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FedNow Service Pilot Program Gaining Traction and Support

*J.C. Boggs, Matthew B. Hanson, George M. Williams jr, Justin M. King, and Andrea Demick**

In January, the Federal Reserve Banks announced that over 110 organizations were participating in the FedNow Service's pilot program. After announcing the launch would move up to 2023, and then setting forth FedNow's message specifications, the Fed published a proposed rule for FedNow transfers.

Unlike many government initiatives that were halted, delayed, or shut down altogether during the pandemic, the construction and development of the FedNow Service by the Federal Reserve System ("Fed") has made significant progress in the past year. FedNow is the central bank's instant payment service, aiming to provide a safe and efficient real-time payment service for financial institutions across the United States.

Initially projected to launch in 2024, the Fed announced in January 2021 that the service's core clearing and settlement functions would be available in 2023.¹

On June 1, 2021, the Board of Governors of the Federal Reserve System took another step forward by inviting comment on a proposed rule to govern funds transfers over the FedNow service.² The proposed rule would amend parts of the rules that apply to the Fedwire Funds Service already in use, adding a section and clarifying existing rules to address issues that arise for the new real-time payments service due to the lack of delay. For example, the rule would define what it means for the beneficiary's bank to make transferred funds available to the beneficiary "immediately."

FedNow will not be the first of its kind. In 2014, 14 countries had real-time payments. By 2018, the number of countries had increased to 40.³ Prompt

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¹ Hannah Lang, Fed more bullish on launch of real-time payments service, American Banker, (Feb. 2, 2021), <https://www.americanbanker.com/news/fed-more-bullish-on-launch-of-real-time-payments-service>.

² Federal Reserve Board invites public comment on proposed rule to govern funds transfers over the Federal Reserve Banks' FedNow Service, The Federal Reserve, (June 1, 2021), <https://www.federalreserve.gov/newsevents/pressreleases/other20210601a.htm>.

³ Moving Money Around: The Rise of Real-Time Payments, Penser, (Jan. 2020), <https://www.penser.co.uk/article/moving-money-around-the-rise-of-real-time-payments/>.

entry is clearly important, given the head start enjoyed by other countries. More importantly, however, FedNow must tackle cross-border capabilities and interoperability.

Globally, the real-time payment industry leaders are well established and include India and the United Kingdom. FedNow will be aiming for comparable, or superior, capabilities, and interoperability will be expected by real-time payment users.

DEVELOPMENTS OVER TIME

After years of criticism and uncertainty regarding whether the Fed would develop its own network for real-time payments or leave it in the hands of the private sector (as is often the case when the Fed wishes to provide competitive services), the Fed announced in 2019 that it would be entering the business.⁴ Although the Fed may not be moving as swiftly as other countries, the magnitude of FedNow makes the project a particularly complicated one that requires careful benchmarking.

Kenneth Montgomery, the Federal Reserve Bank of Boston's chief operating officer and leader of FedNow's development, remarked in a January 2021 interview that the optimistic launch timetable was attributed to the Fed having already reached important benchmarks on building a clearing and settlement engine and on improving security, in addition to already working toward having interoperability with other real-time payment networks.⁵

The COVID-19 pandemic intensified and highlighted the need for programs like FedNow to be available to consumers and businesses, as society moved toward an even-more digital world.⁶

The launch of the pilot program in January 2021 brought together influential banking industry leaders to support development, testing, and adoption of the FedNow Service and encouraged development of services that leverage the program's functionality.⁷ More than 110 banks, credit unions, and

⁴ Lang, *supra*, note 1.

⁵ Lang, *supra*, note 1.

⁶ The Future of Retail Payments In the United States, Federal Reserve Governor Lael Brainard, At the Fednow Service Webinar, Washington, D.C. (via Webcast), (August 6, 2020), www.federalreserve.gov/newsevents/speech/brainard20200806a.htm.

