

The FedNow[®] Service Is Coming: Is Your Credit Union Ready?



Many credit unions chose to wait until the launch of the FedNow[®] Service before embracing real-time payments. However, there is a lot to consider before moving forward. In a Credit Union Times hosted [webinar](#), Dan Gonzalez, VP of Customer Relations at Federal Reserve Financial Services, and Mark Majeske, SVP of Faster Payments at Alacriti, discussed the ROI of real-time payments, lessons learned from financial institutions who have been in the pilot program, and recommendations on how to move forward.

How Many Credit Unions Plan on Connecting to the FedNow Service?

The webinar began with a poll where attendees were asked how soon they expected to connect to the FedNow Service. There were 153 responses, with 21.57% planning on connecting in 2023 and 41.18% planning on connecting within 1-3 years.

How Soon Do You Expect to Connect to the FedNow Service?

This Year



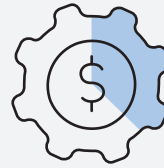
21.57%

Within 1-3 Years



41.18%

We Have Not
Decided to Connect



37.25%

Evolution of Payments

Gonzalez explained how payments have evolved over time. In the beginning, branch networks enabled financial institutions to take deposits and handle payments. In the 70's, ACH (an automated process for exchanging payments between financial institutions) was created. Then ATMs came along, which, similar to ACH, became ubiquitous. In the early 2000s, Check 21 was launched, which is now digitized and cleared electronically.

“When we talk about what’s the next evolution in payments, it’s really about instant payment capability and having the ability to move money instantly between two financial institutions directly. That’s exactly what the FedNow Service is going to be. We create the capability for any financial institution that has the ability to connect to the Fed, either directly through us or through one of the various vendors that are going to be offering this capability to then offer this service to your members,” said Gonzalez.



Branch networks enabled financial institutions to attract customers, take deposits and handle payments



ACH allowed customers to easily get their paycheck into their bank account



ATMs became mainstream, creating a convenient way to get cash



Check 21 allowed financial institutions to create and exchange electronic images of consumer paper checks



Online banking and bill pay made it easy to manage accounts digitally

What is the next opportunity in this ongoing payment evolution?

A key aspect of the FedNow Service is that it provides the ability to move money 24/7/365 (there is no downtime) with direct clearing and settlements. It also enables good funds transfer, which is a confirmation that the payment being made is good funds, and there is no way that those funds can be revoked. “The good news there is that when your credit union receives one of these payments, your members know that these are good funds and they’re not going to be taken away, and your credit union doesn’t have to worry about returns, bounced checks, or anything like that,” Gonzalez shared.

Fast Payments vs. Instant/FedNow Service Payments

Many ask what the difference is between a fast/quick payment and an instant payment like the FedNow Service. With fast payments, a lot of times, the financial institution bears the risk by giving the funds to the end user before they actually settle between the two institutions. Also, the lag in settlement with fast payments creates inner bank obligations and the potential for short-term credit risk. With FedNow, the information changes hands, and the money changes within the accounts of the participants (the sender and receiver), but the money moves between the two financial institutions. At that point, the credit union will know that they have been made whole, they have their money for that payment, and the member can have access to funds immediately. It also has a different process where there’s no delay in gaining access to the funds. This is opposed to, for example, an ACH transaction that goes in a 1-3 day format. Even after hours or on holidays, credit unions don’t have to wait for settlement times or batch transfers to happen.

