

Amidst the backdrop of growing concerns over financial inclusion in the US, the FRB provides new details on its plans for supporting real-time payments.

Introduction

On August 6, 2020, the Federal Reserve Board (FRB) released additional information on its planned FedNowSM Service (FedNow), a solution in support of real-time payments (RTP).¹ The updated details provided in the FRB's release included a response to public comments received on its original announcement and from the August 2019 request for comment.² FedNow is expected to be a real-time gross settlement (RTGS) service that enables faster payments and supports 24x7x365 settlement for all banks and payment processors (financial institutions) to settle directly through the Federal Reserve System (the Fed).

Even though The Clearing House (TCH) introduced its private-sector RTP[®] service in 2017, the US is still behind some countries in the widespread adoption of faster payments.³ On October 14, 2020, the FRB announced the launch of a pilot program to support the development, testing, and adoption of FedNow and has invited a number of financial institutions, as well as service providers and

payment processors that partner with financial institutions to participate. The FRB expects to bring its FedNow products to market on an iterative basis to meet industry demand, and it anticipates having the first version of its release available by 2023 or 2024.

The push forward on real-time payments takes place within important US and global contexts

The FRB's announcement on advancing its RTP initiatives comes amidst the ongoing pandemic, as well as efforts to improve financial inclusion (e.g., providing broader, lower-cost access to faster payments for individuals who are living paycheck to paycheck in the US).⁵ The US government's recent experience delivering economic stimulus payments to vulnerable individuals may have helped to accelerate the FRB's timing on RTPs. With additional relief packages on the horizon, Congress has explored lessons-learned from the prior stimulus payments and the slowness and inefficiency involved in dispensing these payments to more than a hundred million people, many of whom may be outside of the traditional banking system.⁶

Amidst the backdrop of growing concerns over financial inclusion in the US, the FRB provides new details on its plans for supporting real-time payments.

With FedNow, payments that previously would have taken days to become available would be processed within minutes.

FedNow's design has been updated to address the industry's comments by providing more detail on how its functionality can enable financial institutions to support faster payments. Ultimately, financial institutions could build new features on top of the basic clearing and settlement services that exist today.

