



MORE is better than less.

Dear Friends:

Timely payments are crucial to any company's bottom line, and new instant payment methods provide immediate payment, even on weekends and holidays. FedNow, developed by the Federal Reserve Bank, is the newest instant payment system, launched in July. This month's article takes an in-depth look at both the FedNow service and The Clearing House's Real-Time Payments (RTP) instant payment platform.

After a busy August and September with state broadcasting conventions, the Szabo annual Quality Awards Banquet where Krissy Chea, Michelle Pillar, and Karen Trivette received quality awards, and the Annual Media Credit Conference, the last quarter of the year is less busy with company events and more focused on family, friends, and the holidays. November takes us to New York as a sponsor of Forecast 2024, broadcast media's most prestigious leadership conference on November 15, then staff will celebrate Thanksgiving (November 23 and 24) and Christmas (December 25 and 26) with family and friends. I hope your year ends on a high note.

Thank you for your continued support, and best wishes for 2024!

Robin Szabo, President
Szabo Associates, Inc.

Payment in an Instant with FedNow and RTP

Receiving timely payments from your advertisers is crucial; even brief delays can impact cash flow or cause accounts to become delinquent. Two relatively new options enable your customers to make near-instant payments, as long as both your banks are enrolled. Through the Federal Reserve's brand new FedNow service and The Clearing House's Real-Time Payments (RTP[®]) network, payments can be received in real time without the delays of Automated Clearing House (ACH) batched payment processing, not to mention the risks involved in sending checks through the mail.

The new FedNow Service, launched on July 20, 2023, enables participating U.S. banks and credit unions to safely and efficiently transfer funds instantly — 24 hours a day, seven days a week — on behalf of their customers, which is not the case for standard online transfers such as those through the ACH network. ACH transfers can take one to three business days to complete.

Consumers, businesses, and non-bank payment providers will not be able to use FedNow directly, but they can use the service through a participating financial institution. Initially, 35 banks and credit unions and 16 payment-processing service providers are onboard. FedNow will be available to all banks and credit unions, but there's no requirement for them to enroll.

Some banking experts predict that FedNow could be a game changer because thousands of banks already using the Fed's existing ACH or FedWire payment system may see FedNow as a safer and faster option.

The affiliation with the Federal Reserve means FedNow can immediately ensure both banks are made whole. When money is sent, it comes out of the sending institution's master account at the Fed, and it's deposited into the receiving bank's Fed account.

It's the first Federal Reserve-created instant platform to help banks transfer money in real-time, similar to what the private sector has created through payment apps like Venmo, Zelle, and Cash App that send funds almost instantly but are more geared toward personal use.

Here are the details:

Instant Transfer Speed. The Federal Reserve defines an instant payment as a recipient having full access to funds within seconds of the payment being sent.

Cost. As with other Fed payment services, FedNow will charge fees to its participating financial institutions, but it's still to be determined if or how banks will pass on FedNow costs to their customers.

Amount Limits. The Federal Reserve will cap transfer amounts at \$500,000, and set the default transfer limit at \$100,000 for a financial institution; however, a financial institution can raise or lower its limits.

Domestic Only. FedNow will be initially limited to domestic payments between U.S. financial institutions. International customers would have to pay through a participating U.S. bank.

The FedNow service is available to more than 10,000 financial

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institutions that operate within the Federal Reserve's network. The Federal Reserve is encouraging banks and credit unions to enroll. Participating financial institutions can opt into different services within the system. For example, they can elect to send funds back and forth across financial institutions, or choose to receive funds only. They can also opt into settlement service transfers and high-dollar credit transactions called liquidity management transfers.

"Over time, as more banks choose to use this new tool, the benefits to individuals and businesses will include enabling a person to immediately receive a paycheck, or a company to instantly access funds when an invoice is paid," said Fed Chairman Jerome Powell in the launch announcement on July 20th.

The Federal Reserve describes it as a "safe and efficient instant payments infrastructure that will modernize the U.S. payment system." Funds settle between financial institutions in real time.

Initially, the FedNow Service provides account-to-account (A2A) transfers and bill pay services. FedNow seeks to eliminate the several-day lag it commonly takes cash transfers to settle, bringing the United States in line with countries including the United Kingdom, India, Brazil, as well as the European Union, where similar services have existed for years. The Fed also operates the FedWire real-time payment system designed for large-scale, mostly corporate payments, which is only operational during business hours.

The Federal Reserve charges banks up to 4.5 cents for a FedNow payment, with some discounts offered during its first year, compared to less than half a cent for an ACH payment. Banks, however, are free to charge customers what they like for these payments.

Business customers may be less likely to move to FedNow if it turns out to be significantly more expensive than ACH, predicted

author Ron Shevin in the July 24, 2023, *Forbes* article, "What Do We Get with the Federal Reserve's Instant Payments." "A business may be prepared to pay 3.5 cents to receive payment faster, but draw the line at paying 25 cents. Also, how fraud is handled and where liability falls should something go wrong will shape adoption," the article said.

