

FedNow Service 2023: Your Questions Answered



Already in its pilot phase, the FedNowSM Service is a real-time settlement network developed by the Federal Reserve Banks that is scheduled to launch in 2023.

Although it is not the first real-time payment rail, many credit unions have been waiting for the FedNow Service launch to implement real-time payments.

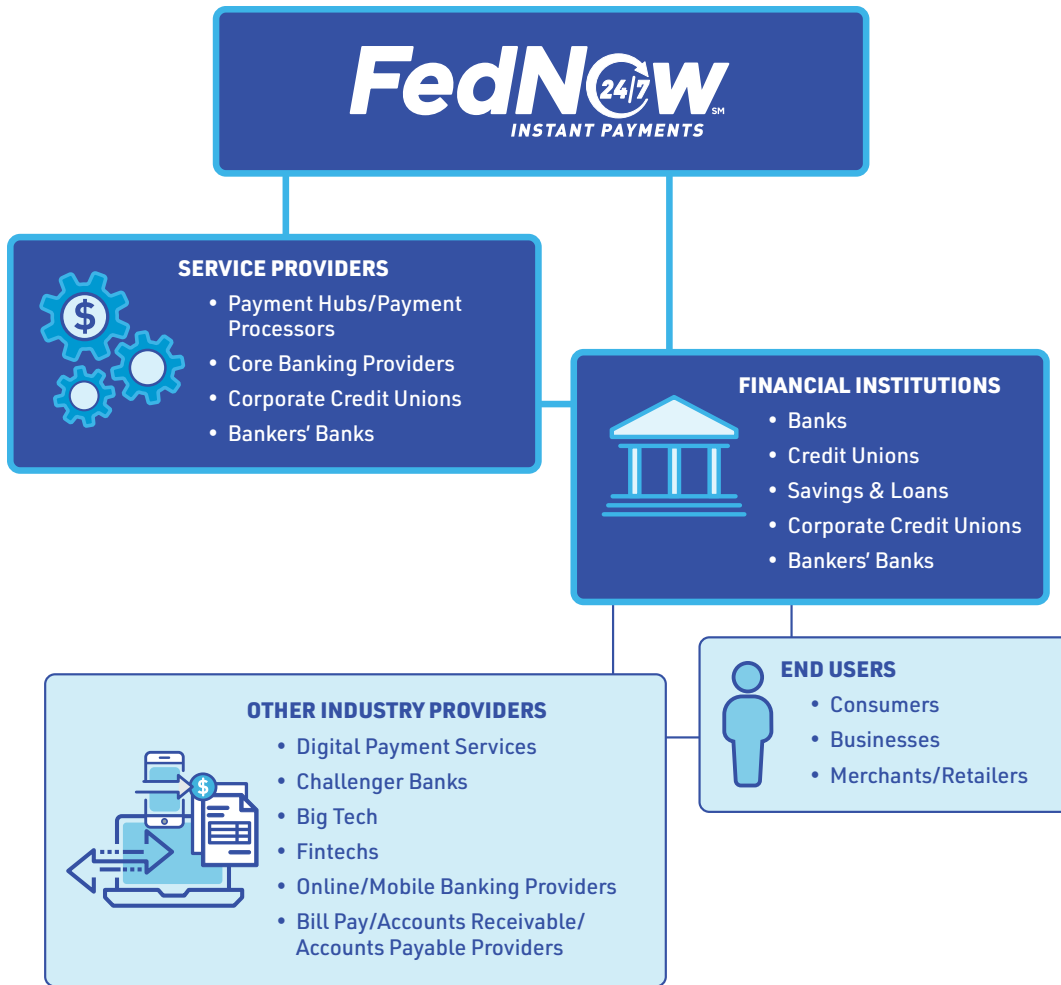
As 2023 draws near, many questions are coming up for financial institutions at all stages of real-time payment participation. In a CUInsight hosted [webinar](#), credit unions had the opportunity to ask questions directly to Joni Hopkins, Vice President, Product and Relationship Management Group at Federal Reserve Financial Services, and Mark Majeske, SVP Faster Payments at Alacriti. Also provided was the latest information on FedNow and how to connect.