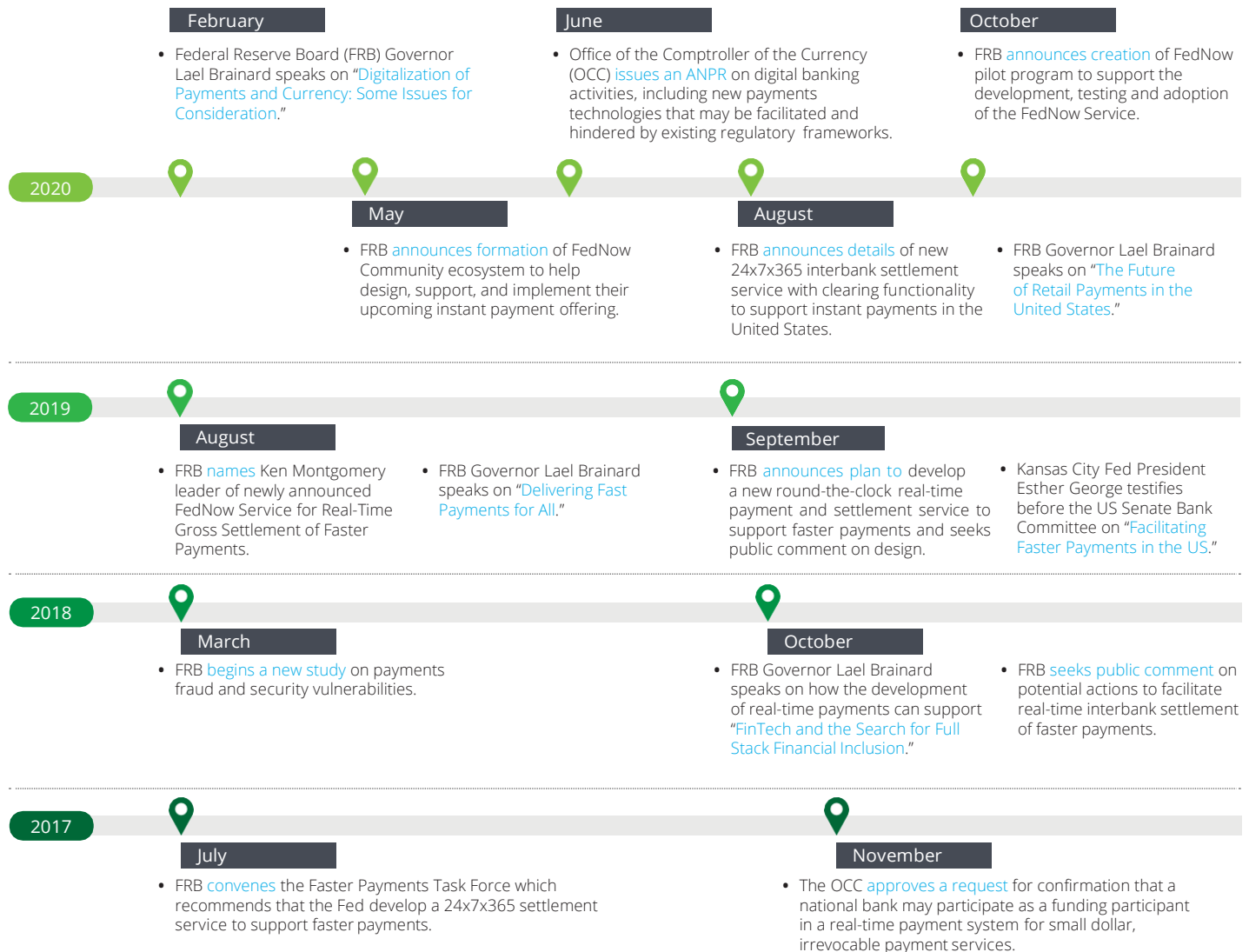
The global payments system is becoming increasingly complex, driven in large part by the expectations of retail and small business customers for faster, near RTP options. Corporate customers have also started adjusting their expectations for faster payments as

corporate leaders begin to expect the same level of service for their corporate payments that they experience as retail customers.

For financial institutions, the potential impact of faster payments on operations, liquidity management, accounting, and technology is substantial. It is important to understand how FedNow can enable faster payment adoption and how this impact translates to wholesale vs. retail payment management. In addition, FedNow will create implications for non-bank financial and payments companies and how they interact with their banking partners, adding to the complexity and number of the in-scope considerations for greater industry adoption.

Evolution of US Financial Regulators on Real-Time Payments

Major developments (from July 2017 to October 2020)



The existing FedWire Funds Service and ACH are robust technologies that continue to support millions of payments and move trillions of dollars daily. Though the Fed believes that the adoption of faster payments technologies is important, the change represented by FedNow is transformational and complex.

The changes introduced with the FedNow Service are not without debate, however. Some question the utility of the US government in innovations that they believe should be driven by the private sector.⁷ The OCC is reportedly nearing completion of its new payments charter that would provide approved organizations with “the ability to operate across state borders with a single set of rules, as well as to expand the suite of financial services they offer.”⁸ Earlier this year, the OCC released an ANPR that requested responses to a series of questions related to the application of new and enabling technologies to enhance digital banking activities, including payments.⁹ The payments charter potentially places payments companies in direct competition with banks, especially if it enables other financial services in addition to payments. It is also facing similar challenges that were encountered with the special purpose national bank charter for fintech companies,¹⁰ where state regulators have raised objections over its legality of the charter.¹¹

High-level overview of the technologies addressed in the FRB’s recent FedNow announcement

While the FRB does not intend to have all functionality discussed in its latest paper available with the initial version of its release, there will be an expectation that banks will have the ability to begin supporting faster payments (initially of \$25K or less) soon after the service goes live. This means that financial institutions will need to consider the impacts of this service on their organizations and begin planning as soon as possible. While some financial institutions are making progress in the migration to faster payments, many in the US still lag behind and will need to prioritize and leverage this change at the Fed to enable their organizations.

