

A Few Things to Know About FedNow and Digital Currency

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The Federal Reserve is set to launch its FedNow service on July 1, 2023. Since this service was first announced in 2019, it has generated significant discussion about financial privacy, digital banking and central bank digital currency. Here are a few things you should know about the FedNow program:

What FedNow Is and What It Isn't

FedNow is not a central bank digital currency (CBDC). Digital currency is any currency, money, or money-like asset that is primarily managed, stored or exchanged on digital computer systems, especially over the internet. Types of digital currencies include cryptocurrency, virtual currency and CBDC. The latter is a digital form of money that could be made available by the Federal Reserve to the general public.

Generally, the Federal Reserve issues liabilities in two forms. First, it offers the general public physical currency like national banknotes (bills in various denominations of dollars), which are considered legal tender for the payment of monetary obligations. Second, it offers commercial banks the ability to maintain digital balances in dollars at the Federal Reserve.

The Federal Reserve does not (yet) offer CBDC to the general public, and there is currently no plan proposed by the Federal Reserve to do so. However, there is speculation based on a Federal Reserve survey on the subject that it could happen in the future.

FedNow, on the other hand, is a digital banking service, and is scheduled to become available on July 1, 2023. It is a portal, created by the Federal Reserve, which permits financial institutions to exchange funds digitally in real time. Because FedNow allows financial institutions to send and receive funds in real time, the process avoids transfer delays on weekends, holidays, and at other times which fall outside of normal business hours.

FedNow and its Relationship to Private Bank Accounts

FedNow, like a commercial bank, generates activity details and reports for private accounts, and so collects certain user data for the purpose of supporting participating commercial banks in conducting their reconciliation and general ledger posting functions. Recently, speculation has surfaced on social media as to whether FedNow grants the Federal Reserve the power to arbitrarily monitor, freeze or seize private bank accounts. This speculation is generally without merit for several reasons.

First, FedNow does not allow the Federal Reserve to surveil private citizens or their purchases. Second, FedNow does not grant the Federal Reserve the authority to monitor or freeze private bank accounts. Third, neither FedNow nor any existing federal law grants the Federal Reserve the authority to act as a seizing agency with the power to conduct administrative forfeitures. Fourth, FedNow does not expand the existing enforcement powers of the Federal Reserve. Fifth, the Federal Reserve does not have the statutory authority to take formal enforcement actions against private individuals, unless such individual is an officer, director, or employee of a bank or similar financial institution. All this is not to say, however, that information legitimately gathered by FedNow is not capable of being used inappropriately by persons having access to FedNow's records.

FedNow's Impact on Financial Transactions

By permitting financial institutions to make real-time electronic payments, FedNow reduces inefficiencies in the marketplace. For example, individuals and entities banking at financial institutions utilizing FedNow can immediately utilize the funds in their accounts, and they will not have to wait 1-3 business days for any such transferred funds to become available in their accounts. Thus, business and personal transactions may now be completed faster, and with relative ease.

Private Sector Alternatives to FedNow

In addition, it is important to note that the Federal Reserve does not require financial institutions to implement FedNow. Several banks, including Wells Fargo and JP Morgan Chase, among others, are co-owners of Early Warning Services, LLC, which is the entity that developed Zelle. Like FedNow, Zelle is a banking service which allows users to make electronic payments to other users in real time.

Thus, if a financial institution (such as Wells Fargo or JP Morgan Chase) prefers to continue to utilize a similar private sector service like Zelle, that financial institution will be able to do so. Other similar private sector services include Venmo, CashApp and Paypal.

Potential Risks of FedNow

While FedNow does provide consumers with benefits such as added flexibility and faster payments, it also implicates possible fraud management and cybersecurity concerns. In particular, it raises questions about whether cybercriminals may begin targeting FedNow.

In the private sector, cybercriminals have targeted instant money transfer systems like Zelle in an attempt to capitalize on the instantaneous nature of the payment system. Like these similar private sector systems, FedNow does not allow users to revoke or cancel transactions; thus, it could become the target of cybercrime.

Some risk may be mitigated because FedNow includes several fraud management features. In addition, financial institutions using FedNow will be able to enhance its existing fraud management features with additional internal fraud management practices of their own.

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