develop to unlock new opportunities, deepen customer relationships and grow revenue. She also highlighted how future customers would want to make payments. To do this, Hopkins recommended putting a team together to create a payment strategy. The strategy should be the outcome of discussions with key customers, internal stakeholders, board members, risk and compliance teams, etc.

Instant Payment Solutions that can be offered include:

BUSINESS CUSTOMERS

- Transferring cash between accounts at separate institutions
- Sending bills or invoices using RFP capabilities
- Paying bills and/or suppliers for inventory, services and rent
- Disbursing payroll

RETAIL CUSTOMERS

- Paying loans or other credit accounts
- Transferring funds between accounts at separate FIs
- Funding/cashing out a digital wallet
- Paying bills
- Reloading prepaid cards
- Paying another person

INTERNAL

- Reimbursing employee expenses
- Providing payroll, incentive pay or corrections
- Disbursing 401(k) loans or investments
- Funding customer or member loans

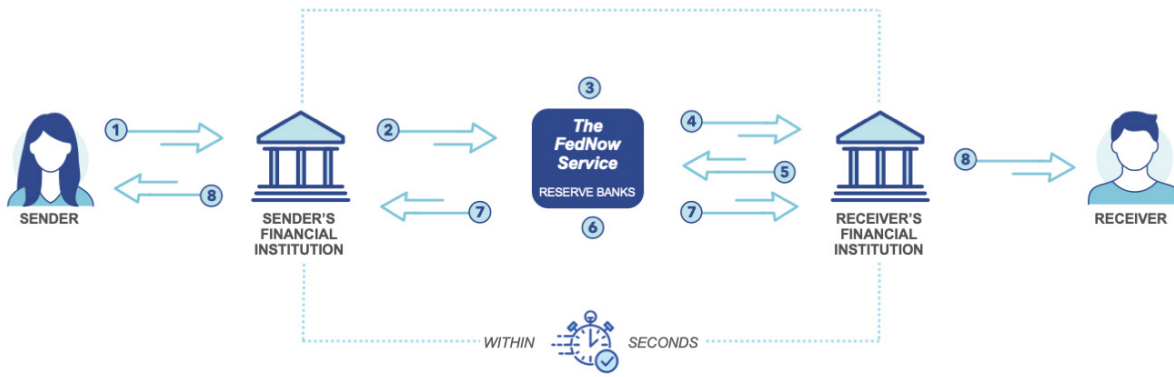
Source: 2022 The Federal Reserve

The second consideration is how to connect. Financial institutions can connect to the FedNow Service through their own FedLine® Solutions connection (Advantage or above), which is a direct line; a provider's connection, which can be a hosted gateway; a banker's bank, a core processor, or a combination of both. In addition, the Fed is in the middle of a VPN refresh (done every few years) at no expense to those directly connected, and the new VPN will be built with FedNow capabilities. Using a service provider is an option because the Fed has built that flexibility into its solutions. "We have some institutions that are even talking about doing both. So connecting to the Fed directly for some use cases and maybe even using a service provider to connect for other use cases," Hopkins added.

A third consideration is how to participate. Will your community bank want to only receive real-time payments or send and receive real-time payments? Is there an interest in receiving Requests for Payment (RfP)?

The U.S. Treasury joined the FedNow pilot in 2022. "While we don't know what agencies will begin to use the FedNow Service, it's not hard to ponder some use cases for the Treasury too. In my personal opinion, when I think about the recent hurricanes, I can visualize how organizations like FEMA might be able to use use cases for FedNow in the future and the ability to get funds to individuals quickly in the event of an emergency," said Hopkins. "And as I think about all the organizations that are working with us in a pilot, I would strongly recommend that you look at receiving payments at a minimum, as soon as possible, to allow your customers the opportunity to receive funds at your institution. But some of your use cases may be to send too, and it may also be that you would like to take a step to receive first and then move to send. With that, a key consideration is how you're going to do real-time processing as the payments will be instant, irrevocable payments in real-time." Thinking of managing real-time processing involves identifying which upstream and downstream applications need to operate on a 24/7/365 basis and what contingency arrangements are needed to mitigate service disruptions.

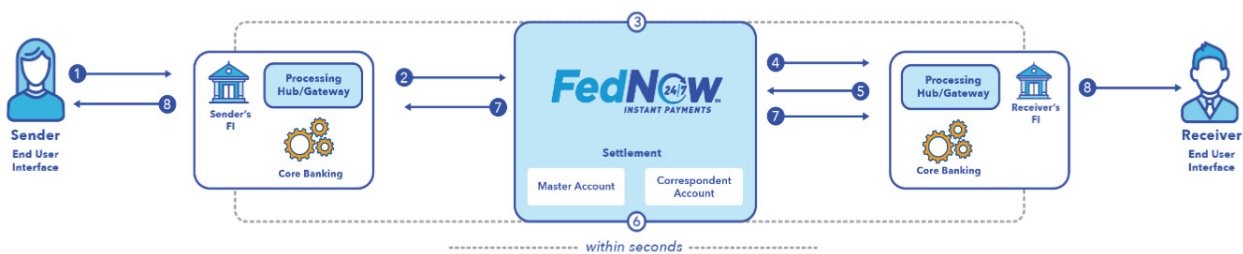
Community banks can settle payments in their own Federal Reserve Bank master account or that of a correspondent. Before thinking about how to do the settlement, it's important to understand the FedNow Service payment flow:



