

Fed's FedNow Service

By now, you should have seen news articles regarding The Board of Governors of the Federal Reserve System's notice and request for comment (RFC) for FedNow. WACHA welcomes a chance to respond and supports the Fed's efforts, but the RFC leaves many questions unanswered. The Fed is seeking comment and direction from the industry, hence WACHA recommends that our members actively participate and provide direction. This document is intended to provide Questions and Key Considerations as well as helpful information to consider as FI's craft their responses. Responses to the Fed are due November 7th and are to be emailed to regs.comments@federalreserve.gov (please include Docket No. OP – 1670 in the subject line).

A description of the processing flow can be found starting in the last paragraph on page 73 of the RFC. A synopsis of the proposed credit push environment is as follows: Sender initiates a payment through their Financial Institution (FI), the sending FI validates the receiving account number by sending a message through FedNow. If the receiving FI sends a positive response, payment is made by debiting and crediting the respective Fed Accounts. Sending and receiving FIs are responsible for debiting and crediting customer accounts immediately and for notifying their customers. All transactions are final and irrevocable.

QUESTIONS and KEY CONSIDERATIONS

Unknown Cost of Service, Implementation Costs and Opportunity Costs

Because the Fed is only in the design stage, the price of the service is unknown and will be for several years. The Monetary Control Act requires the Fed to recover costs incurred and it's likely that the price of the service will include a combination of per-item fees and fixed participation fees. The best guess at this juncture is that pricing will be reasonably competitive to the RTP service and will be based on volumes achieved by other faster payment solutions.

The second unknown cost is the cost of implementation and likely to have multiple components. FedNow is likely to have a similar path to implementation that currently exists with The Clearing House RTP or Zelle solutions. FIs would most likely connect to the Fed through an agency or core processor, which is not an inexpensive prospect. As described in the RFC, FedNow is intended to be a real-time settlement service to enable clearing functionality between accounts held at the Federal Reserve. The front-end processes required to connect to FI customers (through mobile or on-line banking) and mitigate fraud would be handled independently by the FI (most likely through a core provider or other vendor(s)).

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The third significantly unknown cost is opportunity cost or time to market. As defined in Econ 101, the definition of opportunity cost is the loss of potential gain from other alternatives when one alternative is chosen. In this situation, if the FI waits until the Fed's solution is available, consider the cost of waiting while competitors move forward – will customers and revenue be lost? Many FIs have moved forward with other faster payments solutions such as Same Day ACH, Zelle, RTP, Venmo, Visa Direct or MasterCard Send. The RFC anticipates that the FedNow Service will be available in 2023 or 2024. Development of interfaces by core providers for RTP occurred after the RTP product was made available. Hence, FIs may not have the ability to connect for 5-7 years depending on the capacity of core providers. Faster Payment Solution Providers obviously feel the demand is adequate to move forward. A key consideration is the opportunity cost of lost income and market share waiting for the Fed's solution in the interim.

End of Business Day, Weekends and Holidays

The RFC states the Board believes that a 7-day accounting regime is appropriate for the FedNow Service. The Federal Reserve would record and report transactions as they occur, each day of the week, including weekends and holidays. This does not dictate or preclude the use of other accounting regimes by participating banks. In considering the implications of a business day, the Board has determined that the business day should align with the business day of the FedWire Funds Service (6:30 PM ET close). Next day opening time to occur immediately after closing time. Transactions completed after FedNow Service closing but before midnight each calendar day would be recorded on Federal Reserve accounts as transactions occurring on the next business day. However, FIs are expected to post these transactions based on the calendar day in which they are received.

The Board considered setting a midnight ET closing time for the FedNow Service to align across business and calendar days. However, this approach would not allow balance calculations performed by the Federal Reserve to be measured on the same business day for the Fedwire Funds Service and the FedNow Service.

WACHA would like to ask our FI members to comment on impacts that would be expected with a 6:30 PM ET end-of-day for FedNow with real-time entries expected to post on a calendar day basis. The RFC seems to state that memo-posting entries on the day received and hard posting on the following day provides immediate availability but avoids reconciliation issues.

