

FEDERAL RESERVE SYSTEM
[Docket No. R-1086]
Federal Reserve Bank Services

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice.

SUMMARY: The Board has approved the fee schedules for Federal Reserve priced services and electronic connections and a private-sector adjustment factor (PSAF) for 2001 of \$206.9 million. These actions were taken in accordance with the requirements of the Monetary Control Act of 1980, which requires that, over the long run, fees for Federal Reserve priced services be established on the basis of all direct and indirect costs, including the PSAF.

DATES: The new fee schedules become effective January 2, 2001.

FOR FURTHER INFORMATION CONTACT: For questions regarding the fee schedules: Erik Kiefel, Financial Services Analyst, Retail Payments, (202/721-4559); Susan Foley, Senior Financial Services Analyst, ACH Payments, (202/452-3596); Cynthia Yablon, Financial Services Analyst, Funds Transfer and Book-Entry Securities Services, (202/452-2046); Donna DeCorleto, Financial Services Project Leader, Noncash Collection Service, (202/452-3956); Michael Lambert, Senior Financial Services Analyst, Special Cash Services, (202/452-3376); or Paul Grabow, Senior Information Technology Analyst (electronic connections), (202/452-2830), Division of Reserve Bank Operations and Payment Systems. For questions regarding the PSAF: Gregory Evans, Manager, Financial Accounting, (202/452-3945), Division of Reserve Bank Operations and Payment Systems. For users of Telecommunications Device for the Deaf (TDD) only, please contact Janice Simms (202/872-4984). Copies of the 2001 fee schedules for the check service are available from the Board, the Reserve Banks, or the Federal Reserve Banks' financial services web site at www.frbservices.org.

SUPPLEMENTARY INFORMATION:

I. PRICED SERVICES

A. Overview--The Federal Reserve Banks continue to meet the Monetary Control Act's requirement that they recover, over the long run, their direct and indirect costs, including imputed costs and profits, of providing priced services. Over the period 1990 through 1999, the Reserve Banks recovered 99.7 percent of their total costs for providing priced services, including imputed expenses, special project costs that were budgeted for recovery, and targeted after-tax profits, or return on equity (ROE).¹

¹ These imputed costs, such as taxes that would have been paid and the return on capital that would have been earned had the services been provided by a private business, are referred to as the PSAF. The PSAF is based on data developed in part from a model comprising the nation's fifty largest (by asset size) bank holding companies. Based on consolidated financial data for the holding companies in the model for each of the last five years, the targeted ROE is the

For 2000, the Reserve Banks estimate that they will recover 100.4 percent of the costs of providing priced services. They project a 98.0 percent recovery rate in 2001, largely due to transition costs associated with the check modernization project and the transition to a new cost-allocation method for the book-entry service. The primary risks to the 2001 projection are the Reserve Banks' ability to meet aggressive revenue and cost targets in the check service, because of the impact of the check modernization project; the uncertain effects of price-structure and service-level changes being implemented for automated clearinghouse (ACH) interoperator transactions; and increased competition for ACH and funds-transfer services.

In their 2001 fee schedules, the Reserve Banks include changes that continue to provide an economic incentive for depository institution customers to make greater use of electronic payment services. In particular, the price index for electronic payment services (ACH, funds transfer and net settlement, book-entry securities, and electronic check) and electronic connections is projected to decline approximately 1.9 percent in 2001. The index for paper-based payment services (check, special cash, and noncash collection) is expected to increase 6.4 percent. The overall 2001 price index for all Federal Reserve priced services is projected to increase 4.2 percent, the same as the increase in 2000. Since 1996, the overall price index has increased only half a percent.²

The following are changes in fee structures and levels for priced services in 2001:

- The Reserve Banks will make no changes to fees for the Fedwire funds transfer

budgeted after-tax profit that the Federal Reserve would have earned had it been a private business. This ten-year recovery rate is based upon the method used for the pro forma income statement for Federal Reserve priced services published in the Board's Annual Report. The pro forma income statement reflects certain offsets to costs related to the transition to financial accounting standards number 87 (FAS 87) that have not been included in the 1999 repricing pro forma in this memorandum. Beginning in 2000, the PSAF includes additional financing costs associated with pension assets used by priced services. This ten-year cost-recovery amount has been computed as if these costs historically had been included in the PSAF calculations. If this modification were not applied to prior periods, the ten-year recovery rate would increase to 101.1 percent. In order to provide a more accurate comparison against the targeted return on equity that was used for establishing prices within those services, the 1999 service-line recovery data in this memorandum do not reflect the revisions to the PSAF method.