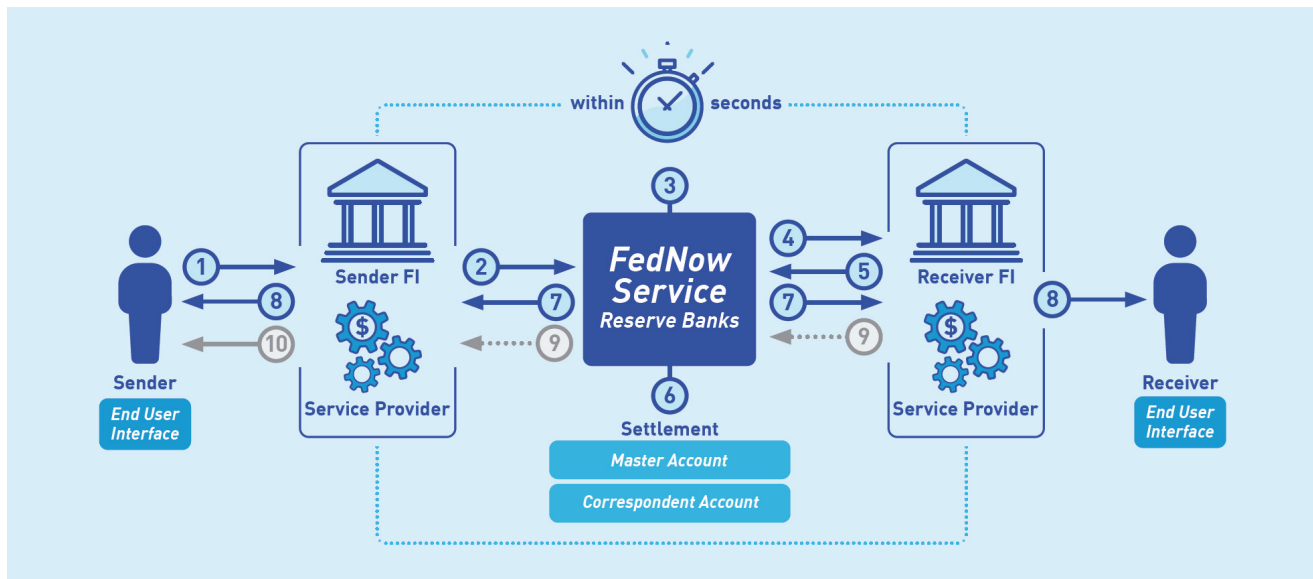
FedNow Service Payment Flow

The chart below shows the payment flow of the FedNow Service, with everything beginning on the left-hand side of the screen with the sender. There are no debit or poll capabilities with these transactions. It actually has to be initiated by either the entity or the person who is looking to send the money to a recipient. That will occur through the sender’s financial institution, which could leverage a service provider to facilitate that process for them. Whether it’s through online banking or treasury management portals, the sender can initiate those payments. It goes to the FedNow service, and they do some validation checks on that payment to make sure that it is an eligible recipient. The Fed will then forward that message to the receiver’s financial institution or their service provider. And then, they will also do a confirmation that the receiver, the actual account holder, is eligible to receive those payments.

Once the receiver’s financial institution confirms that it is willing to accept and receive that payment, it will send a message back to the FedNow Service. And then simultaneously, the Fed will send a message back to the sender’s

financial institution to let them know that it's a good payment and it's going to be received and posted. Then, the Fed will settle that payment again at the same time. The Fed will move the money between the two financial institutions, and that can be done in a credit union's master account at the Federal Reserve (if it has one of those) and elects to use its Fed Master account. Or, it can be settled with a correspondent who is participating in the service and is willing to settle FedNow transactions. It can also be settled in a corporate credit union, which is where a lot of credit unions keep their accounts. Once all that occurs, the confirmations are made between the two financial institutions. Those funds will then not only be posted to that member's account or the receiver's account but also made available to them. Those payments will become available instantly, which means they could either walk into a credit union branch and take the money out, go to an ATM, or have another payment type draw against those funds.

All of this happens within seconds. "Our expectation is that these will typically happen within 5 seconds on average. We do have a timeout because if you've got a sender looking to send an instant payment if you're sitting there for too long, it could get a little frustrating. So, we will have a timeout on the upper limit of 20 seconds. But again, our expectation is that we will have most of these payments completed within 5 seconds or less. The most important thing to remember is that this is a one-way transaction from a money movement standpoint. It's not like ACH, where there are debits and credits. These are all credit push transactions," Gonzalez explained.



Source: Federal Reserve July 2023

Lessons Learned From the FedNow Pilot Program

The pilot program for the FedNow Service started end-to-end technical testing in September 2022. They had 120 organizations participating in the pilot program. They worked in an advisory capacity in addition to getting certified and getting ready to launch in time for FedNow to go live. As a result, the Fed received feedback, especially from credit unions and smaller financial institutions, regarding the tools and capabilities needed to manage this new process in a 24/7 world.

The Fed has been able to do a lot of updates with its technical specs, capabilities, and interfaces to ensure financial institutions have all the tools they need to efficiently and effectively operate in this new 24/7 world. All payment options have fraud, but the goal is to manage and mitigate that fraud. So, the Fed provides some tools to help financial institutions mitigate fraud as well, and a number of service providers will be providing various tools and capabilities from a fraud mitigation standpoint.

