



FedNow and the RTP Rules

by **TOOLCASE**

By now, many of you must have heard about these two terms, FedNow and RTP. But the information gathered may have been too overwhelming to completely understand how both payment services are interlinked and how they benefit both banking institutions and their customers. **In this report, we will take you through all the rules and controls of FedNow and RTP.**



The Clearing House and Real-Time Payment

In November 2017, the first new payment system in 40 years¹ was launched in the United States. The Clearing House (TCH) brought real-time payments to the United States by launching its Real-Time Payments (RTP) network.

How does the RTP Network Operate?

The RTP network operates through a joint account at the Federal Reserve Bank of New York. This account is jointly owned by the participating banks and managed by TCH as their agent. The participating banks in this payment service must prefund the joint account and maintain sufficient balance to meet the liquidity requirements to settle instant payments continuously.

¹ <https://www.prnewswire.com/news-releases/first-new-core-payments-system-in-the-us-in-more-than-40-years-initiates-first-live-payments-300555234.html>



What is Real Time Payment (RTP)?

If you are a credit card or debit card holder, it does not mean you're making real time payments.

Even digital wallets and mobile payment services such as Zelle and Venmo may seem like real-time transfers; however, they are not RTPs. The actual system of credit card transactions are structured loan products that are settled by payers each month. Meanwhile, debit cards are linked directly to the payer's bank account but are not settled in real-time. You will be surprised to know that even digital wallet transfers are not real time payments since the only immediate transfer is between funds held in those wallets. Moreover, fraud detection is getting more difficult for institutions not utilizing the **ToolCASE AI suite**.

The true meaning of real time payment is where funds transfer almost instantaneously from one bank account to another, 24 hours a day, 7 days a week, and 365 days a year. The RTP network was designed to meet the needs of the customers, businesses, and government.

With this payment system, recipients receive payments within seconds after the sending bank initiates the transaction. On the other hand, the receiving bank is required to make funds available immediately, except for situations of risk management or legal compliance. There must be a certainty that the sending bank will not recall or withdraw the transaction once it has been authorized and submitted to the network.

The RTP transactions are universal – all depository institutions that are federally insured can be RTP participants, regardless of their size. RTP has several advantages. A few of them are mentioned below:

Businesses and consumers can send and receive payments around the clock.

With RTPs, customers can initiate payments from their existing accounts without setting up a separate funding account.

RTP allows businesses and consumers to manage cashflows because now they can send and receive immediate payments, which will be extremely beneficial for small-scale businesses that are cash-constrained.

According to TCH, the RTP network's real-time payment capabilities are accessible to financial institutions that hold 70%² of U.S. demand deposit accounts (DDAs). The network currently has a reach to 56% of U.S. DDAs. However, its reach is not because of the number of participating banks but due to the large market share that these banks hold. So far, smaller banks and credit unions have not heavily participated with the RTP network, hoping that Fed will come up with a competing service with added benefits. That has now materialized with the introduction of the new service FedNow.

² <https://www.theclearinghouse.org/payment-systems/rtp/institution>



FedNow Service

Recently, in August 2019, the board of governors of the U.S. Federal Reserve announced that it would develop a new instant service³, offering 24x7x365 payment processing, with a real time gross settlement system (RTGS) called FedNow. The primary purpose of introducing this system is to provide end-to-end payment service for consumers and businesses and support faster payments in the United States. The new payment system of FedNow will allow near-instant settlement of transactions in final funds through debits and credits to member bank's master accounts at Federal Reserve Banks.



What is FedNow?

FedNow is a real-time payment and settlement service that incorporates clearing functionality into the process of settling each payment.

It enables financial institutions to exchange the information required for debiting and crediting customers' accounts and notify them of completed and failed payments. FedNow will provide access through the Fed's FedLine network, which currently provides Federal Reserve Bank payment and information services to more than 10,000 financial institutions, both directly and through their agents.

FedNow will take a phased approach for implementation, including pilot programs, providing additional features and functionalities over time. The targeted date to release this service is now 2023⁴, with the development schedule recently moved up a year. FedNow will exist independently of the existing RTP and compete head-on with The Clearing House (TCH).