² These estimates are based on a chained Fisher Ideal price index. This index provides customers with a representation of the total price or cost of Reserve Bank services, offering a more complete picture than is possible solely from comparing changes in individual service fees over time. This index is not adjusted for quality changes in Federal Reserve priced services. Data elements used in calculating the index include explicit fee revenue from priced services products and services and electronic connections to the Reserve Banks, volumes associated with those products and services, and imputed income associated with clearing balances through the Reserve Banks. The price index is calculated using the actual, estimated, or projected full-year revenues and volumes. For 2001, the year-over-year percentage change in the index results from a comparison of the 2001 projections to the 2000 estimates for priced services revenues and volumes. The Reserve Banks delayed implementing the fee changes for 2000 until April to minimize changes for depository institution customers during the period surrounding the century rollover. The 2001 index, therefore, does not directly compare the impact of the prices implemented on April 2000 against the 2001 prices because the 2000 estimate includes revenues and volumes from the first quarter of 2000. The changes in the price index since 1996 are calculated with full-year 2001 projected and 1996 actual revenues and volumes.

and national net settlement services. The price index for Fedwire funds transfers has declined more than 46 percent since 1996.

- The Reserve Banks will increase the surcharge for an off-line Fedwire book-entry securities transfer 39 percent in 2001 to \$25. The fee change is expected to cost customers approximately \$197,000 next year. Other book-entry fees will remain at 2000 levels. Including the fee change for 2001, the price index for the book-entry securities service has declined more than 9 percent since 1996.
- The Reserve Banks will retain current prices for customers of the FedACH service. The Reserve Banks are initiating discussions with private-sector operators (PSOs) to negotiate deposit deadlines and fees for transactions that they exchange with each other. The new deadlines will be in place no later than June 2001, and the price structure modifications will be implemented no later than September 2001. Since 1996, the price index for the ACH service has decreased almost 49 percent.
- The Reserve Banks will increase transaction fees for all check products 2.6 percent compared with current prices or 3.9 percent compared with April 2000 fees. Transaction fees for paper check products are projected to increase 2.6 percent over current prices or 3.9 percent compared to April 2000 fees. Paper check products include forward-processed, fine-sort, and returned checks. Reserve Banks are standardizing paper check products and implementing a more-consistent pricing structure across the Reserve Banks. Reserve Banks also will introduce new prices designed to encourage the accuracy of qualified returned checks and discourage the use of large-dollar checks. Transaction fees for payor bank services, which include electronic check products, will increase 2.9 percent from current prices or 3.7 percent from April 2000 fees. Electronic check products include electronic check presentment, image services, and electronic information. The price index for all check products, which includes imputed fees and other product and service fees not captured in the comparison of the individual transaction fees, is projected to increase 5.9 percent in 2001. The price index for paper check products is increasing 6.3 percent, while that for payor bank and check electronic connection services is decreasing 2.2 percent. Including the fee changes in 2001, the price index for the entire check service has increased almost 23 percent since 1996. Aggregate check service fee increases in 2001 are expected to cost depository institution customers approximately \$50 million, assuming no changes to current customer processing choices.³

³ The volume-weighted fee calculations for 2001 are based on a comparison of current and April 2000 transaction fees with the 2001 fees for check products, all weighted using the projected 2001 volumes. These volume-weighted calculations summarize changes in specific check product transaction fees while the chained Fisher Ideal price index

B. Discussion -- Table 1 presents an overview of the budgeted 2000, estimated 2000, and projected 2001 cost-recovery performance for all priced services.