The initial release of FedNow will include basic functionality that is intended to support banks in the transition to 24x7x365 service. The smaller scope ensures that the core functionality is delivered with a high level of security and resiliency integral to the adoption and functioning of the service.

The FedNow service will have several core features in support of RTP processing and 24x7x365 processing. These features include:

- Supporting a real-time credit transfer payment flow, utilizing the ISO 20022 message standard developed for financial services transactions. New message types will be introduced for a) return transfers and b) interbank funds transfers for liquidity management-related transfers that do not involve end-users. Several non-value message types (e.g., request for return, payment status request) will also be introduced. Request for payment non-financial messages and functionality will also be part of the FedNow functionality at launch.
- Providing a continuously operating service, with 24-hour business days aligned to the closing times of the FedWire Funds Service. The FedWire Funds Service will shift to a 7:00pm ET closing time in March 2021 and therefore the FedNow service would run its business day from 7:00pm each calendar day until 7:00pm on the next calendar day. The Fed does not expect banks to adjust their definition of a business day, but consideration needs to be taken for the ability to make customer funds available on days that banks do not normally consider ‘business days’.
- The shift to a 24x7x365 for the FedNow service requires Reserve banks to adopt a seven-day accounting regime. While banks that utilize the FedNow service will not be required to adopt a seven-day accounting structure, they will need to consider the implications for this change at the Fed. The Fed will offer guidance in support of transitioning to their seven-day accounting regime as part of the transition process.
- Offering enhanced reporting capabilities for banks – including correspondent banks that will be able to facilitate the use of the FedNow service. This includes enhanced end-of-day reporting, intraday account balance reporting, summary-level reports of sent and received transactions, etc. The final set of reports will be announced prior to the launch of the initial functionality.
- Providing 24x7x365 access to intraday credit for banks that will be available on the same terms and conditions as other Fed services. Banks that utilize intraday credit currently will need to review their liquidity risk monitoring and management procedures to determine where adjustments will need to be made. Discount window hours will remain aligned to the FedWire Funds Transfer System hours Monday through Friday, though this may change over time.
- Developing a liquidity management tool (FedNow LMT) that enables participants to transfer funds between their reserve accounts and the RTP joint account to support liquidity requirements related to FedNow payment activity. The FedNow LMT will be available to full participants as well as financial firms that are not full participants. Controls will be put in place by the Fed to ensure that the FedNow LMT is used in only in support of RTP.

Amidst the backdrop of growing concerns over financial inclusion in the US, the FRB provides new details on its plans for supporting real-time payments.

- Enabling fraud prevention tools at launch that include a) the ability to set transaction value limits; b) the ability to define conditions under which transactions would be rejected; and c) reporting functionality on payment messages rejected based on conditional settings. Additional tools that will be available as part of later functionality include value limits tailored to certain uses; aggregate value or volume limits for a given time period; and centralized monitoring and analytics.

The Fed is planning to have this core functionality available at an initial level of maturity at launch and to make the technology flexible enough to continue to be easily advanced as the FedNow service matures.