The Evolution of the FedNow Service

The past two years have accelerated an already existing need for things faster and quicker. The decision for The Fed to build an instant payment rail was a multi-year initiative in response to this need. They conducted research, and it was clear that the

demand was there—9 in 10¹ businesses expect to be able to make and receive faster payments within 3 years. “The FedNow Service is a safe, efficient, instant payments infrastructure that will modernize the U.S. payment system and enable credit unions of all sizes to offer members the ability to send and receive money in near real-time around-the-clock, 365 days a year,” said Hopkins.

The FedNow system is designed to be very flexible, so financial institutions can work with their partners to integrate the rail into their payment systems. In fact, from end users to third-party service providers, a dynamic network of stakeholders is needed to enable instant payments.



Source: The Federal Reserve Financial Services

¹Source: 2020 Federal Reserve Survey

Not only is the FedNow Service flexible, but it's also highly accessible. "Every financial institution that is eligible today to use financial services through the Federal Reserve is eligible to use FedNow. There's no special, additional approval needed," stated Hopkins. "We're going to allow financial institutions to connect directly to us or through a service partner. Payment service providers can connect directly to us on behalf of any FedNow participant, and end users like your members will not come directly to the Fed. They will come through your financial institution and their payment across on our payment rail. This also allows other industry partners to participate.

Described by Hopkins as a "great collaboration", the FedNow Service pilot program was launched in 2021, and has over 120 participating financial institutions and processors. It reflects a diverse group of organizations, from small to large institutions, thrifts, processors, and aggregators, and different geographic locations, so it's very widespread with different market segments. Pilot participants participate in 2 sessions that the Fed hosts a month. This pilot is actively moving to the testing stage from the advisory stage. Originally, the official launch was said to be in 2024, but now the FedNow Service is scheduled to go live by the end of 2023.

The focus of the FedNow service is instant payment settlement and enablement. To ensure that they have a universal standard, they are using [ISO 20022](#), which is international. Although some may be apprehensive about ISO 20022, Hopkins is confident that this will be no different than previous changes. "I like to tell folks when Check 21 came out, all of the sudden we had a lot of new standards that seemed foreign, and we quickly adapted. It's going to be no different here." Another focus for the Fed has been efficiency and ensuring that there's liquidity management, intraday transfer credits are available, and advancing their payments management services while reducing operational risk. Also on the list is security and supporting fraud mitigation services from both the Fed and the services their partners provide.

Preparing for FedNow

With the launch happening by the end of 2023 at the latest, it's time to start preparing if that process hasn't already begun. Hopkins advised, "So as you prepare and think about your offerings, it's really important to think about unlocking new opportunities at your institution. What is something new and different that you might be able to offer that will deepen member relationships and help grow revenue? And ponder what the next generation will want because they are going to expect this to be the status quo in the financial institution they use." Talk to members, pull together internal stakeholders and board members, and think about what value you want to provide and how members are going to be able to use this service most efficiently. This is an opportunity to innovate.

What Instant Payment Solutions Do You Want to Offer?

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: *The Federal Reserve Financial Services*

To prepare, Hopkins recommended that credit unions first think about what payment solutions they want to offer. Will the focus be on retail members or businesses? What are your members' biggest pain points that instant payments could alleviate? What instant payment use cases will offer your members the most value? The FedNow Service is a neutral platform that supports a broad variety of payment options. At the very least, it allows financial institutions to have interbank settlement and enable funds to move from a sender financial institution to a receiver financial institution immediately at any time.

The next thing to consider is how to connect. Will you connect through your own FedLine Solutions connection (existing or new), a service provider's connection such as [Alacriti](#), or a combination of both (e.g., based on use cases or account types)? FedLine Direct®, FedLine Command®, and FedLine Advantage® are all direct means of connection. However, FedLine Web® users will need to switch to one of the three aforementioned solutions for FedNow Service connection. Types of service providers included hosted gateways, bankers' banks, corporate credit unions, and core processors. Whether you use Alacriti, a core processor, or your corporate credit union (if preferred), credit unions can have more control by managing their profile directly through the Federal Reserve (through your FedLine Advantage or above connection). Because of the FedNow Service's flexibility, credit unions can connect even with multiple partners, e.g., a core processor and online banking service.

The third key consideration is what level of participation is appropriate for your financial institution, which will be based on the use cases and services your credit union would like to offer. Determine whether you need to enable the following capabilities:

- Receive member credit transfers
- Send and receive member credit transfers
- Receive requests for payments (RFP)

Some start with just receive-only as a start, or go right to send and receive upfront.

