

PAYMENTS PROS – THE PAYMENTS LAW PODCAST: FEDNOW IS HERE!**HOST: CARLIN MCCRORY****GUEST: TERRI SANDS****Carlin McCrory:**

Welcome to another episode of *Payments Pros*, a Troutman Pepper podcast focusing on the highly regulated and ever evolving payment processing industry. This podcast features insights from members of our fintech and payments practice, as well as guest commentary from business leaders and regulatory experts in the payments' industry. I'm Carlin McCrory, one of the hosts of this podcast. Before we jump into today's episode don't forget to check out our other podcasts on [Troutman.com/podcast](https://troutman.com/podcast). We have episodes that focus on trends that drive enforcement activity, digital assets, consumer financial services and more. Make sure to subscribe to hear the latest episodes.

Today I'm joined by Terri Sands from Stout to discuss evolution in payments and FedNow. Stout is a global investment bank and advisory firm specializing in corporate finance, transaction advisory, valuation, financial disputes, claims and investigations. Terri, who is the Managing Director of the Disputes Compliance and Investigations Group at Stout, specializes in payments and regulatory compliance and financial crimes. Terri has extensive experience in the financial services industry, including 20 years of consulting experience and 15 years of direct banking experience, including the Federal Reserve Bank of Atlanta and serving in various positions in a community bank, including Director of Payment Strategy and Risk Management and Director of Financial Investigations Unit.

Throughout her career, Terri has served as a leader in the payments, BSA AML, and OPEC sanctions in broad and risk management areas providing education, risk management, strategy, compliance and program enhancement support for financial institutions of all types and sizes, including fintech providers. I'm thrilled to have Terri on the podcast today and I'm looking forward to our discussion. Terri, let's go ahead and just dive on in. We'll start with a broad question for you. So over the past several years, what would you say the biggest advances in payments have been?

Terri Sands:

Probably just in the different ways to submit payments or to be paid. The good old traditional ACH or checks are still around, checks are still going strong, it's the way that we process checks that are different, but people are still writing checks. There's also Zelle, there's real-time payments, RTP, credit cards, debit cards, crypto, you have remote cash, you have remote deposit, and now you have FedNow. So, it's just the different ways to pay. Also, how customers choose to even present their card. We have the zip, tap, swipe. So, you can insert your card to the chip reader, if you so choose, you can tap your card to be a bit smoother, or you can swipe it to be more traditional, whatever you want. You pretty much have the option; we have the ability to pay.

It's just interesting, we used to, if you were trying to pay a babysitter and you didn't have cash, you could say, "Let me do that later." But now there's no excuse, so you have to pay because there's Venmo, there's Zelle, there's all of these different things that you have the ability to pay in different access points. So that's the biggest advances, it's all technology, all technology.

Carlin McCrory:

Yeah. You mentioned FedNow, that's been a really hot topic in the payment space. Now that FedNow is here, what in your opinion will be the focus for financial institutions and their real-time payment space?

Terri Sands:

With any new payment channel, FedNow is obviously here, and it will go strong and I'm very excited for the Fed and their customers on this, but I think it's really going to be for financial institutions, the continuation of making it better for the customer member. When any new payment comes out, we saw this with Zelle, when Zelle came out it was new and it was wonderful, and financial institutions have to work out the kinks. So, it's really the continuation of making it better, working out the kinks, getting their procedures in places, getting their controls in places, and quite frankly it's also about improving their monitoring controls for suspicious activity and fraud.

With financial institutions, they've prepared for FedNow for a very, very long time. Fraudsters have also prepared for FedNow for a very, very long time. We saw this with Zelle, we saw it with Cash App, and we will see it with FedNow. It's faster money, faster fraud. Fraudsters will use their skillset to scam people in sending money. We see this in the variations of scams today. So financial institutions will have to improve, just as fraudsters have improved in advancing their controls. They will and they have. We have financial institutions who are on FedNow and they're already talking about ways that they can improve the customer member experience, even as it is just now beginning.

Carlin McCrory:

Are you seeing financial institutions have both RTP and FedNow? How is that playing out, since RTP has been around?

Terri Sands:

What we're seeing, and again this is just what we're seeing from the Stout point of view, is we're seeing people go with one or the other. It's just easier to manage one instant payment processing, especially with your smaller financial institutions, it's much easier. Because they're not going to have all of these different payment collection channels in their house, they're just not, because the more you have, the more you manage, the more you have to monitor, the more potential for fraud. So really one or the other is what we're seeing.

Carlin McCrory:

That makes a lot of sense. Can you give us some examples of use cases potentially for FedNow? I juxtaposed this with wire transfers. Wires have been around forever, so where do we see the interplay and where do we see that FedNow comes into play with businesses and consumers?

Terri Sands:

Businesses have to pay out vendor payments, and I think we've talked just to businesses who are going to use this for paying out insurance premiums and paying out vendors and paying different things, and they're really folding this into their accounts payable stream, which is nice. Especially FedNow is going to work very nicely for smaller businesses who just have a couple of

vendor payments to make, so we're seeing a lot of good case studies there, and also just in general people paying other people. We're going to see more people go, "Okay, do we want to go on the Zelle network, or do we want to pay by FedNow?"