Linkage between FedNow and other faster payments initiatives in the US, including Central Bank Digital Currency (CBDC)

During a recent speech on CBDC, FRB Governor Lael Brainard discussed FedNow, acknowledged ongoing stablecoin initiatives, and introduced the Fed's collaboration with the Massachusetts Institute of Technology, global central banks, and the Bank for International Settlements (BIS) on CBDC research to build and test a hypothetical digital currency.¹² CBDC is a digital representation of fiat currency issued by a central bank and is another foundational area of financial innovation that is under the intense focus of regulators. FRB Chairman Jerome Powell has recently said that it is "more important to get [CBDC] right than to be first" and to "not only look at the

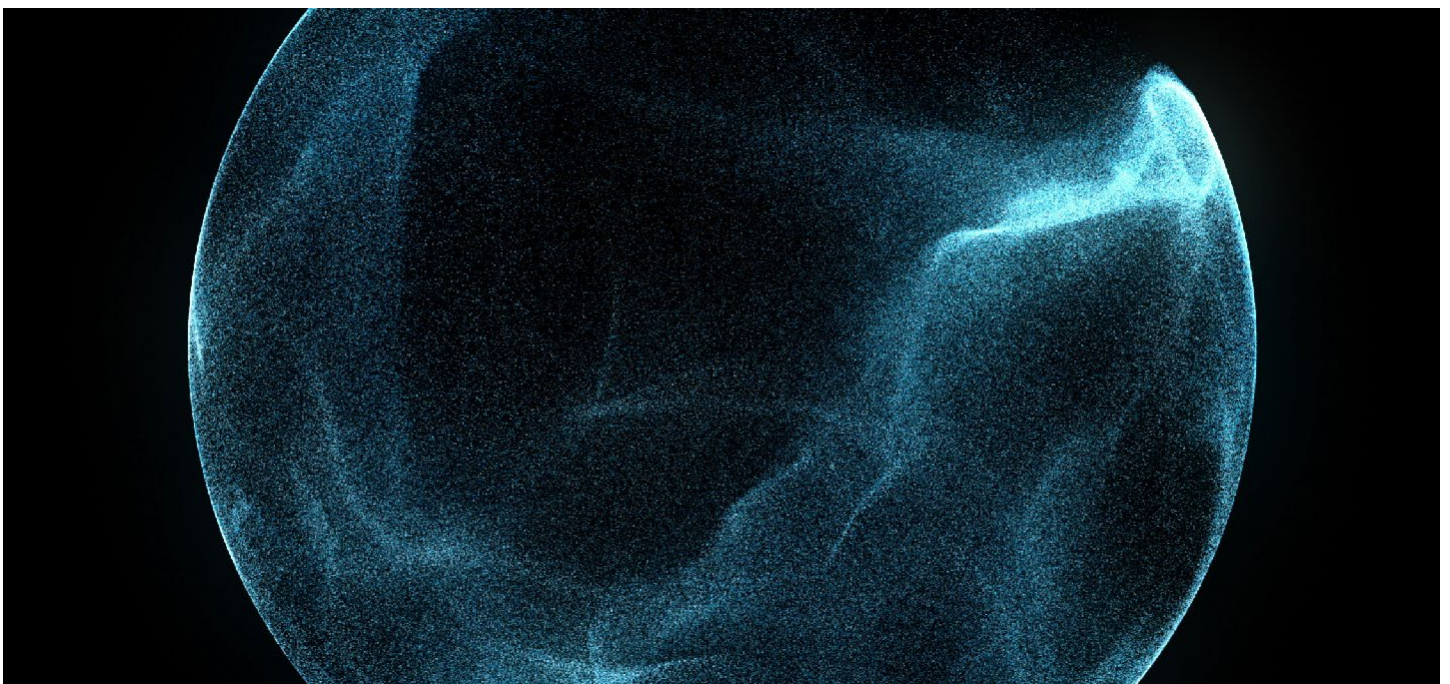
potential benefits of a CBDC but also the potential risks."¹³ While the relationship between CBDC and FedNow is still being defined, there is an interdependency between the ongoing development of RTP and central bank digital currencies. As part of its ongoing development of the FedNow service, the Fed will continue to develop its understanding of how to incorporate CBDC alongside the 24x7x365 settlement capabilities of the FedNow Service.