Table 1

Priced Services Cost Recovery (percent)			
PRICED SERVICE	2000 BUDGET	2000 ESTIMATE	2001 BUDGET
All services	99.0	100.4	98.0
Check	98.7	100.3	97.7
ACH	100.0	100.1	100.2
Funds transfer	100.4	100.0	100.1
Book-entry	101.3	102.4	94.9
Noncash collection	108.5	110.8	102.2
Special cash	101.6	103.4	100.6

The aggregate cost-recovery rate is heavily influenced by the check service, which accounts for approximately 83 percent of the total cost of priced services. The electronic services (ACH, Fedwire funds transfer, and Fedwire book-entry securities transfer) account for about 17 percent of costs. The noncash collection and special cash services represent a de minimis proportion of priced services expenses. Figure 1 shows the proportion of 2000 estimated priced services costs attributable to each service.

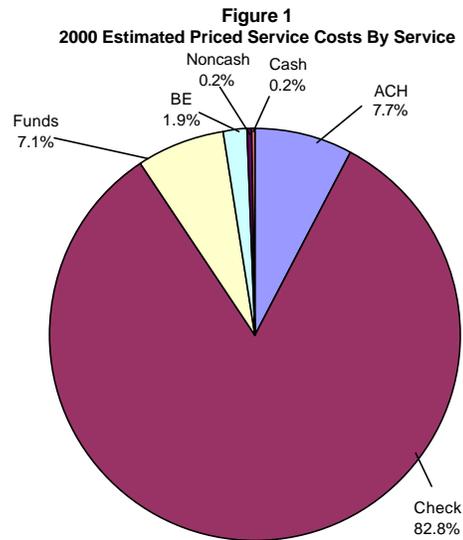


Table 2 summarizes the cost and revenue performance for priced services since 1999.

includes the all-in costs to a customer of purchasing a market basket of Federal Reserve check products. The fees being introduced to encourage the accuracy of qualified returned checks and the greater use of electronic payment systems instead of large dollar checks are not included in the calculation of these transaction fee changes.

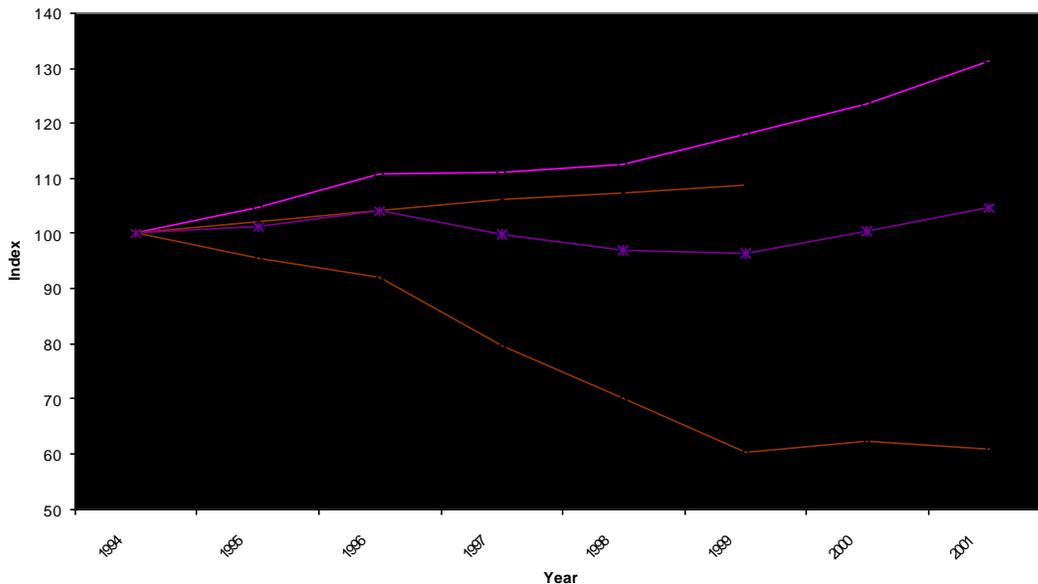
Table 2

Pro Forma Cost and Revenue Performance (a)					
(\$ millions)					
YEAR	1 REVENUE (b)	2 TOTAL EXPENSE (c)	3 NET INCOME (ROE) [1-2]	4 TARGET ROE (d)	5 RECOVERY RATE AFTER TARGET ROE [1/(2+4)] (e)
1999	867.6	787.0	80.6	56.0	102.9%
2000 (Estimate)	920.5	818.7	101.7	98.4	100.4%
2001 (Budget)	978.5	889.4	89.1	109.3	98.0%