To send and receive instant payments, banks have to enroll. The *What's Going on in Banking 2023* survey of banks and credit unions by Cornerstone Advisors found that less than half of banks and 42 percent of credit unions expect to offer real-time payments by the end of 2023.

Another factor influencing the uptake of FedNow is the "send" versus "receive" aspect. Many of the early providers of the service plan to accept, or receive, real-time payments, but few of them are planning to turn on the "send" capabilities. But if nobody sends instant payments, how can anyone receive them?

Payment Flow Process, Start to Finish.

In this example scenario, Joe's Coffee Shop is paying its advertising bill from Main Street Press.

Step 1. The sender, Joe's Coffee Shop, initiates a payment with their bank through an end-user interface outside of the FedNow Service. Joe's Coffee Shop's bank is responsible for validating the payment according to its internal processes and requirements.

Step 2. Joe's Coffee Shop's bank submits a payment message (to the FedNow Service).

Step 3. The FedNow Service validates the payment message — for example, by verifying that the message meets proper format specifications and complies with applicable controls.

Step 4. The FedNow Service sends the contents of the payment message to Main Street Press' bank to seek confirmation that the media outlet intends to accept the payment message. At this point, Main Street Press' bank will determine whether to accept, reject, or accept without posting. The bank would check that an account for Joe's Coffee Shop is identified in the contents of the payment message.

Step 5. Main Street Press' bank sends a positive response of "accept" to the FedNow Service, confirming it intends to accept the payment message. (Steps 4 and 5 are intended to reduce the number of misdirected payments and resulting exception cases that can occur in high-volume systems.)

Step 6. The FedNow Service settles the payment, debiting and crediting the designated master accounts of both bank accounts. Steps 2-6 all take place in 20 seconds or less.

Step 7. The FedNow Service notifies both banks that the payment order was executed and the transaction was completed. As a term of participation in the FedNow Service, the Federal Reserve Bank requires funds to be available to the recipient immediately after Step 7.

Step 8. Main Street Press' bank has the option of sending a message through the FedNow Service to Joe's Coffee Shop's bank, indicating that the payment has been posted.

Instant Payment Through Real-Time Payments Network.

Though it is the only government-aligned instant payment profile, FedNow is not the only option. Back in 2017, The Clearing House rolled out its own high speed money transfer system, the Real-Time Payments Network (RTP).

Other than the transaction limit (RTP's \$1 million and FedNow's \$500,000), the main difference between the two services is the networks' ownership. The Clearing House is privately owned and operated by an association made up of large banks, while FedNow is operated by a government entity.

Like FedNow, RTP processes U.S. domestic payments 24/7/365 with immediate settlement, but RTP works differently in how it accesses interbank liquidity and confirms settlements.

Financial institutions must opt in to become part of the RTP network, granting customers access through an Application Programming Interface (API). When accessing RTP through solutions like Orum's simple API, the process is seamless for customers. The person sending the payment initiates the transaction (as a credit push), and the

RTP network processes the payments individually in real time.

To do that, the RTP network requires participating funding institutions to hold a separate, pooled account for liquidity purposes at The Clearing House. Interbank settlement happens immediately, before the receiving bank confirms details of the recipient's account. As with FedNow, both the sender and receiver of RTP transactions get payment status updates instantly to confirm success and the amount paid.

RTP has also added a couple services that FedNow does not provide. Secure Token Exchange is an optional capability that issues tokens to stand in for real account numbers when sending or receiving payments. It's a way to reduce the potential for theft and fraud. RTP's new Document Exchange Service provides access to PDF or XML documents such as bills, invoices, and remittances as part of an RTP payment or request for payment message.

Payment Method Comparison.

- ACH payments can take two to three business days
- Same Day ACH payments clear the same business day (still no weekend and holiday processing)
- Wire transfers clear the same

business day if within the availability window

- RTP and FedNow payments clear instantly

Neither FedNow nor RTP have captured a large market share thus far. In the first quarter of 2023, \$26 billion was transferred over RTP, equal to 0.13 percent compared to the \$19.7 trillion sent over the nation's dominant but slower ACH, according to the July 20, 2023, *Forbes* article, "Better Late Than Never, Federal Reserve Platform Will Finally Bring Instant Payments to More Banks and Customers" by Emily Mason. Another \$277 billion was sent in the first quarter over FedWire, the Federal Reserve-run service for one-time wire transfers.

One of FedNow's biggest differentiators is its integration with the Federal Reserve's larger network, which means it will be accessible to smaller local banks in communities across the United States. Small banks, in particular, have been reluctant to sign on to the big-bank-controlled RTP system. Industry experts predict that more banks and credit unions will now sign up for FedNow and that the existence of two competing systems may speed innovation and widespread adoption of instant payments.