I was talking about this the other day to someone, it's going to be just different. We're going to have an app on our phone that is FedNow, that's just different. It's not like you're going directly to the Fed, you have to go through a financial institution, but it's just different and it's very, very exciting. But again, it's all about what the individual or what the business wants to do, but we're seeing a lot of smaller businesses fold that into their accounts payable channel of how they're going to pay, because it is safer. They're looking at FedNow as a safer way to pay, and financial institutions are talking about this to their smaller businesses and their consumers as well. Like, "This is a very safe way to pay." So I think people, again in the fraud invested world in which we live today, are thinking about how to keep their money safe. So FedNow is going to be a really good business case for individuals and businesses alike.

Carlin McCrory:

Our clients especially have been talking about tech fraud, our financial institution clients at least, and so this would be a great opportunity for these small businesses, instead of putting a check in the mail, to just use the FedNow system it sounds like. On that topic, who bears the risk of loss in any event if a payment is sent to the incorrect recipient, let's say, in the FedNow system?

Terri Sands:

It's always the originator of that payment. It's always going to be the originator of that payment. So the originating financial institution is going to hold the warranties and liabilities always. That's where financial institutions are really having this conversation. Back to what you were saying about check fraud, check fraud is out there and we work a lot of check fraud cases, and you're putting a check in the mail, you're sending it out there, you're dropping it into what you think is a trusted mailbox, but the fraudsters are there, it's all over the place, US postal inspectors all over the country are freaking out about how much check fraud there is.

So, I think FedNow is obviously a trusted source, but it is going to be the same thing where financial institutions today, if their customers or members are sending money and they're scammed or they send it to the wrong recipient, it's up to the sending financial institution to help get that money back. That is a struggle, it's something that financial institutions absolutely hate, because they're in the driving seat to get that money back. Sometimes it's just not that easy to do so.

Carlin McCrory:

You also mentioned sending out a program for FedNow for your financial institution clients, and the policies and procedures that entails. How else could Stout, or how does a financial institution stand up a program like FedNow? What are the steps that you recommend?

Terri Sands:

It's like any new payment channel that a financial institution is going to in, or any new service or product, you always want to start with the risk assessment. Because the risk assessment is designed so that you know what are all of those things that you have to do in order to develop your program. You can't really start a program without a risk assessment because the risk assessment looks at, for example with FedNow or any of your payment channels, is going to

look at all of the associated risk. For example, you have credit risk, every single time a payment is sent you have credit risk, reputational, third party, legal and compliance, fraud, liquidity risk.

So, you have all of these various risks, so in order to build your program you first have to go through the process of the risk assessment before you get there. So, one of the things that we talk about to financial institutions, and we're doing now, is that we do the risk assessment first, then we do the program development, and then we do the training based on the program to train all the applicable areas on the new system, FedNow being a big one just coming out. That is the best way to approach it, otherwise you get turned upside down and you miss some of the internal controls that you would have known had you had done the risk assessment in the first place.

Carlin McCrory:

Yeah, that's great. Terri, we may have covered this point, but what do you see as driving financial institutions towards instant payments?

Terri Sands:

The driving force, in my opinion, is just basic, it's technology and people. Both technology and people advance expectations. You have technology and then the technology isn't good enough, so it's advanced to something bigger. We see this on the good side of technology where it improves the customer experience, and we see it on the bad side of technology where fraudsters, the technology is not good enough to caught that it's tricked people into surrendering their information, so technology gets advanced. In my opinion, I think it's really both, both advance expectations.

So many things are instant, and people typically get upset if they have to wait for things. It's interesting, we even had a complaint not too long ago with even bill payment. A bunch of customers of a bank, they were complaining because their money wasn't debited immediately when the bill payment was sent. They want instant gratification; they want to see things in real-time. That becomes very, very important. It really goes back to the very basics of technology and people.

Carlin McCrory:

Then for those financial institutions that may wait to see how things play out, what's the adoption that you're seeing? Are a lot of folks adopting this, in your opinion? Or are there a lot of holdouts? Or is this a larger institution thing that you're seeing play out?

Terri Sands:

Well, we're experiencing larger community banks and larger credit unions signing up for FedNow, they're in the beta process of FedNow, that's what we're seeing. A lot of the smaller financial institutions are waiting and seeing. This has to do with people are equating their experience with Cash App and Zelle and all of those things with FedNow. The unfortunate thing is that we worked through the whole COVID-19 thing with all of the scams, and I know we had a lot of Cash App fraud and a lot of Zelle fraud because of all of the scams that were taking place during COVID-19, and I think it's a residual of that.