Fed Account Balances, Interest, and Correspondent Banks

One of the primary changes from the *Federal Register* notice in November 2018 is planned flow of real-time entries directly to the FI's Master Account at the Fed. This negates the previous



proposed use of subaccounts and a liquidity tool for managing balances between the Master Account and the subaccount. The Fed now believes that it would be easier for FIs to manage a single account rather than separate account for FedNow entries. This eliminates the need for a liquidity tool. Funds held in a Federal Reserve Master Account earn interest and count toward reserve requirements. This is a competitive advantage that FedNow will have when compared to RTP. FIs will have the option to direct FedNow transactions to a Correspondent Bank's Master Account.

FIs will be expected to manage their account to have a positive end-of-day balance (at 6:30 PM ET) to avoid intraday and overnight overdrafts including weekends and holidays, according to a 7 day-a-week accounting practice. Because FedWire activity occurring between 6:30 PM ET and midnight are considered next day transactions, FIs may need to utilize anticipatory prefunding of the Master Account to cover any debits that may occur through the FedNow Service during this timeframe or on weekends and holidays.

The Board supports modernization of and upgrades to Federal Reserve Services to facilitate Faster Payments. Further, RFC acknowledges that it plans to solicit comments later regarding expansion of hours for FedWire and the National Settlement Service. WACHA views upgrades to FedWire to support extended hours through midnight and on weekends as critical to the success of FedNow, especially as volume increases over time. It's also important to consider that expansion of hours for FedWire and the National Settlement Service could benefit other systems such as ACH and debit card programs, providing for additional growth and innovation.

Liquidity Management

Account balance management would become more complex in a 24x7x365 environment where payments settle continuously in master accounts. Participating banks would access the FedNow Service through the FedLine® network, which would be enhanced to support the Service's 24x7x365 processing environment. The Federal Reserve is conducting analysis of when it may be beneficial to extend discount window operations to include weekends or holidays. Subject to change, but initially, the discount window for loan originations would not be available on weekends and holidays. If the Board confirms a need exists to extend access to the discount window, the FedNow Service would provide access to intraday credit under the same terms and conditions as for current Federal Reserve services. Such intraday credit would lower the risk that payments will be rejected when sent due to lack of funds.

Transaction Limits

The RFC proposes a \$25,000 transaction limit initially. This is intended to help limit the risk in a new payment environment and consistent with initial phases of other faster payment environments. Same Day ACH and RTP will both move to a \$100,000 limit in 2020. However,

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both systems started with \$25,000 and only raised the limit after verification of limited risk. A question to consider is “would a lower limit for FedNow limit adoption?” That would depend on the business case used to move the funds. For person-to-person payments, which is the primary use case for Venmo and Zelle, \$25,000 should be sufficient. \$25,000 would not be sufficient to facilitate many business-to-business transactions.

Irrevocability

As mentioned previously, all transactions would be final and irrevocable. This component means that the sending FI will need to implement rock solid processes to prevent both fraud and misdirected payments - just because the account number was validated by the receiving FI does not mean that the funds went to the intended party. The Electronic Fund Transfer Act (EFTA) will apply to FedNow transactions and requires the FI to investigate errors reported by consumers. Because the transaction will occur in only a few seconds, consumers will not be able to issue a “stop payment” request on a real-time payment. Apps that grant access to faster payment options need to have security controls in place to prevent unauthorized use. The CFPB is committed to protecting consumers.

24x7x365 Settlement

The Fed is signaling the advent of 24x7x365 payment systems and banking. The development of the internet has ignited an expansion of services that are provided on a 24x7x365 basis. The U.S. marketplace operates across time zones and facilitates sales of goods and services at any time of the day, any day of the year. Consumers can access funds through ATMs and debit cards, access financial information, pay bills, complete loan applications and transfer funds between accounts all on a 24x7x365 basis. Core processors and other vendors are critical to community FIs to facilitate a real-time 24x7x365 environment.

Education

Member owned Payment Associations such as WACHA provide reach to 90+% of all U.S. financial institutions. This positions the Payment Associations as a unique resource to provide training and education on faster payment solutions. For over 40 years, the Federal Reserve has assisted (through train-the-trainer efforts) in the educational effort of Payment Associations and we would like to encourage continued use of these organizations.

Action

WACHA will submit a response to the RFC in advance of the November 7th deadline. If your FI is interested in cosigning the response, please let us know. If you have read through the Notice and Request for Comment and have identified additional issues, please contact WACHA at (800) 453-1843 or send an email to mgilmeister@wacha.org.

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