The Strategic Imperative of Instant Payments for Community Banks

Remarks by

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Good morning and thank you for the opportunity to be with you today. Events like this one are a big part of how the Federal Reserve stays connected to the communities we serve. I appreciate everything you do and value the partnership we have. The Federal Reserve Bank of Kansas City covers a seven-state region, and conversations with bankers, business owners, and community leaders inform the perspective I bring to the discussion of monetary policy at the Federal Open Market Committee. We must ensure the views of individuals across the Tenth District, including all of you, are part of that discussion.

This morning I will start with a brief look at where the economy stands. I will then turn to a topic important to everyone in this room: the payment system and the future of instant payments.

Economic Outlook

On Wednesday the Federal Open Market Committee voted to raise the policy interest rate and to tighten the stance of monetary policy. I supported this decision. In tightening policy, the FOMC was responding to inflation that has remained too high for too long. Inflation has run above the Committee's 2 percent price stability objective for over five years now, and the most recent readings suggest a pace that is trending above 3 percent. As Chairman Warsh said at the Kansas City Fed's Jackson Hole Economic Symposium last month, the Fed has work to do on inflation and this week's action was a step in that direction.

Higher oil prices have been an important driver of elevated inflation, but it is important to acknowledge that our inflation problem is not just about energy. Inflation excluding energy has also been running hot and a broad range of goods and services are showing price growth inconsistent with our price stability target.

While it might be tempting to focus on oil and other supply issues, I would argue for taking a broader view. Inflation always reflects both supply and demand developments, with rising prices indicating an imbalance between the two. And while supply is certainly an issue for some commodities, the Fed should keep its eye on the overall balance in the economy. High inflation is a signal that the economy is out of balance, and the Fed, through its influence on demand, always has a role to play when it comes to keeping inflation in check.

Outside of inflation, the economy is performing well. The labor market appears to be in balance. The unemployment rate, at 4.1 percent, is in the range of what most observers would consider to be full employment. While the pace of job growth over the past year has been slow, this is not unexpected given the aging of the workforce and an increase in the number of retirements.

Overall economic growth is solid, supported by continued consumer spending and strong business investment. With the labor market in balance and growth resilient, inflation is my primary concern as I think about the correct course for monetary policy.

Reflection from Jackson Hole

I would now like to turn our discussion to payments. Last month, the Kansas City Fed convened its annual Economic Symposium in beautiful Jackson Hole, Wyoming. Some of you may know that the Kansas City Fed has hosted this annual Symposium for nearly five decades, dating back to 1978. What fewer people know is that the very early versions of this event, before it found its permanent home in Jackson Hole, were held right here in Colorado, in Vail and Denver.

This year's theme was "Financial Innovation: Implications for Payments and Policy," and it drew central bankers, academics, and policymakers from around the world into a genuinely wide-ranging discussion. Sessions touched on everything from the evolution of digital currencies to the economics of instant settlement to how emerging technology is reshaping monetary policy transmission. I encourage you to review the papers discussed at this year’s Symposium; you can find them on our Bank’s website, KansasCityFed.org. The breadth of topics on the agenda showed just how central payments innovation has become to the broader conversation about the future of finance.

As the discussion made clear and as everyone in this room knows, efficient and safe payments are the circulatory system of commerce and banking, keeping money and businesses moving. Taking it a step further, our conversations in Jackson Hole strengthened my growing conviction that a bank’s position within the evolving payments landscape will be a key driver of bank valuations much like a strong core deposit base. Payments infrastructure is the foundation that makes everything else possible. Without efficient, reliable money movement, other products and services lose much of their value. That idea is exactly why I want to spend the remainder of my time this morning talking about the Federal Reserve’s newest payments rail—FedNow.

The Federal Reserve's Role in Payment Modernization

By design, the Federal Reserve has been an active participant in the payment system since our inception. Over the decades, we’ve evolved and expanded the payments ecosystem to facilitate a broad range of everyday financial transactions. FedNow is the newest chapter in that story, and it represents what I believe may be the most significant shift yet, moving us to instantly settled, always available payments. Amidst evolution, our mission has stayed the same.