⁷ Francis Bignell, FedNow Pilot Programme Continues Garnering Support as Finastra Joins, The FinTech Times, (Mar. 17, 2021), <https://thefintechtimes.com/fednow-pilot-programme-continues-garnering-support-as-finastra-joins/>.

payments technology organizations have been selected to participate in the pilot program, which will offer the Fed a crucial opportunity to engage with the industry and gather feedback.⁸

According to the press release announcing the pilot program, a “key objective in selecting participants for the pilot was to ensure diverse representation across financial institutions and service providers, connection types, settlement arrangements and experience levels.”⁹ Of particular importance is the list of processors who will be working with the Fed to develop the integration tools necessary to connect to FedNow and take advantage of the opportunities of real-time payments. The list of participating processors includes ACI Worldwide, Finaxt, Fiserv, Jack Henry, and Shazam.¹⁰

After the initial announcement of the FedNow pilot program, industry interest continued to build, and in March 2021, the Fed selected additional participants, including First Internet Bank, Finastra, and CGI All Payments. Further, in April 2021, Arvest Bank was also added to the growing list of participants.¹¹

At the end of March 2021, the Fed released message specifications, which set the message flows and formats for when the service becomes operational in 2023.¹² The pilot program participants unanimously supported aligning the message specifications with the ISO 20022 message standard, which is the international standard for messaging that allows for data exchanges, efficient end-to-end processing, and interoperability.¹³ Adherence to this standard opens opportunities for FedNow implementation across products and market segments in the real-time payment industry.

After the initial few months of the pilot program, a senior vice president at one of the pilot program’s participants, Bank Independent, emphasized the heightened need for interoperability, explaining that “the smallest institutions

⁸ *Id.*

⁹ Federal Reserve announces FedNow Pilot Program Participants, The Federal Reserve, (Jan. 25, 2021), <https://www.frbservices.org/news/press-releases/012521-federal-reserve-announces-fednow-pilot-program-participants.html>.

¹⁰ Real-Time Payments: Everything You Need to Know, PaymentsJournal, (Mar. 23, 2021), <https://www.paymentsjournal.com/real-time-payments-everything-you-need-to-know/>.

¹¹ Arvest joins FedNow pilot program, Times Record, (May 2, 2021), <https://www.swtimes.com/story/business/2021/05/02/arvest-joins-fednow-pilotprogram/7346089002/>.

¹² Federal Reserve Announces Message Specifications For FedNow, PYMNTS.com, (Mar. 31, 2021), <https://www.pymnts.com/news/fasterpayments/2021/federal-reserve-announces-message-specifications-for-fednow/>.

¹³ *Id.*

just don't have the financial capability [or] the people capability to implement multiple channels of payment rails."¹⁴ Interoperability is key to opening FedNow access to participants of different sizes.¹⁵

PROPOSED RULE

As currently worded, Regulation J provisions that apply to the existing Fedwire Funds Service would not clearly apply to transfers over the new FedNow service. In an effort to provide legal clarity, a new subpart to Regulation J, subpart C, has been recommended “to provide a clear, predictable, and comprehensive set of foundational rules for the service.”¹⁶ This subpart would specify the terms and conditions of funds being transferred and processed through FedNow by incorporating Uniform Commercial Code Article 4A, while also clarifying that the Electronic Fund Transfer Act’s rules for “electronic fund transfers” would prevail to the extent there is a conflict.¹⁷

Similar to Regulation J’s current subpart B applicable to the Fedwire Funds Service, subpart C would address issues relating to the processing and settlement of funds transfers, including overdrafts, reliance on routing numbers, liability of Reserve Banks involved in processing payments, and payment finality.

The notice also proposes clarifications to existing subparts of Regulation J to make clear they apply only to the existing services and to make a number of technical corrections.¹⁸

In particular, the notice sought public comment on the practical meaning of funds being made available “immediately” and whether the Board should specifically set out specific time parameters that would qualify as “immediately.”¹⁹ For example, should the rule state that funds must be made available within

¹⁴ As Real-Time Payment Rails Rise, Interoperability Comes Into Focus, PYMTS.com, (Apr. 29, 2021), <https://www.pymnts.com/news/b2b-payments/2021/payment-rails-real-time-interoperability/>.

¹⁵ *Id.*

¹⁶ Memorandum from Staff to Board of Governors of the Federal Reserve System, Proposed Amendments to Regulation J (Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire) to Govern Transfers over the FedNowSM Service, at 1 (May 7, 2021), <https://www.federalreserve.gov/newsevents/pressreleases/files/other20210601a2.pdf>.