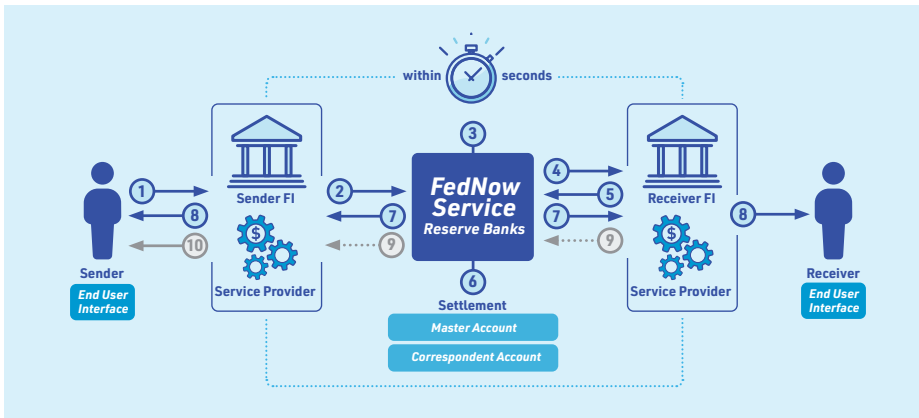
When considering the impact that real-time processing will have on operations, there are further questions to consider. How will you manage real-time processing? Which of your upstream and downstream applications need to operate on a 24x7x365 basis? What contingency arrangements are needed to mitigate service disruptions? Hopkins shared that the impact on operations is a significant concern for many credit unions. "When I'm talking to credit unions, a lot of times people get a little nervous when they think about real-time processing. Does 24x7x365 mean that I have to have someone sitting at the credit union 24 hours a day, seven days a week, 365 days a year? The answer is no. When we're your service providers, you will understand more about how this can look for you in your organization and how you can offer 24x7x365 and have real-time processing without someone physically having to be in the bank. Understand that this is different, but your partners are going to walk you through it."

Initial Questions to Ask Service Providers:

- Will you support real-time processing 24x7x365, and will your customer service be available outside regular business hours, including weekends? Understand what your credit union's responsibilities will be here.
- Do you provide services to support the needed updates to our online and mobile banking and bill pay platforms? Will the updates be universally made to all of your systems?
- Do you have fraud mitigation tools that operate on a 24x7 basis without needing manual intervention?

The last consideration is how will your credit union settle. Are you going to settle in your Federal Reserve master account, or are you going to use a correspondent, e.g., a corporate credit union? If the former, you have to make sure that your credit union is managing the master account.

The FedNow Service Payment Flow



Source: The Federal Reserve Financial Services

Cost

Hopkins shared a sneak preview of anticipated pricing. However, she encouraged attendees to review their next pricing announcement for official pricing, which will likely be at the end of 2022. Overall, it won't be a lot more than what financial institutions are paying today for legacy services, such as checks and ACH. It is likely to be a \$25 monthly fee per routing number that's enrolled in the Fed. The prices anticipated are a fee of \$0.045 per credit transfer to be paid by its sender, including returns, and a \$.01 Request for Payment fee.

The transfer value limit for the FedNow Service is \$500,000, and the default value limit is \$100,000, which can be intimidating for some. However, the Fed allows financial institutions to set their own risk tolerance. For instance, a credit union can choose to set it lower for certain payment types. The reason it goes up to \$500,000 is due to use case scenarios such as possibly having real-estate closures over the weekend.

Hopkins also recommended several resources to prepare:

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

Connection

Majeske provided insight on the possibilities of connecting to FedNow with a partner. "Alacriti offers a payments hub, [Cosmos](#), which is in a payments as a service model. We are 100% cloud-based and AWS hosted, and we integrate with many existing banking cores. We are ISO 20022 native, with open APIs, and we offer smart routing.

Alacriti

Think of it as a payments hub with multiple available rails including Fedwire, ACH, the RTP® network, FedNow (in 2023), and Visa Direct and MasterCard Send, acting as a one-stop shop for your credit union to access all of the rails. It's also a grow as you go model, meaning you don't have to choose all of the rails. You can start with rails you need and grow as your member needs change. We are also a fully committed participant in the FedNow Service pilot”.