³ <https://www.federalreserve.gov/newsevents/pressreleases/other20190805a.htm>

⁴ <https://frbsecurities.org/news/press-releases/020221-federal-reserve-updates-fednow-service-launch-to-2023.html#:~:text=launch%20to%202023-,Federal%20Reserve%20updates%20FedNowSM%20Service%20launch%20to%202023,instant%20payments%20platform%20to%202023.>

Key Features of FedNow Service

There are several decisions that the Fed still has to make in the multi-year building phase of FedNow, but these are the most important features that have been announced:

- **As mentioned before, FedNow is designed to process and settle payments in a matter of seconds**, the total time it takes for a sender to initiate a payment until the time when the funds become available in the receiver's account.
- **Initially, FedNow will only support the domestic payment within the United States in U.S. Dollars.** However, the Fed has stated that it would expand the payments across the border in the later stages of the phased approach. For this, the Fed and banks will have to weigh the regulatory and operational considerations, coordinate with international operators, and evaluate the costs and benefits attached to it.
- **FedNow will operate through credit transfers only.** It is a push payment in which the sender initiates the payment to its intended receiver. However, it will provide nonvalue message types, such as a request for payment, to enable various transactions. They do not support debit transfer because it has a higher fraud risk outweighing the service's potential benefits.
- **Banks participating in FedNow can only access the service through the FedLine network**, a set of electronic connection products used by more than 10,000 banks to access the Fed's payment and information services. FedLine is enhanced to support the service to be available around the clock, with 24x7x365 processing. Therefore, the banks will need to deploy the upgraded FedLine components to enable the FedNow service.
- **Only Fed member banks will participate directly**, though the bank may choose to enroll in FedNow as a receiver participant, designate a service provider to process payments on its behalf, or settle payments through the master account of a correspondent bank.
- **The nonbank Fintech's will be able to access FedNow indirectly via their financial institutions, an agent, or a service provider.** It is quite similar to the current Automated Clearing House (ACH) system, commonly used by agencies for electronic funds transfer.
- **The initial per transaction limit will be \$25,000**, though participating banks can set a lower ceiling on the payments they send.
- **Inter-bank messages used by FedNow will conform to the ISO 20022 standard** as well as support non-value message types, such as invoice details and requests for payment messages.
- **It will include liquidity management tools** that enable FedNow participants to transfer funds between one another in real-time.
- **Fraud prevention tools** to set limits on transaction activity.

FedNow is also considering including ancillary services in the later stages, after 2024. This feature will enable end-users to send payments without knowing the receiver's account number, based on public identifiers such as the receiver's phone number or email address. Moreover, it will also include some embedded fraud mitigation and identify authentication features. However, there may not be enough fraud prevention tools to stop modern real-time financial crimes.



Eligible Participants for FedNow

To use the FedNow service, you need to be eligible to hold an account at the Reserve Bank.

This service is not only for banks but for all kinds of institutions working in the financial sector. It includes U.S. depository institutions, U.S. branches of foreign banks, U.S. treasury, GSEs, certain international organizations such as multilateral development banks and non-U.S. states and central banks. If you belong to any of these, you can utilize this service to your benefit.

However, nonbanks, such as payments companies, and nonbank lenders cannot directly participate in FedNow because they are not eligible to hold Reserve Bank accounts. But there's a catch; **the nonbanks may act as a service provider or agent for participating banks.**

Fraud Prevention Tools

FedNow will offer some fraud prevention tools to the participants. Firstly, it can set transaction value limits at an amount lower than the permitted maximum. Secondly, the ability to specify certain conditions under which transactions would be rejected. Finally, by reporting features and functionality, including reports on the number of payment messages rejected based on a participant set. Other than this, the Fed intends to explore other features to allow smooth transactions between the parties released in the later stages.

Those Fed supplied fraud tools will not be enough. Detecting sophisticated modern financial frauds in real-time will require additional safety measures.

Since these payment and transfer processes will occur within seconds, a fraud detection solution must operate with real-time analytics measures and have the predictive capabilities of artificial intelligence.

**The ToolCASE
AI suite** is the
solution.

It operates across all transactional channels and identifies fraud as it's occurring in real-time —giving you time to detect and stop fraud before it's too late.

AI will have a big impact on the future of the RTP and FedNow process. Systems will require sophisticated and reliable intelligence to detect and automate the handling of suspicious or fraudulent transactions. ToolCASE has been a leader in utilizing AI in real-time and has been delivering solutions to financial institutions since 1999.

Conclusion

FedNow and RTP share numerous similarities, such as transaction limits, permitted participants, operating hours, and transfer types. However, some differences will entice the participants to shift to FedNow.

With FedNow, the participants can use their master accounts to earn interest towards reserve requirements. In contrast, RTP requires prefunded accounts that do not accrue interest towards reserve requirements. The question remains how the market can balance the agenda for private sector organizations. For RTP to succeed in the United States, the Clearing House and the Fed need to find a way to ensure their systems are integrated, fast and accurate and importantly, safe from fraud.

To learn more about the ToolCASE suite of real-time artificial intelligence products and how to protect your institution in the best possible manner today, please contact us.

CONTACT US