¹⁷ *Id.* at 3.

¹⁸ *Id.* at 6.

¹⁹ *Id.* at 4.

seconds or, alternatively, would it be reasonable to require only that funds be made available within one minute?²⁰ All comments were due within 60 days of the proposal's publication in the Federal Register, which occurred on June 11, 2021.²¹

REMAINING QUESTIONS

Although the pilot program is only in the initial testing phase, the current participants' input will help further define the service and adoption roadmap, industry readiness approaches, and the Fed's overall instant-payment strategy. During this pilot program, the Fed is not focused solely on the core clearing and settlement engine; it is also evaluating broader issues like resiliency, security, integration with back-end systems, and the ability to service thousands of financial institutions across the country.²²

Before FedNow is launched, however, the pricing structure will also need to be determined. The Fed must ensure that the service can recover the network's development costs, although no current estimate for the cost of the system has been announced.

The Fed's efforts to enter the real-time payments business trails the private sector's developments. For example, The Clearing House's network was launched in 2017.²³ The relationship between FedNow and existing private-sector real-time payments systems remains unclear, as does FedNow's relationship with the many international programs already in use. The Fed has been collaborating with The Clearing House to optimize compatibility between the two services, knowing that they will likely have users in common.²⁴

INTEROPERABILITY AND CROSS-BORDER CAPABILITIES

One goal of FedNow is interoperability between in-country payment systems and cross-border payment capabilities. While these features are not currently expected to be available by the initial launch date in 2023, cross-border

²⁰ *Id.*

²¹ Collection of Checks and other Items by Federal Reserve Banks and Funds Transfers Through Fedwire (Proposed Rules and Request for Comment), 86 Fed. Reg. 31376 (June 11, 2021).

²² Lang, *supra*, note 1.

²³ Understanding the Roadmap to Real-Time Payments Modernization, *PaymentsJournal*, (Mar. 17, 2021), <https://www.paymentsjournal.com/understanding-the-roadmap-to-real-time-payments-modernization/>.

²⁴ PYMNTS, *supra*, note 12.

payment capabilities will be crucial for widespread adoption of the FedNow service. That is especially true in light of the fact that several other competing services, including those in other countries, are already established in the real-time payment industry.

According to one report from FIS Global, India has emerged as the global leader in real-time payments, handling 41 million transactions per day.²⁵ The country's National Payments Corporation of India launched the Immediate Payment Service in 2010, followed by the country's Unified Payment Interface ("UPI") in October 2016, which was the first to allow the instant transfer of funds between two bank accounts. UPI has gained plaudits for its scale and speed, with more than 100 million active users on the platform.

As of early 2020, at least 140 Indian banks were live on the UPI platform.²⁶ UPI has also received praise for its interoperability, allowing complete bank-to-bank and social-media-to-social-media usage. UPI allows India to challenge the traditional financial model, opening opportunities for transferring money through various methods, including QR scan codes.²⁷ In the last year, the Reserve Bank of India has invited private institutions to form a new pan-Indian umbrella entity for retail payment systems.²⁸

Other notable countries in the real-time payments field include the United Kingdom, Australia, and Canada.

- The United Kingdom launched its real-time payments system, Faster Payments, in 2008. Fintech companies have been allowed indirect access, and the Faster Payments system has grown considerably.²⁹ The service is directly available only to approximately 35 member banks, but other financial services firms can access the service through agency arrangements with a member bank.³⁰

²⁵ Subrata Panda, India leads world, processes 41 mn real-time transactions a day: Report, Business Standard, (Oct. 8, 2020), https://www.business-standard.com/article/economy-policy/india-leads-world-processes-41-mn-real-time-transactions-a-day-report-120100700905_1.html.

²⁶ Craig Ramsey, PayThink U.K. and India show how real-time payments are done, PaymentsSource, (Jan. 24, 2020), <https://www.americanbanker.com/payments/opinion/u-k-and-india-show-how-real-time-payments-are-done>.

²⁷ See QR code must accept all UPI apps, says RBI, The Times of India, (Oct. 23, 2020), <http://timesofindia.indiatimes.com/business/India-business/qr-code-must-accept-all-upi-apps-says-rbi/articleshow/78817264.cms>.