- a. Calculations on this table and subsequent pro forma cost and revenue tables may be affected by rounding.
- b. Includes net income on clearing balances.
- c. The calculation of total expense on this and subsequent pro forma cost and revenue tables includes operating expenses and imputed costs plus special project costs recovered during the year. Imputed costs include interest on debt, taxes, FDIC insurance, Board of Governors expenses related to priced services, and the cost of float. Credits for prepaid pension costs under SFAS 87 are also included. In 1999, the book-entry service recovered \$1.7 million in special project costs related to the completion of the automation consolidation project. In 2000, the check service estimates that it will recover fully \$6.3 million in special project costs related to the ongoing check modernization initiative. In 2001, the check service projects that it will recover fully \$15.1 million in special project costs related to check modernization.
- d. Target ROE is based on the ROE included in the PSAF and has been adjusted for taxes, which are included in column 2.
- e. If the PSAF method used to calculate the 2000 and 2001 aggregate priced service cost in this table were applied to the actual 1999 calculations, the recovery rate would decline to 100.4 percent.

1. 2001 Price Index — The price index for electronic payment services and electronic connections is projected to decline approximately 1.9 percent in 2001, and the index for paper-based payment services is expected to increase 6.4 percent. The overall 2001 price index for Federal Reserve services is projected to increase 4.2 percent, the same as the increase in 2000. The overall price index has increased half a percent since 1996. The higher overall price index in 2001 is attributable mainly to increased check prices. Figure 2 compares the Federal Reserve's price index for priced services with the gross domestic product price deflator, which shows that the cost of Federal Reserve priced services has historically increased more slowly than that of the deflator.

Figure 2
Federal Reserve Price Index
Chained Fisher Ideal index compared with GDP price deflator



The decline in the price index for electronic payments services since 1996 has reflected, in large part, the ability of the Reserve Banks to capitalize on the operational efficiencies and scale economies inherent in providing payment services through centralized electronic payment processing applications. Between 1992 and 1998, the Reserve Banks' automated data processing facilities were consolidated into three sites, significantly reducing the cost of providing electronic payment services.

2. Allocation of Corporate Overhead Costs to Priced Services —

Corporate overhead costs are allocated to priced services in total and to other Reserve Bank activities based on their proportion of total Reserve Bank costs (expense-ratio basis). Because corporate overhead costs are not closely related to any particular priced service, the priced services portion of these costs are assigned among the individual services to facilitate the funding of significant multiyear strategic investments that would otherwise result in short-term price fluctuations, subject to established minimum and maximum amounts.⁴ To a small extent in 1999, the Reserve Banks assigned these costs among priced services to accelerate the retirement of debt associated with the automation consolidation special project. In 2000, the assignment of corporate overhead costs to individual priced services supported the Reserve Banks' strategic check modernization

⁴ Under the new Reserve Bank cost accounting method, corporate overhead costs for 2001 include all of the following activities: corporate administration functions, budget preparation and control, expense accounting, and general ledger accounting. Corporate overhead costs for 1999 and 2000 also included all or a portion of central mail operations, legal, records management and contingency planning, motor vehicles, and audit, which have now become support costs.

project. In 2001, the overhead costs will be assigned along the traditional expense-ratio basis. Table 3 shows the assignment of corporate overhead costs for the years 1999-2001.