The pilot program demonstrated the benefits of the FedNow Service:



Service providers

- Create new sources of revenue by developing innovative and exciting products and services for customers
- Deliver leading-edge services that customers truly want



Financial institutions

- Stay competitive and meet customer expectations
- One single solution for all instant payment needs due to a flexible, neutral platform that supports a variety of use cases
- The ability to connect directly to the Federal Reserve or work with third-party processors allows for flexibility in implementation



Individuals

- Greater flexibility and confidence to better manage money and make time-sensitive payments
- Reduce the risk of account overdrafts, late fees or damaged credit scores
- Gig economy workers can get paid immediately for work done the same day



Businesses

- Avoid complicated cash flow management, overdraft fees and costly short-term loans
- Reduce or eliminate manual, time-consuming payment processes
- Determine the date and time of settlement and receive timelier access to funds

FedNow's Use Cases

The FedNow Service supports a wide range of use cases. Even though real-time payments are relatively new from a U.S. marketplace standpoint, they have been available in other countries for a number of years. The UK was probably one of the most prevalent when they launched faster payments in 2008. Use cases demonstrated over there will probably roll over into the U.S. marketplace.

Service providers have the benefit of offering new and innovative solutions, either through mobile banking apps or through some of their back-office applications. Banks and credit unions will have the ability to stay competitive and meet member expectations. Consumers today are going to apps that are working outside of the banking infrastructure to meet the need to move money instantly. Individual members get better flexibility and confidence in the way they manage their money, such as reducing the risk of account overdraft.

Gig economy workers are a prime example of those who appreciate the ability to get paid immediately. This is one of the largest and increasingly growing use cases. Businesses are also a high-value use case, and a lot of credit unions offer business accounts now. It gives businesses the ability to better manage their cash flows, understand where they stand, and make just-in-time payments for deliveries or other services they're receiving.

Some of the other high-value use cases identified by the Fed are around P2P, B2B, C2B, or B2C payments. "I think B2C payments will be critical, especially in the credit union space, because you've got a lot of retail account members that are going to want to have the ability to get some of these business payments into their accounts immediately," said Gonzalez.

A2A transfers (sometimes referred to as me-to-me) are also critical because they move money between accounts that an individual or business has between two different financial institutions. It could also be a mobile wallet that individuals have money in that they're looking to get into their credit union account.

Gonzalez explained the value of A2A today. "A recent survey that we did noted that about 40% of consumers have accounts at two financial institutions. So, being able to move money between financial institutions immediately is a significant benefit to members. If they're standing outside of an ATM and need some cash, having access to it immediately is critical. So A2A is one of those places that we do expect will see a lot of activity initially between the participants within the FedNow Service."

Since credit unions were historically formed around various employer groups and the ability to service those members, business-to-consumer payments are expected to be one of the big use cases as well. "One of the ones that we have seen really start to ramp up is immediate payroll or earned wage access. Typically, this occurs in an hourly wage situation, or maybe a gig economy worker where they're a driver and they finish a shift or a ride and can get paid immediately after that. In the payroll situation, this is happening more and more now when workers complete a shift, and as soon as they clock out of that shift, it triggers a payroll transaction that is then linked to an immediate pay or an immediate payment process. Where

you'll have differentiating factors is if one customer or one employee has a bank or credit union participating in an instant payment scheme and gets immediate payroll, whereas the other employee has to wait a week or two for the regular payroll to show up. It's going to be a big differentiating factor with the experience for those consumers or employees depending on what financial institution they're actually banking at," Gonzalez predicted. Benefits, emergency payments, and insurance payouts are other valuable use cases for C2B disbursements.

Ways to Participate in FedNow

There are two ways to participate in the FedNow Service. The minimum participation type is to be a receiving financial institution, which means the financial institution has the ability to receive payments and post them to members' accounts instantly. Credit unions may have the perspective that their existing systems work well enough with ACH, checks, wires, credit, and debit cards. However, at a minimum, credit unions will want to give their members the minimum capability to get their money into their account(s) as quickly as possible.

"This is something that you can do through service providers like [Alacriti](#), to have the connectivity to bring the money into your members' accounts and post it immediately, and then make it available immediately. Your members' accounts are already there. This is just another type of incoming payment that needs to post to their account," said Gonzalez.

The next step in real-time payments is the capability to send. A receiving institution that elects to send has a little more work to do that goes into having that capability. They're opening up for members to move money out of their accounts. At that point, it's necessary to make sure all of the security protocols and fraud mitigation tools are in place and have a way to ensure that members are not sending out money erroneously or getting defrauded. Also, with Send, that doesn't mean that it's necessary to open the capability up to everybody. For example, Gonzalez explained that a lot of credit unions may not give every member access to mobile deposit capabilities. They can credit score them, wait until they're a member for 60 days, etc. There can be different Send capabilities and different limits for individual members or business clients.