Source: 2022 The Federal Reserve

First, someone who wants to send a payment will initiate the payment to their financial institution, and then their financial institution will submit the message to the FedNow Service. The Fed then validates the message and sends it to the receiver's financial institution. Then, the receiver financial institution is going to accept the payment message and return a message back to the Fed. When the payment is accepted, the Fed will be debiting and crediting master accounts at The Federal Reserve for the sender and receiver's financial institution. After the payment has settled in the master account, the FedNow Service will send a message back to the receiver's financial institution with an advice of credit and also notify the sender's financial institution that the settlement is complete. Finally, the receiver's financial institution credits the receiver's account with the option to submit a posting confirmation back to the sender's financial institution. All of this happens within nanoseconds.

For service providers, the flow is a bit different:



Source: 2022 The Federal Reserve

The Fed doesn't require financial institutions to prefund any accounts, so they can settle in their master account or correspondent accounts in the same way as for other FRB services today.

What's it Going to Cost

The Federal Reserve will be charging a monthly fee of \$25. It will be \$.01 for a payment to be sent and \$.045 for credit transfer fees. However, there will be no FedNow fees before general availability. There are no other fees. This is less expensive than a wire and a little pricier than ACH fees.

The credit transfer limit will be \$500,000 at general availability, but the default will be \$100,000 (a limit that can move up or down). The Fed will continue to evaluate limits on an ongoing basis. Hopkins also recommended several resources to prepare:

- [Service Readiness Guide](#)
- [Get Ready for the FedNow Service Video](#)
- [FedNow Explorer](#)
- [Readiness Roadmaps](#)

In Conclusion

Majeske explained that Alacriti's [payments hub](#) solution, [Cosmos](#), offers banks the ability to connect with the FedNow Service and other rails such as The Clearing House's RTP® network, Visa Direct, ACH, and wires. And that the smart-routing feature ensures that the customer only sees what they can use. He continued with how Alacriti is different. "The first thing is that we were built from the ground up in the cloud. In addition, we are ISO 20022-based, which services us well for the faster payment options in the marketplace. Thirdly, we are heavily using APIs, which help us to both integrate with legacy systems as well as new platforms. There are a lot of items that have to be checked off to participate in faster payments, and we remove friction by bringing in all required services under one umbrella." Alacriti has a "grow-as-you-go" model that provides the flexibility to pick and choose what rails are best for the financial institution. In addition to a rapid time to market, Alacriti offers integration with many existing cores, online banking, and mobile banking vendors. So expensive infrastructure spending is not needed.

Majeske discussed topics that came up in his conversations with prospect banks, "Banks have been contemplating fraud, whether they should use a funding agent or not, and the overall user experience. We're adding turnkey services, for example, our new partnership with Socure." The Socure partnership arose from a desire to establish a proactive fraud detection system that runs 24/7/365 and automates instant decisioning using transactional analysis and scoring. Majeske explained, "We wanted the banks to be able to customize the outcome of the analysis applying its own tolerance levels to the score and total outcome of the decision of

the transaction. And we designed it to augment existing systems because a lot of banks were asking if they would need to replace their entire fraud system. If your system's working well for ACH and wire today, and you want to add faster payments, then obviously, you're going to need to analyze those transactions." Cosmos AIQ Fraud Solution, powered by Socure, offers full-featured activity reporting. Although it's a full end-to-end fraud system designed for faster payments, it can be used on any other rail on the Cosmos platform.

Liquidity management is important as banks may want to use a correspondent or a funding agent. For that reason, Alacriti is partnering with a bankers bank as a part of the Cosmos platform solution.

The user experience really comes down to the products. "It's one thing to connect to the network. It's another thing to offer new and innovative ways for customers to move money," Majeske explained. "What we're doing at Alacriti is building those products, enabling you to white-label them in your online banking or mobile apps—working with your vendor. The idea is to instead of just offering the service, offering the service, and wowing your customers at the same time."

Hopkins had some concluding remarks. "I want to reiterate that the FedNow Service is a high priority of the Federal Reserve. We are progressing rapidly, and we understand that this is a complex undertaking that will serve as a foundational infrastructure for the U.S. payment not only today but into the future. Our phased approach of deploying the FedNow Service is going to ensure that at our initial release that we are going to be able to bring to market something quickly that provides flexibility but also gives the ability to adjust, augment, and add features to future releases, to respond to industry news. We have put a lot of effort into making a safe, efficient, and effective payment rail."

QUESTIONS FROM THE AUDIENCE

Will FedNow replace existing P2P services like Zelle® and Venmo, or will it complement/work in conjunction with them?