We exist to promote the safety and efficiency of the payment system, to ensure every depository institution has equitable access to that system, and to do so in a way that supports competitive fairness across institutions of every size.

The trust essential to the smooth functioning of this system is easy to take for granted. Here in the United States, our payments infrastructure has a long history of reliability and resilience. That is not the case everywhere. In markets where payment systems are newer, less established, or have faced periods of instability, we often see much faster and broader adoption of alternatives like cryptocurrencies and stablecoins, even though those alternatives carry their own risks. It is a useful reminder that trust in a payment system cannot be assumed. It must be earned and maintained, and that is very much part of our focus with FedNow.

The Fed's mission isn't just a historical anchor. It's a useful lens for understanding why instant payments, specifically FedNow, matter right now, particularly for community banks. Your customers may not be asking for instant payments. But that might be because they are seeking those services elsewhere. Let me walk you through some reasons I believe FedNow provides value, with an emphasis on safety and competition.

Let's consider the safety profile. FedNow is built on a credit push only architecture, meaning funds can only be sent, never pulled. That characteristic creates a fundamentally different risk posture than checks or ACH, where funds can be pulled from an account, and it is something I will return to shortly because it deserves real emphasis.

Also consider the competitive landscape. FedNow gives every institution with a master account at the Federal Reserve access to the same instant payments infrastructure, regardless of size. A community bank in Grand Junction, Colorado, has access to the same rails as the largest banks in the country. That access creates a level playing field and is particularly important for the many small and regional institutions our district serves.

FedNow: Designed for Safety

Signing up for FedNow is not an all-or-nothing decision, and it is certainly not a matter of flipping a switch, crossing your fingers, and walking away. Institutions have real, meaningful control over how they choose to participate in the service.

Start again with that credit push only design. Because transactions can only be initiated by the sender, there is no mechanism for unauthorized parties to pull funds from an account. That single feature closes off an entire category of fraud that exists in other payment rails.

Beyond that architectural safeguard, institutions can configure their own send-side transaction limits and controls within FedNow, tailored to their risk appetite and customer base. Additionally, enabling FedNow does not mean your systems must run unsupervised, 24/7. On the receive side, institutions must remain live, ensuring they can always accept incoming payments; however, institutions can configure send-side processing windows and controls that align with their operational capacity as well as their risk appetite. Institutions in the FedNow ecosystem are not simply turning on a service and hoping for the best. They are making deliberate choices about how much exposure they are comfortable with, and adjusting as their comfort grows.

The data backs all of this up. Fraud rates on FedNow remain meaningfully lower than those associated with other payment types. For example, many of you are painfully familiar with check fraud: altered checks, stolen mail, forged endorsements. FedNow's credit push only design eliminates that entire possibility.

And the safeguards available will only get stronger from here. There's a network intelligence tool, which uses historical FedNow data to flag patterns and insights in real time, giving institutions one more layer of information, and one more layer of confidence, before a transaction is finalized. More broadly, the network's risk management features continue to evolve in close partnership with the industry, meaning what's available with FedNow today is really just the starting point.

FedNow: Adoption and Use Cases

Let me share where adoption stands today. Since FedNow launched in July of 2023, more than 1,900 financial institutions have signed up, and more than 96 percent of participants are smaller depository institutions, meaning those under $10 billion in assets. At the same time, 7 of the top 10 largest financial institutions in the country are also on the network. Supporting all of this is a growing service provider ecosystem, with more than 50 service providers now certified to support payment processing for participants.

Still, only 20 percent of the roughly 8,500 small institutions nationwide currently participate. Notwithstanding, there is real momentum, with year-over-year growth among smaller institutions running around 30 percent.

FedNow gives institutions of every size the ability to compete effectively in an evolving industry while maintaining their own approach to trust and customer relationships. The infrastructure is there. The opportunity is there. What remains is closing the adoption gap. And as more institutions come online, the value compounds. Greater ubiquity will unlock additional use cases, and innovation will continue to grow.