Table 3

Corporate Overhead Allocations to Priced Services							
(\$ millions)							
YEAR	CHECK	ACH	FUNDS TRANSFER	BOOK- ENTRY	NONCASH COLLECTION	SPECIAL CASH	TOTAL
1999 Actual	38.8	3.7	6.0	0.0	0.1	0.2	48.8
2000 (Estimate)	55.6	2.4	3.1	0.8	0.1	0.1	62.1
2001 (Budget)	45.1	4.2	2.9	1.1	0.1	0.1	53.5

3. 2001 Projected Performance — The Reserve Banks project that they will recover 98.0 percent of total expenses related to priced services, including imputed expenses and target ROE, in 2001. The 2001 fees for priced services will result in a net income of \$89.1 million, compared with a target ROE of \$109.3 million. The check service will recover fully the approximately \$15.1 million of 2001 priced services costs associated with the check modernization special project.

4. 2000 Estimated Performance — The Reserve Banks estimate that priced services will yield a net income of \$101.7 million in 2000, compared with a target ROE of \$98.4 million. In 2000, the Reserve Banks estimate that they will recover 100.4 percent of the costs of providing priced services, including imputed expenses, all check modernization special project costs, and target ROE, compared with a target recovery rate of 99.0 percent.⁵

5. 1999 Performance — In 1999, the Reserve Banks' priced services revenue yielded a net income of \$80.6 million, compared with a targeted ROE of \$56.0 million. The Reserve Banks recovered 102.9 percent of total expenses, including imputed expenses, automation consolidation special project costs budgeted for recovery, and targeted ROE, compared with a targeted recovery rate of 101.0 percent. The Reserve Banks recovered a larger-than-expected percentage of costs because of higher volumes, midyear increases in check prices, and increased pension credits.

In 1999, the Reserve Banks completed their recovery of transition costs associated with the automation consolidation project (special project costs) and associated financing costs. In addition to facilitating fee reductions in electronic payment services, the consolidation initiative has dramatically improved the Reserve Banks' disaster recovery and information security capabilities, increased the System's responsiveness to change, and enhanced the central bank's management of payment system risk.

⁵ Through August 2000, the Reserve Banks recovered 101.5 percent of total priced services expenses, including imputed expenses, check modernization special project costs, and target ROE.

C. Check -- Table 4 presents the actual 1999, estimated 2000, and projected 2001 cost-recovery performance for the check service.

Table 4

Check Pro Forma Cost and Revenue Performance					
(\$ millions)					
YEAR	1 REVENUE	2 TOTAL EXPENSE	3 NET INCOME (ROE) [1-2]	4 TARGET ROE	5 RECOVERY RATE AFTER TARGET ROE [1/(2+4)]
1999	707.3	649.8	57.5	45.1	101.8%
2000 (Estimate)	762.2	678.9	83.3	80.8	100.3%
2001 (Budget)	816.1	745.2	70.9	90.3	97.7%

1. 1999 Performance — The check service recovered 101.8 percent of total costs in 1999, including imputed expenses and targeted ROE. Higher-than-anticipated volume growth at most Reserve Banks and midyear price increases helped actual cost recovery to exceed the targeted rate of 101.0 percent. The volume of checks collected increased 3.0 percent from 1998 levels because of several factors, including the increased reliance on Reserve Bank check processing by some banks during merger-related operational changes and the introduction of new check products.

2. 2000 Performance — Through August 2000, the check service has recovered 101.0 percent of total costs, including imputed expenses and target ROE.⁶ The Reserve Banks estimate that the check service will recover 100.3 percent of its costs for the full year compared with the target 2000 recovery rate of 98.7 percent. The higher recovery rate is due to improved cost controls implemented by Reserve Banks, midyear price increases at a number of Reserve Banks, and increased pension credits.

Volume growth within paper check products through August 2000 has varied from the original budget projections. Growth of the volume of forward-processed items slowed substantially from the 1999 pace as some merger and acquisition volumes that were outsourced to the Reserve Banks reverted back to the merged institutions' processing platforms. Return-item volume has been higher than anticipated Systemwide as several correspondents have stopped providing return-check services. Table 5 summarizes the year-to-date and full-year estimated growth rates for all paper check products.