²⁸ Panda, *supra*, note 25.

²⁹ Moving, *supra*, note 3.

³⁰ Directly Connected Participants, Faster Payments, <https://www.fasterpayments.org.uk/directly-connected-participants> (accessed May 25, 2021); Daniel Bardini, The evolution of UK

- Australia launched its New Payments Platform in February 2018. As of March 2021, the real-time payment system handled approximately 2 million transactions daily.³¹ The system initially focused on enabling consumers to pay merchants and other consumers. Recently, the focus has been on developing future plans, including request-for-payment functionality, bulk business-to-business transactions, and international operability.³²
- Canada plans to launch in 2022 what it calls the Real-Time Rail (“RTR”).³³ In March 2021, following a selection process, Payments Canada designated an exchange solution provider for RTR with existing connectivity to nearly 300 financial institutions.³⁴ Earlier this year, Payments Canada also announced the results of a public consultation process begun last fall, which sought feedback on policy proposals to support RTR.³⁵ Canada’s service is aiming for broad accessibility by financial institutions, fintech companies, enterprises, and consumers.³⁶

CONCLUSION

As businesses and banks continue to recognize the value of real-time payments, adoption will further increase and desire for additional features will continue to emerge. Among the advantages of business-to-business real-time payments are:

- The ability to move rich data that offer possible insights into client

Faster Payments: creating a level playing field for smaller financial institutions, FinTech & Finance News, (Sept. 11, 2020), <https://ffnews.com/thought-leader/the-evolution-of-uk-faster-payments-creating-a-level-playing-field-for-smaller-financial-institutions/>.

³¹ New Payments Platform Australia On Creating a Forward-Looking Real-Time Payments System, PYMNTS.com, (Mar. 26, 2021), <https://www.pymnts.com/news/faster-payments/2021/new-payments-platform-australia-real-time-payroll-b2b-c2b-transaction/>.

³² *Id.*

³³ Payments Canada selects Interac Corp. as the exchange solution provider for Canada’s new real-time payments system, the Real-Time Rail, Payments Canada, (Mar. 2, 2021), <https://www.payments.ca/about-us/news/payments-canada-selects-interac-corp-exchange-solution-provider-canada-s-new-real-time>.

³⁴ *Id.*

³⁵ Payments Canada’s public consultation shows support for real-time payments system, Payments Canada, (Jan. 25, 2021), <https://www.payments.ca/about-us/news/payments-canada-s-public-consultation-shows-support-real-time-payments-system>.

³⁶ Platform for innovation: connecting the Canadian real-time rail ecosystem, The Payments Canada Summit, (May 31, 2021), <https://www.thesummit.ca/agenda/session/559140>.

needs;

- Payment confirmations;
- Greater control over the timing of payments;
- Liquidity management;
- Bill payment without delays; and
- Data regarding remittance payments.³⁷

The ability to make real-time payments will likely also ultimately affect the development and regulatory treatment of digital fiat currencies, a matter that is currently being considered by numerous central banks and legislatures around the world and by an advisory committee formed to make recommendations regarding potential amendments to the Uniform Commercial Code to deal with such currencies and other kinds of digital assets.

In the United States, FedNow is set to launch in phases. The first release will include fraud prevention tools, the ability to join instantly as a receive-only participant, requests for payment capability, and tools to support participant inquiries.³⁸ One ultimate goal of the program will be for FedNow to provide access to the platform through the Fed's FedLine network, which currently provides Federal Reserve Bank payment and information services to more than 10,000 financial institutions, directly and through their agents.³⁹

Questions around interoperability, cross-border features, and security features have yet to be resolved. That all makes the current pilot program for FedNow an even more valuable, influential opportunity for developments of key features and the regulatory and compliance structures necessary to make the system a reliable global standard.

³⁷ Real-Time, *supra*, note 10.

³⁸ Five Banks To Test FedNow Real-Time Payments System, PYMTS, (Apr. 4, 2021), <https://www.pymnts.com/news/faster-payments/2021/fivebanks-test-fednow-real-time-payments-system/>.

³⁹ *Id.*