The ROI of Real-Time Payments

Majeske said that credit unions often ask Alacriti about business cases and the ROI of instant payments. This is a challenging question since it's a new capability. "I want to stress that FedNow is not a product but a capability enabling you to move money. When you come down to it and start looking at ROI, you've got to look at what you're offering your members and how they're

going to use it because that's where your revenue is coming from. Also, the use cases need to be defined, and products need to be built right to satisfy your members. When you are doing Receive only, your members are going to be able to maybe get their payroll earlier. Who doesn't like that? On the flip side, on the Send side, there are a lot of options. Most people will go first to doing an A2A or a P2P scenario. What we are doing at Alacriti is creating those use cases for you to brand and use because they're sometimes difficult to build out tests and get in front of your members."

"Another question I get a lot is, 'What is this going to do to my ACH or wire business?' Everyone's concerned that there's gonna be a shrinkage of ACH or wire. There's going to be a shifting of volume, and all that's based on the use case. So, for instance, if I'm sending something and I'm allowing you to send or receive on the weekend, obviously, that's going to be FedNow because of the timing. I'm seeing a shift in volume away from ACH and maybe away from wire for those specific applications that require real-time. I look at costs because that adds positive ROI to my business case. And also, can I add revenue? There was a [study](#) done in 2019 showing that actually instant payments cost less per transaction than the same type of transaction. What you do have to look at is the volumes. What volumes do you think you're going to have at what time? But be assured that at the end of the day, your cost basis for that transaction that's all in is lower," Majeske continued.

Majeske had additional comments about implementing real-time payments, which can lead to a decrease in net payment systems over five years.

"I've worked with a number of institutions that are implementing instant payments, or are getting ready to and they're looking at their operations and their processes, and touchpoints within those and saying, how can I take advantage of efficiencies now that I'm going to have this mechanized system? Some of the responses that I've gotten from some credit unions is, you know what? This is actually easier than I thought. And it's making other payment rails more efficient as well because we've had a chance to look at our processes and put efficiencies in place. So I think that's an important thing to consider when you're looking at business cases."

Majeske also addressed a common misconception that people have to be added to implement real-time payments because of the 24/7 requirements.

"Actually, in all of the implementations that I've seen, they're not really adding people. You're usually able to reconfigure your processes. You don't have to be there 24/7 to do these transactions."

Since many financial institutions don't charge for ACH, they wonder if they should charge for instant payments. However, there is enough differentiation in the speed and weekend access to warrant charging. PayPal and Venmo have proven that if customers want something immediately, they will pay a fee. The disbursement of loans is a good example of a use case where a member could

appropriately be charged a fee. If they apply for a loan on a Saturday, they may not have to wait until Wednesday of the following week for the disbursement. FedNow can be instrumental in bringing that level of service to members.

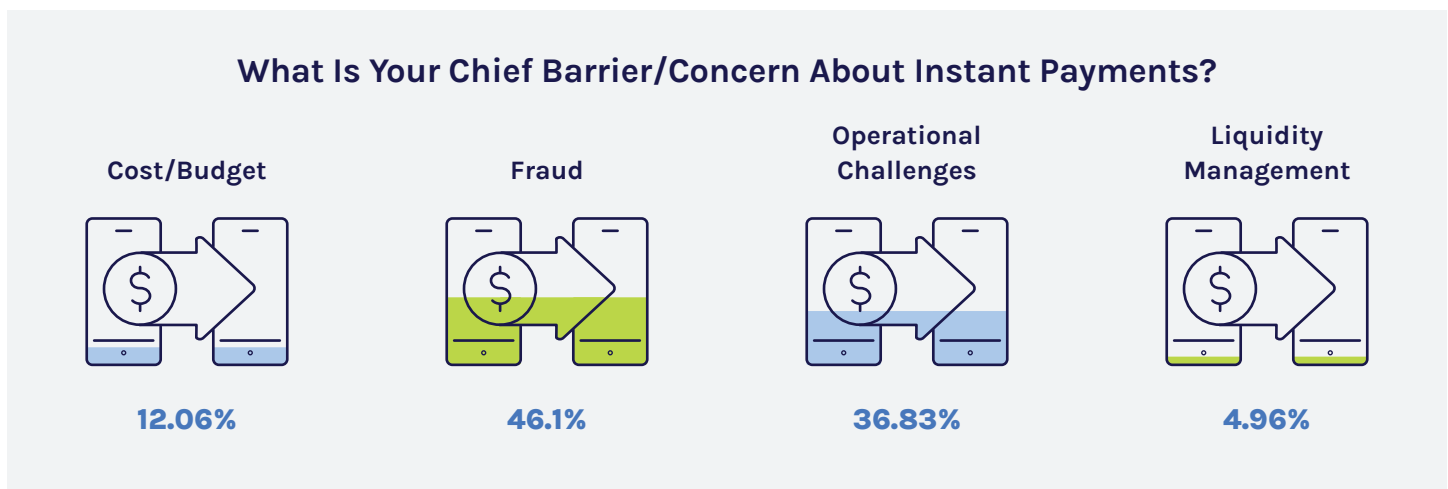
Although it's recommended that credit unions speak with their members to assess the need for real-time payments, Majeske advised against asking them specifically if they want FedNow. "They're not going to know what it is. Ask them what they want to do. They may say they want their payroll faster or to be able to move money to friends and family on the weekend. I find that most people in the consumer market don't really care how we move the money as long as we do it."