Let me ground this in some real examples. Earned wage access and same day pay have moved well beyond the gig economy and into mainstream employment, giving hourly, shift, and even salaried professional workers access to pay when they need it. Instant loan disbursement is helping institutions offer indirect financing at the point of need—nights, weekends, or emergencies—without waiting for the next business day. Instant settlement is also protecting small business cash flow, giving buyers and sellers price clarity from the start rather than absorbing costs from market shifts during a payment delay. And last year, we saw the first federal emergency relief disbursement sent instantly through FedNow, via the U.S. Treasury's digital pay program, a genuine game changer when speed matters most.

I want to build on these examples with a story that captures why instant payments matter more than any statistic could. It's a peer-to-peer example, but I'd ask you to listen with an eye toward your commercial customers too, since the same dynamic could play out just as easily in a business-to-business setting, with much higher stakes.

Not long ago, one of our staff members set out to find a financial institution that would allow for peer-to-peer instant payments, specifically one that enabled send capability, not just receive.

As you may be aware, receive-only participation across the FedNow network is common, but send enablement is less common, though growing significantly, with year-over-year growth in active senders recently reaching 85 percent. After some searching, this employee found a bank right here in Colorado, a community bank that has embraced full send capability for its customers. Never mind that this employee lives in Kansas City. In today's banking environment, geography is no longer the barrier it once was. The employee opened an account remotely, and the capability was in place, anticipating opportunities to use it.

Our employee needed to send a bit of money to a colleague, and rather than reaching for a third-party app, decided this was the perfect opportunity to put that bank account to work.

Here is where it got more interesting. The recipient's first instinct was to receive the funds into an established checking account at a regional bank. That did not work. Their institution was not set up to receive instant payments. So, the recipient pivoted to another account they held, this one at a local credit union, and the transaction went through instantly, just as it should.

I share this story not to single out any institution, but because it captures something important. Two people wanted to use their primary financial institutions to make a simple transfer. They could have been splitting a lunch bill. And they hit friction along the way. The interesting part is not that one attempt failed. It is what happened next. Our colleague did not call his regional bank and ask them to adopt FedNow. Instead, he used the account that worked. No conversation, no complaint, just a quiet shift of activity to the institution that met the need.

Your customers may not contact you to request instant payment capabilities. They may not file a complaint when a transaction does not go through the way they expected. They too are most likely going to simply reach for whatever account, or provider, that does work.

The credit union in this story did not win that transaction through a marketing campaign or a slick app. They won it because they had already built the infrastructure to say yes when the moment came. Stories like this will only become more common as adoption grows—the more institutions that come online with full send and receive capability, the more ubiquitous instant payments become, and that ubiquity will create use cases we haven't even imagined yet. Innovation tends to follow infrastructure. Once the rails are widely adopted, the products built on top of them multiply further. That was true for ACH and debit cards a generation ago, and it is true for instant payments today. That is the opportunity sitting in front of community banks across Colorado and throughout our District and the U.S. right now.

So as you think about what comes next, consider a few things: Educate your boards and management teams given this is a strategic decision, not just a technology one. Talk to your service provider about send-side offerings, not just receive; as noted earlier, receive-only leaves real value on the table. Engage your commercial customers because you may find use cases already sitting in your loan portfolio or deposit base. And know you're not doing this alone: Our team stands ready to help through advisory groups, education, and research tailored to institutions like yours.

I'll also mention one piece of news relevant to this conversation. Federal Reserve Financial Services recently announced a FedNow discount program beginning January 1st, offering statement credits to new and existing customers that meet certain criteria. Ask your relationship manager for details.

Conclusion

In closing, let me say plainly what I believe to be true: Colorado's banks are strong. Recent data suggests sound fundamentals, disciplined lending, and solid capital positions that give you a firm foundation to build from. That strength is something you can invest with, and it puts you in a position to think seriously about what comes next.

Real-time payments and settlement are here, and your customers are looking for ways to take advantage of the speed and security that's now available. Whether or how you engage with that opportunity is up to you, but I would encourage you to consider what it might mean for your customers and your community.

Thank you for having me this morning, and for the important work you do every day in the communities you serve. I look forward to your questions.