Additional Considerations

There are potential hurdles that credit unions should consider. One of them is a fraud system. Majeske observed, “What I'm finding is that many credit unions have fraud systems or enterprise fraud systems that handle ACH and wire because that's what they do today. But the faster payments arena poses new challenges. And so, at Alacriti, we're creating a fraud system that's proactive in real-time. We want you to be able to decision the transaction based on a model that has been devised through many banks so you can make a more intelligent decision on whether to send those transactions. This system would fill in the gaps and communicate with a financial institution's existing enterprise system, making it better.”

Another priority is the funding agent option. If a credit union doesn't have a master account, then it will need to manage its own liquidity. “We're bringing funding agent capabilities to the table in the Cosmos environment, so you would not have to arrange that on your own,” Majeske explained.

Lastly, there can sometimes be challenges in the member-facing experience. “What we're doing is creating overlays, something that would be member-facing, but credit union branded that you can put in front of your members so they can use the product from day one,” shared Majeske.

Next Steps

Majeske concluded with closing remarks, “You have a lot to think about. But I always say that when you're thinking about making the move to FedNow, talk to your customers. Don't forget to do that and identify gaps and the needs that they have. And so when you're coming up with solutions for FedNow, think about that. Because that's the most important person—your member.”

“I would agree with that. The FedNow service is a high priority for the Federal Reserve and is rapidly progressing. It will be a phased-in approach—we're going to have the initial release in 2023, with other services quickly being brought to the market after the release with additional functionality. So think big, think how this is going to go in your organization and keep feeding us your ideas by joining the community and telling us what you think, and let us know how we can help you. Because that's what we're here for. We're here to make sure that your credit union has the opportunity to be involved in instant payments, no matter if you are a two-person credit union up to a very large credit union. We just look forward to partnering with you,” added Hopkins.

QUESTIONS FROM THE AUDIENCE

How does Alacriti support FIs that operate in a batch processing environment so they can provide the 24X7X365 support?

Majeske: If you're presenting us with a batch file instead of one-offs, we would take that file and, for all intent and purposes, decrypt it. You have a lot of options there because you could still send us your batch file, but what we would do is assign those transactions to the appropriate rail. If you had a preference, we would take your preference and prioritize it so more payments are sent via the rail that you would like. That might be based on speed, a combination of speed and cost, or a number of things. So if you are in a situation where you need to send a batch file, that's something that we can accommodate.

Could FedNow replace ACH origination?

Hopkins: There are use cases for FedNow that are a little bit different but may look similar to ACH. But I do not see this replacing ACH as a whole, just as people thought ACH would replace checks. I think there is room for a lot of variety in the payment system, and this gives us options. I don't think the ACH batch processing is something that we're going to see go away because I think traditional payroll and traditional direct deposit have phenomenal use cases that will continue and pass the test of time.

Majeske: I'll just reiterate that it really is about the use case. And so if I'm the federal government or FEMA and I go into a hurricane area and need to make payments for people to get food, clothing, etc., and it's Saturday, these emergency funds are the perfect FedNow Service use case. So do we still need ACH? Absolutely. Do we still need wire? Because I'm often asked that as well. Yes! There are certain circumstances where a wire is appropriate, but there are use cases that you're going to find over time (particularly Saturday, Sunday, and holidays) where FedNow will prevail.

If these types of transactions are 365 days a year, how will exceptions and returns be handled?

Hopkins: This is an instant payment, which is very similar to wire, which means when the funds go, the funds go. And so there isn't a recall system built into instant payments. That's why it's very important that you have fraud protection to ensure that your members and your businesses when they are using this service, understand who they are sending the payment to. So I think there's a lot of consumer education that will be really important around instant payments to help people know that it is irrevocable—and there are no exceptions. Those are handled outside of the payment system.

Majeske: The immediate scoring of transactions and having a decent fraud system in place to warn you that the transaction that your member is trying to send looks like other fraudulent transactions is important. It also helps on the Receive side as well because fraud systems today are very sophisticated, and they're starting to identify mule accounts. So, let's say, for instance, your member is a victim of fraud. And so were 10 other people who did FedNow transactions. The model would pick that up and warn you your member is trying to send it to someone who has been suspicious in the past. As the fraud systems get better and more proactive, there's certainly a layer of protection.

How does a sender know the recipient participates in FedNow?