⁶Total costs include special project costs of \$15.1 million. None of those costs are deferred and financed.

Table 5

Paper Check Product Growth Rates			
(percent)			
	BUDGETED 2000	VOLUME GROWTH THROUGH	ESTIMATED 2000
	GROWTH	AUGUST 2000	GROWTH
Total forward-collected	4.5	0.7	1.9
Forward-processed	4.7	2.4	3.0
Fine-sort (a)	2.6	-10.2	-9.3
Returns	-2.3	1.3	-1.6

a. Electronic fine-sort volume is excluded from these numbers. Electronic fine-sort is a service that allows depository institutions to exchange fine-sort information electronically among themselves while also exchanging the actual checks. Including the electronic fine-sort product offered at one Reserve Bank, budgeted 2000 fine-sort volume growth is actually targeted to decrease 1.6 percent, with the estimated 2000 volume growth decreasing 14.2 percent.

The Board considers the Reserve Banks' 2000 volume estimates for forward-processed items to be reasonable. The Board believes, based upon year-to-date trends, that return-volume growth may be understated.

Continuing a trend over the last few years, the Reserve Banks have seen steadily increasing demand for electronic check products. Reserve Banks provide electronic check data or images provided to paying bank for about 35 percent of checks they collect. Year-to-date 2000 demand for image products has grown to approximately 800 million items, or 7 percent of checks collected by the Reserve Banks in 2000. Growth and penetration rates for electronic check products are summarized in table 6. Given the current volume growth through August, the Board believes that Reserve Banks are underestimating demand for electronic check services.

Table 6

Electronic Check Product Penetration and Growth Rates			
(percent of checks collected)			
	PENETRATION RATE	YEAR-OVER-YEAR	
	THROUGH	GROWTH THROUGH	ESTIMATED
	AUGUST 2000	AUGUST 2000	2000 GROWTH
Electronic check presentment	20.6	10.2	5.6
Truncation	5.4	9.8	4.5
Non-truncation	15.2	10.4	6.0
Electronic check information	7.3	-7.4	-11.9
Images	6.9	46.2	34.8

3. 2001 Pricing — For the coming year, the Reserve Banks will focus on the check modernization initiatives to standardized check processing across all Reserve offices. The Board expects the Reserve Banks to incur significant transition costs associated with these initiatives over the next several years. These initiatives include

- Check standardization -- implement a standard, centrally managed, check-processing environment at all Reserve Banks
- Enterprise-wide adjustments -- implement a standard, centrally managed, enterprise-wide adjustments system at all offices
- Image services system -- redesign the current image-processing infrastructure based on a standard, centrally managed, single platform
- Electronic access and delivery -- design and execute a strategy to provide customers with remote electronic access and delivery of check services over the Internet.

The check modernization initiatives are expected to reduce costs and improve service over the long term. This effort will lead to better quality and more technologically advanced products and services for customers, greater flexibility and responsiveness to customer needs and requirements, and more consistent price and product structures across the Reserve Banks. Ultimately, the efficiencies gained through the modernization initiatives should lead to cost savings at the Reserve Banks.

In 2001, per-item and cash-letter fees for all check products are increasing 3.9 percent on a volume-weighted basis compared with fees introduced in April 2000 and 2.6 percent compared with current fees. Per-item and cash-letter fees for paper-based check products are increasing at about the same rate. This increase was driven by price adjustments for both forward and return products. On a volume-weighted basis, the average per-item and fixed fees for payor bank services will increase 3.7 percent compared with April 2000 fees and 2.9 percent compared with current fees.

Table 7 provides details on the 2000 price changes.

Table 7

2001 Price Changes		
(percent)		
PRODUCTS	2001 vs. APRIL 3, 2000 FEES	2001 vs. CURRENT 2000 FEES
All check products	3.9	2.6
Total paper products	3.9	2.6

Forward-processed	3.6	2.5
Fine-sort	7.0	5.1
Returns	3.7	2.9
Payor bank services	3.7	2.9
Electronic check presentment	0.4	0.1

Table 8 summarizes ranges of key check fees for 2001.