Another use case for instant payments is real-time data and cash forecasting. Regulations have shortened the time period when funds had to be available, making cash flow more important than ever. Another factor was that interest rates were lower before. Driving the use cases helps achieve what the members want. Also, the improved process efficiency reduces cost and improves overall revenue.

Businesses can benefit from instant payments as well. For instance, a title company could be more competitive by offering closings on weekends or holidays if necessary. In addition, RfP (Request for Payment) will allow the sharing of data with the request for funds. This will streamline account receivable systems and provide more data when needed.

Chief Concerns About Instant Payments

Another poll was conducted asking attendees what their chief concerns or challenges were about instant payments. There were 141 respondents, with the majority (46.1%) saying fraud was a top concern and operational challenges coming in as a close second at 36.88%.



Considering the level of concern from the audience about fraud, Majeske suggested that credit unions look at their current fraud system and analyze what it can and cannot do. “Remember, in instant payments, things are decided in milliseconds. You want to be proactive, meaning that you analyze the transaction before it goes to the recipient.”

Gonzalez weighed in as well. “There will be a number of tools that the FedNow Service will have available to credit unions on day one. We’re actually going to require that participants report any fraud to the service. And when they do report fraud on the service, we will notify the counterparty of that fraud so they can investigate it as well. So, both sides of the equation will know that there was some type of fraud between two participants. Secondly, we will have the ability to create negative lists, which will give the credit unions the ability to block certain payments, either from leaving their organization or coming into their organization. So if they see a bad actor at another financial institution and they wanna make sure they don’t ever get or send a payment to that bad actor, they’ll be able to block that within the system. Dollar is also a fraud mitigation tool. So, initially, the dollar limit for transactions will be set at \$500,000 per transaction. But, every financial institution will have the ability to set their own maximum limit for any transaction to go out the door. So essentially, if a credit union is only comfortable with maybe a thousand because you’re doing P2P transactions initially, you’ll be able to set the limit, and no transaction can ever go out the door over a thousand dollars through our system.”

Moving Forward

Majeske explained how Alacriti connects credit unions with the FedNow Service and other rails. [Orbipay Payments Hub](#) is a cloud-based payments-as-a-service solution that integrates with many banking cores. This is an important feature, since many financial institutions assume that they must go with their core provider. Orbipay Payments Hub is also ISO 20022 native, open API-based, and offers smart routing. This means if a credit union sends Alacriti a batch file, Alacriti could decrypt it based on the credit union’s rules and send ACH, FedNow, RTP®, or Visa Direct payments, depending on what the needs are. It’s a grow-as-you-go model. So, if customers wish to come to the hub as just a FedNow customer, they can do that and add additional rails in the future.

Alacriti has been a long-time partner with the Fed for FedNow. Alacriti participated in the pilot, is fully [certified](#), and continues to work with the Fed on a daily basis. Alacriti offers a short time to market (can go live within 90 days if the core integration already exists) and works with customers with non-competitive collaborative sessions or communities.

Gonzalez suggested that after learning more about instant payments, credit unions should speak with members and identify opportunities to improve the member experience with instant payments. Although FedNow is not a product, it can be used to create products for members. It's also an opportunity to build efficiencies. Lastly, Gonzalez recommended that credit unions work with their service provider and partners to understand what their offerings are and how they can work together.

To get insights, strategies, and actionable steps to ensure your credit union is ready for the FedNow Service, watch the full webinar, **The FedNow Service is Coming: Is Your Credit Union Ready?**, featuring the Federal Reserve and Alacriti.

WEBINAR PLAYBACK

**The FedNow® Service is Coming:
Is Your Credit Union Ready?**

WATCH NOW

Alacriti | THE FEDERAL RESERVE
Financial Services

FedNow^{24/7}
INSTANT PAYMENTS

The graphic features a large play button icon in the center, a 'WATCH NOW' button, and logos for Alacriti, The Federal Reserve Financial Services, and FedNow 24/7 Instant Payments. The background is a light gray grid with a brick wall effect on the right side.

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

Alacriti