Real-time payments adoption will accelerate in the US

The financial industry and the banking organizations that would be the Fed's RTGS service's traditional clients understand that the migration to RTP is inevitable. Many banks have already adopted some RTP capabilities for their retail customers by leveraging the RTP@ service of The Clearing House. This new service provided by the Fed will only serve to accelerate RTP adoption by those banks and other non-bank financial institutions that are fast becoming their competitors.

This article is part of a new series on how technology and innovation shape financial regulatory initiatives and the impacts on the global payments system.

In subsequent blog posts, Deloitte will continue to explore the primary considerations that banks will need to address in the transition to RTPs and 24x7x365 settlement, including intraday credit management, defining the close, managing funds availability, and leveraging the FedNow monitoring tools.



Contacts:

Joan Cheney

Managing Director | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP

Ken Lamar

Independent Senior Advisor
Deloitte & Touche LLP

Austin Tuell

Manager | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP

Kyle Cooke

Senior Consultant | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP

Deloitte Center for Regulatory Strategy

Irena Gecas-McCarthy

FSI Director, Deloitte Center for Regulatory Strategy,
Americas
Principal | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP

Endnotes

1. Federal Reserve Board, "[Federal Reserve announces details of new 24x7x365 interbank settlement service with clearing functionality to support instant payments in the United States](#)," accessed on October 19, 2020.
2. Federal Reserve Board, "[Federal Reserve announces plan to develop a new round-the-clock real-time payment and settlement service to support faster payments](#)," accessed on October 19, 2020.
3. The Clearing House, "[TCH Releases Business Principles that Outline the Operation of the RTP® Network](#)," accessed on October 19, 2020.
4. Federal Reserve Board, "[Federal Reserve Announces Creation of FedNowSM Pilot Program](#)," accessed on October 19, 2020.
5. By using the term "financial inclusion" within the context of access to real-time payments, we refer to FRB Governor Lael Brainard's speech, "For households living paycheck to paycheck, the difference between waiting for a payment to clear and receiving a payment in real time is not merely an inconvenience; it could tip the balance toward overdraft fees, bounced checks, or collection fees. Of course, faster payments would not address the root causes of financial fragility, but they could help reduce the strain on some." Please see, Federal Reserve Board, "[FinTech and the Search for Full Stack Financial Inclusion](#)," accessed on October 23, 2020.
6. US House Committee on Financial Services, Task Force on Financial Technology, "[Inclusive Banking During a Pandemic: Using FedAccounts and Digital Tools to Improve Delivery of Stimulus Payments](#)," accessed on October 20, 2020.
7. Brendan Pedersen, "[OCC's Brooks questions need for government-owned payment systems](#)," American Banker, August 13, 2020, accessed on October 19, 2020.
8. Victoria Guida, "[Top regulator pushes ahead with plan to reshape banking, sparking clash with states](#)," Politico, August 31, 2020, accessed on October 19, 2020.
9. Office of the Comptroller of the Currency (OCC), "[National Bank and Federal Savings Association Digital Activities: Advance Notice of Proposed Rulemaking](#)," accessed on October 19, 2020.
10. Office of the Comptroller of the Currency, "[OCC Begins Accepting National Bank Charter Applications From Financial Technology Companies](#)," accessed on October 19, 2020.
11. Conference of State Bank Supervisors, "[CSBS Sues OCC Over Fintech Charter](#)," accessed on October 20, 2020.
12. Federal Reserve Board Governor Lael Brainard, "[The Future of Retail Payments in the United States](#)," accessed on October 20, 2020.
13. Federal Reserve Board Chairman Jerome Powell, "[Remarks to International Monetary Fund panel discussion on digital payments](#)," accessed on October 20, 2020.



This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

As used in this document, "Deloitte" means Deloitte & Touche LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of our legal structure. Certain services may not be available to attest clients under the rules and regulations of public accounting.

About Deloitte

As used in this document, "Deloitte" means Deloitte & Touche LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of our legal structure. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2020 Deloitte Development LLC. All rights reserved.