People are still thinking about that time, and they have that in their head. Financial institutions, from what we're seeing as the smaller financial institutions, are sitting still for a while to figure out what is good, what is bad. Because you can go on LinkedIn and you can go on the news

and you can see this, there's going to be things that are going to be announced like the fraud, and the good things too. It's not just all the bad stuff, it's all the good stuff. So, I think for the smaller institutions, you're definitely going to see the wait-and-see approach, that's what we're seeing at Stout.

Carlin McCrory:

That makes sense. Do you have any other thoughts on instant payments here or FedNow, RTP or the like?

Terri Sands:

One of the questions that we're starting to get asked a lot by our clients is what about the money laundering side? FedNow, there's a lot of discussion on fraud and there's a lot of discussion on the customer experience, and I think FedNow is going to be great. I'm super excited about it. But what we're getting now is more of let's talk about the BSA side of the house, what about the money laundering? With any payment, it doesn't matter what the payment is, but with any payment there could be money laundering. There could be fraud, there could be money laundering.

So, what we're getting is strategically planning this, how are we going to approach the monitoring of suspicious activity and also fraud? Even the smaller financial institutions asking us to look at their systems, like their AML systems and their fraud systems, because in the past, and even today, a lot of financial institutions are reactive to fraud. They're very reactive, it's like, "We're going to wait until fraud happens and then we're going to try to get the money back." So a lot of financial institutions, and we're super happy about this, are looking at strategic planning for fraud management. That simply means being proactive rather than reactive. You're looking at real-time monitoring rather than next day monitoring.

With instant payments, things are faster. So, if you have next day monitoring on one side, and you have instant payments, that doesn't reconcile. So, you have to have the real-time monitoring with real-time payments, otherwise it doesn't balance. So, the good thing is that we're getting a lot of requests to optimize AML and fraud systems, and also develop strategic planning documents for how are we going to approach next generation fraud, and next generation monitoring for BSA, what does that look like? So that becomes a really nice thing, we're excited about that, because that's how financial institutions should be thinking.

Carlin McCrory:

Are you seeing any new types of fraud with instant payments generally? There's been so many scams, like you talked about during COVID, but is there anything new that folks who are listening in should be aware of and be on the lookout for?

Terri Sands:

One of the things that we're seeing today is something called deep fakes, where a fraudster will capture the voice of a person, or just capture a person, whether that's a consumer or a business, and they'll use the voice to maybe do like grandparent scamming. So, the grandparent scam where the grandparents think that their grandchild has been abducted, kidnapped, whatever, and they're playing back their voice. So that becomes very scary, and again, just like all of the advancements in fraud, we're seeing a lot of that. That's something that is not new, but newer, and it's scary.

Carlin McCrory:

Wow, that's terrifying and also interesting at the same time. The last question I wanted to ask you was of course you're training on the front lines, but then how are you also getting management involved, board involved, and the higher-level folks involved with FedNow to have their buy in on all of these fraud protections that are necessary for a service like FedNow?

Terri Sands:

Our financial institutions are bleeding money on check fraud. It is really, really bad. So, check fraud starts that conversation into we're having all of these check fraud losses, what are the other payments? What are we going to lose on something like FedNow? What does that look like? So, it's just fraud in general, what are all those channels? How many different ways, what are we offering out there to our consumers and our businesses, and what fraud are we experiencing?

The problem that we see with financial institutions is that you have to report it to know what's happening. So, there's a big difference between what the first line of defense, what the people in the jobs are doing, and what the board of directors understands. If you have a big gap between what happens on the front line, what happens on the first line of defense, and what the board knows, that's a problem. The good thing is that we're seeing more financial institutions closing that gap and reporting on the fraud.

Again, whether it's FedNow or traditional ACH or checks, you've got to be able to report it to understand what you need to do. If it's more fraud, then what are you going to do to mitigate it? Do you need more effective monitoring systems? Do you need more education? What do you need out there? I think that's what financial institutions are moving towards, and those financial institutions who are not moving towards that are going to find themselves in a bad situation.

Carlin McCrory:

That makes sense. Having that board buy in and management buy in is so critical. Terri, I thank you so much for your time, it's always a pleasure to have you on in a super interesting conversation. Thanks to our audience for listening to today's episode. Don't forget to visit our blog [ConsumerFinancialServicesLawMonitor.com](https://www.consumerfinancialserviceslawmonitor.com), and subscribe so you can get the latest updates. Please make sure to also subscribe to this podcast via Apple Podcasts, Google Play, Stitcher or whatever platform you use. We look forward to next time.

Copyright, Troutman Pepper Hamilton Sanders LLP. These recorded materials are designed for educational purposes only. This podcast is not legal advice and does not create an attorney-client relationship. The views and opinions expressed in this podcast are solely those of the individual participants. Troutman Pepper does not make any representations or warranties, express or implied, regarding the contents of this podcast. Information on previous case results does not guarantee a similar future result. Users of this podcast may save and use the podcast only for personal or other non-commercial, educational purposes. No other use, including, without limitation, reproduction, retransmission or editing of this podcast may be made without the prior written permission of Troutman Pepper. If you have any questions, please contact us at [troutman.com](https://www.troutman.com).