To participate in an instant-payments system, financial institutions

need a user-friendly customer interface. Integrating this API into existing, legacy bank systems can require time-consuming and costly upgrades. Many banks are hesitant to make that investment until they are convinced that they will need such a system to compete against other banks and meet customer demands.

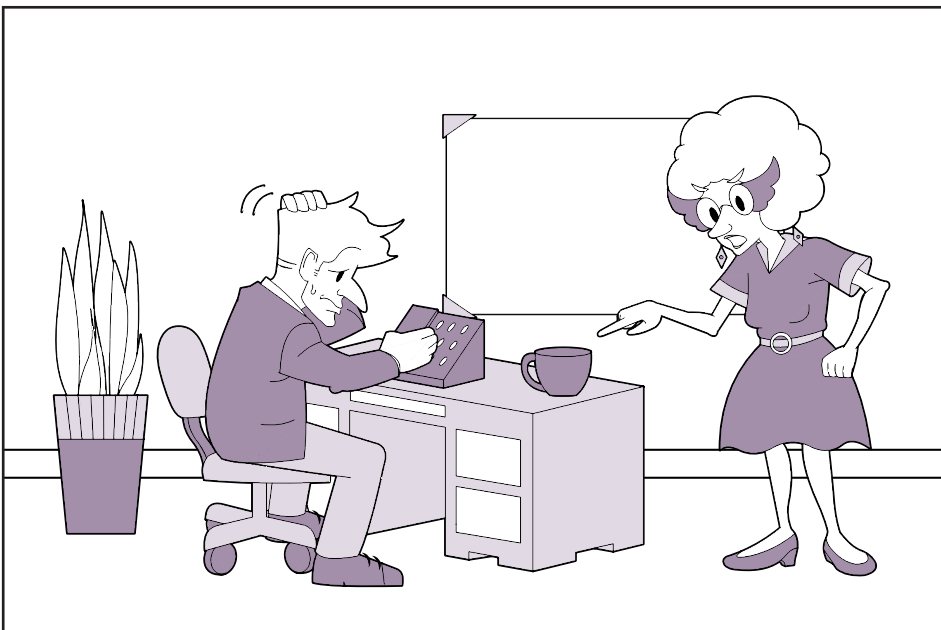
FedNow makes universal adoption more likely and the technology investment more compelling. Nearly a quarter of financial institutions were waiting for the FedNow launch to even adopt a real-time payments strategy, according to the *What's Going On In Banking 2023* survey and report from financial services consulting firm Cornerstone Advisors.

In the short term, smaller institutions are likely to gravitate to FedNow while larger institutions stick with RTP, the report predicts. Over time, as demand for instant payment grows, institutions of all sizes are likely to adopt both networks to ensure they are able to reach all U.S. consumers and businesses regardless of the size of their financial institution.

Fraud Prevention and Management.

New ways of making payments invariably introduce fresh fraud management challenges to financial services sectors and their customers. While instant transactions offer greater convenience for consumers and businesses, they also make it far more difficult to recover funds sent by mistake or under false pretenses.

According to Nick Stanesco, senior vice president and business executive for the FedNow Service, fraud management features are a high priority for FedNow and went through extensive testing before the launch. In addition, the Fed plans to roll out additional anti-fraud measures in 2024 and beyond. One feature under consideration would enable financial institutions to activate a control setting that rejects payments that exhibit unusual frequency patterns or cumulative value over a period of time. This could thwart fraudsters' efforts to work around transaction limits by originating large numbers of low-value payments in a short window.



What do you mean 'the check is in the mail?' You call that customer back and tell them to get in step with the times! We need that payment before your coffee gets cold!

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FedNow and RTP —

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Other updates under consideration would use Artificial Intelligence to review patterns and detect potential fraud.

Some market participants have raised concerns that FedNow could exacerbate a potential bank run by facilitating fast withdrawals from financial institutions, though Fed officials have downplayed those concerns, arguing that banks have tools available to mitigate a wave of outflows.

Instant Payment Adoption: Not Instant.

It will take some time to get comfortable with the instant payment process. Banks and their customers would need to lay the groundwork before instant payment systems are widely adopted. Banks are not required to participate, and it's unclear if or when individual banks will enroll in FedNow, RTP or both systems. In addition, the ACH electronic payment network used by all banks and credit unions in the United States is widely used and here to stay.

However, media outlets – and all other types of businesses – can benefit

from these faster payments, which translates to positive cash flow. Instant payments also facilitate better cash management and quicker payments to and from suppliers and vendors. A big benefit is that customers will have proof that their payments were posted on time, even over holiday weekends when ACH and wire transactions are not processed, and delinquent accounts can be brought up to date in minutes. The challenge might be getting customers onboard with the instant payment platforms and making sure both parties' banks are enrolled. ♦



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