Hopkins: At our initial launch, we will not be building any type of directory service. So you'll need to rely on external directory services or things that are developed within your processors. Similar to how we have participants listed on our wire system and in our ACH, we will be updating our systems to allow you to know which routing numbers are eligible to send or receive. Our ultimate goal is ubiquity. And just like every service we have offered at the Fed, you are going to see additional products and services related to FedNow rolled out in releases that will happen after our initial launch. But at the beginning of service, you're going to need to rely heavily on the processor you are working with or the vendor that you're working with to feed into our system to determine which routing numbers are available.

What is a good fraud system?

Majeske: A good fraud system is one that actually helps minimize the risk of fraud before it happens. There are two components of that. One is the ability to take information out of the model and then digest it quickly enough to make a more intelligent decision. But the other piece to it is that it has a very effective and broad-based model. So, for instance, when shopping for a fraud model, I shop for one that has a multitude of banks involved in the building of it and the maintenance of it. AI and machine learning are also extremely important because as fraudsters change their patterns of conducting fraud, the model should change as well.

I am hearing most FI's are choosing to start with Receive only for FedNow real-time payments. If that's the case, what percentage of pilot financials will be initiating real-time payments?

Hopkins: We did ask our pilot participants when they joined to look at their own use cases and how they could use it. Most of them are working towards being able to Send and Receive. We have a number of financial institutions, even outside the pilot, that want to be early adopters that have use cases for Send

already. So while some may dip their toes in with Receive, I think you all will be pleasantly surprised about the amount of payments that will be moving from a Send perspective. I don't have a percentage as it's hard to tell at this point, but our goal is eventually to have ubiquity and to have all 10,000 institutions that we're working with Receiving. And the majority Sending also, because we think as you go about your own planning at your credit unions, you're going to find use cases that will have you sending payments through an instant payment rail.

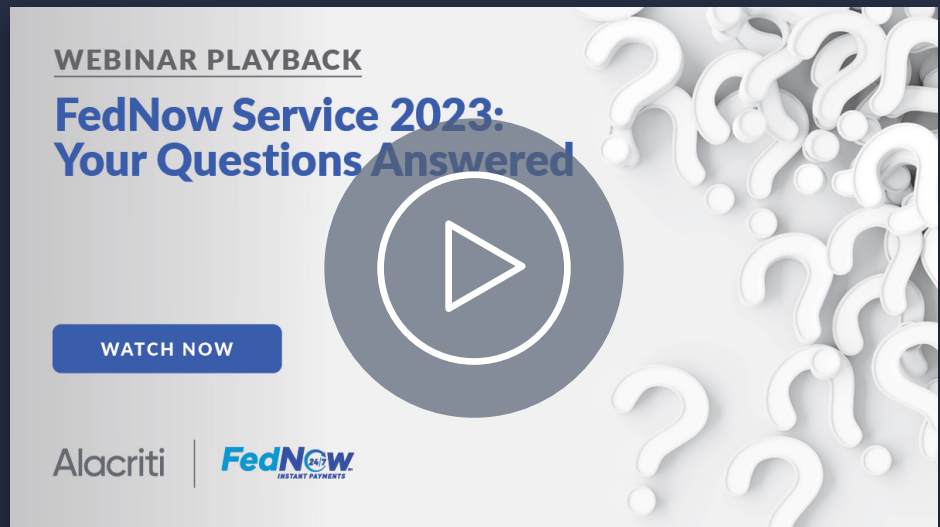
Are you focused on both the Send and Receive side as related to fraud services?

Majeske: Definitely both. If you look at faster payments, the knee-jerk reaction would be: let's focus on the Send side because that's where we have control, whether we're going to send the transaction or not. However, with the amount of data and the possible depth of analysis, I think it falls on both. It's extremely important that we look both ways, and fortunately, the fraud systems that I see out there will be offering a look at both. You have to look at the entire transaction, not just one side.

Can you speak on how the various options provided by FED come into play with this product: FedLine Advantage, Command, and Direct?

Hopkins: We will be offering FedNow over all three of those electronic solutions today. So we have built it into our VPN solution that we offer through FedLine Advantage® then is carried over to FedLine Command® and FedLine Direct®. So if you have one of those three, it will already be set up to run the FedNow transactions over it.

To get an update from the Federal Reserve and learn the answers to commonly asked questions, watch the full webinar, **FedNow Service 2023: Your Questions Answered**, featuring the Federal Reserve and Alacriti.



WEBINAR PLAYBACK

**FedNow Service 2023:
Your Questions Answered**

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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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