Hopkins: That is a great question. I personally do not see FedNow replacing existing P2P services. For instance, if you were using Venmo today and wanted to transfer funds to your bank and chose that instant payment option, that transaction could ride the FedNow rail to do an instant transfer between your Venmo and your account today instead of waiting the two to three days. So there are instances where Venmo might ride over the rail, but I do not see FedNow replacing current or existing P2P services. I think they can be complementary.

Majeske: I agree, Joni. I've been in the product development area within banks, and so I look at payment rails as tools. When I'm building a product, I start with my customer and what gap I'm trying to fill or what problem I'm trying to solve, and then I select what rail or rails I want to offer the product in. It's just a good way to do it because you're satisfying your customer first, right? I don't think there's going to be one leader or one rail that's going to take over another rail. I think you're going to have to use a composite or a number of them, and that's why we developed Cosmos the way we did—to be able to bring in additional rails as you need them.

Can this be branded and customized with our own name and brand?

Majeske: All of the overlays or the products that we're talking about developing and offering to banks are enabling you to white-label it. You can call it what you want and have your own name on it. With the features and functionality, we're going to be starting off very simply with usual to and from scenarios, but we'll start to look at different segments of the economy, such as the insurance sector for businesses, that sort of thing. Maybe applications, where you want to go buy a car on President's Day, and the bank is closed. We're looking at situations like that, that we can build and that you can brand.

Hopkins: Using the example of loans over the weekend. I have had more financial institution loan officers come up to me and talk about closing mortgages on the weekend or doing auto loans on the weekend and the excitement that they have over that. So yes, you can white brand, but I love that you use that example because that's when we hear a lot when I'm out at conferences.

It sounds like FedNow payments do not adhere to business day and holiday banking rules. It's instant 100% of the time. Is that accurate?

Hopkins: That is correct. It is going to be 24/7/365. The Federal Reserve is going to be expanding our customer support hours to be around the clock. But again, your debit cards are used around the clock today. Your ATMs are available. So it doesn't mean that someone necessarily has to be sitting in your financial institution 24/7/365, but the services that you're going to be able to get from the Federal Reserve are going to be expanded, including liquidity management, which we announced will

also be happening over the weekends. So we are changing how we do business to adapt to the needs in the marketplace. So you are correct that the payments world is changing, and banking hours and holidays and things like that will not be the same.

Will ACH and wires post instantaneously via FedNow? I don't fully understand how I need to be thinking about this.

Hopkins: From the Fed's perspective, ACH and wires will continue to post as they do today because those are batch systems. So just as ACH rides its own rail, FedNow will ride the FedNow rail. When one of your business customers wants to send you a direct deposit file, and they've realized there's an error and they miss the deadline, there are a couple of options that you do today. You might be able to switch and send it as a same day ACH file, or you might do individual wires to try to meet a payroll obligation. And sometimes we have seen instances where the wire deadlines have closed, you can't get it in the ACH windows, and checks have actually been created to pay employees in the Fed. If the wires have closed down and the ACH is closed down, you would have the option of converting and moving those payments into a FedNow world. And in fact, when we talk about use cases, gig workers or day workers are one use case for payments of people's wages for the day. So while ACH, wires, and the FedNow rails are going to stay separate, it's important to remember that FedNow gives another option to help when there is an issue—for instance, payroll.

How will core systems that have nightly downtime for rolling the business day need to change to ensure real-time on the receiving end?

Majeske: For most real-time systems, there is no end of day. However, we do know that there are times when you need to do maintenance. And so there are blocks of times that are set up for you to do system maintenance through the day when you do settlement. However, transactions will still occur during settlement.

Hopkins: From the Federal Reserve's perspective, there is no downtime. When we're working in our testing environment with our pilot organizations, we're talking about how that will work. And so universally answering those questions is hard because you're going to need to talk to your own core provider about how they are going to meet the needs. We have some institutions that are going to be slipping between

their backup systems and their regular systems to keep people online. Fednowexplorer.org does have a showcase theater. And the Showcase is a place where organizations can go that are going to offer services over FedNow and have been screened with their presentations (not necessarily recommended). You can work directly with your core provider, or you can work with someone like Alacriti, which would be an add-on through using APIs. There's a lot of flexibility in our tool.

To find out more about what's expected in 2023 from the FedNow Service, watch the full webinar, **FedNow Service: What's Coming in 2023**, featuring The Federal Reserve and Alacriti.



WEBINAR PLAYBACK
FedNow Service:
What's Coming in 2023

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Alacriti | THE FEDERAL RESERVE
Financial Services

FedNowSM
INSTANT PAYMENTS

Alacriti's centralized payment platform, Cosmos Payments, provides innovation opportunities and the ability for members to make smart routing decisions at the credit union to meet their individual needs. Credit unions can unify payment processing all in one cloud-based platform—ACH, the FedWire Funds Service, TCH RTP[®] network, Visa Direct, and soon, the FedNowSM Service. To speak with an Alacriti payments expert, please contact us at (908) 791-2916 or email info@alacriti.com

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