Table 8

Selected Check Fees				
Items:	2000 PRICE RANGES		2001 PRICE RANGES	
	(PER ITEM)		(PER ITEM)	
Forward-processed				
City		\$0.004 to 0.081		\$0.005 to 0.079
RCPC		\$0.004 to 0.180		\$0.004 to 0.200
Forward fine-sort				
City		\$0.004 to 0.015		\$0.005 to 0.020
RCPC		\$0.0025 to 0.018		\$0.004 to 0.019
Qualified returned checks				
City		\$0.17 to 1.11		\$0.17 to 1.10
RCPC		\$0.21 to 1.75		\$0.21 to 1.50
Raw returned checks				
City		\$1.00 to 5.50		\$1.00 to 5.50
RCPC		\$1.00 to 5.50		\$1.00 to 5.55
Cash letters:		(PER CASH LETTER)		(PER CASH LETTER)
Forward-processed (a)		\$1.75 to 9.25		\$2.00 to 13.50
Forward fine-sort		\$3.00 to 14.00		\$3.00 to 14.00
Returned checks: raw/qualified		\$1.75 to 14.00		\$1.75 to 14.00
Payor bank services:		(MIN.) (PER ITEM)	(FIXED)	(PER ITEM)
MICR information	\$5-\$30	\$0.001-0.0060	\$2-\$15	\$0.0012-0.0060
Electronic presentment	\$3-\$14	\$0.001-0.0045	\$2-\$11	\$0.0010-0.0100
Truncation	\$3-\$25	\$0.004-0.0170	\$2-\$10	\$0.0060-0.0180
Image			\$2-\$15	\$0.0020-0.0200

a. Includes a fifty-cent check-relay surcharge due to higher fuel costs. Both bounds of the price range would decrease \$0.50 if this surcharge were not included.

The Reserve Banks will adopt several pricing strategies that are designed to increase the efficiency of Reserve Bank operations, improve the quality of return-check deposits, and reduce the risk associated with the check payments system. In turn, these improvements will decrease the costs associated with processing payments, and the savings will ultimately be passed along to customers in the form of lower transaction fees. Specifically, the Reserve Banks will price for certain categories of return-item exceptions

that can be identified in Reserve Bank processing operations. The Reserve Banks also will charge for processing commercial checks with a value of \$10 million or more to depositing customers. It is expected that this charge will encourage customers to use electronic payment systems, such as funds transfer and ACH, for large-dollar payments. These prices will be introduced during the second quarter of 2001.

For 2001, the Reserve Banks project that the check service will recover 97.7 percent of total costs, including imputed expenses, costs associated with the check automation standardization special project, and target ROE. Total expenses are projected to increase approximately \$66.3 million, or 9.9 percent, from estimated 2000 expenses. Total expenses for 2001 include approximately \$67.6 million for the four check modernization projects and a special project for related extraordinary expenses, a total increase of \$44 million from the 2000 estimate.

The check service is projected to have revenue in 2001 of \$816.1 million from forward collection and return-item processing (81.4 percent), payor bank services (10.8 percent), and other operating and imputed revenues (7.8 percent). Total revenue is expected to increase approximately \$53.9 million, or 7.1 percent, in 2001 as a result of increased service revenue (\$53.4 million).

In 2001, forward-processed volume is projected to be 15.5 billion, an increase of 1.6 percent compared with the 2000 estimate. Fine-sort volumes, without electronic fine-sort, are estimated to be 1.3 billion, or 5.2 percent, less than the 2000 estimate. Fine-sort volumes including electronic fine-sort are estimated to be 2.0 billion, or 3.5 percent, less than the 2000 estimate. Total returns are projected to be 175.8 million, an increase of 0.5 percent from the 2000 estimate.

MICR presentment and MICR presentment plus volume are projected to be 2.9 billion, reflecting growth of about 17 percent in 2001. Truncation volume is expected to be 987.0 million, an increase of almost 10 percent, and image services volume is budgeted to be 1.5 billion, reflecting growth of nearly 27 percent in 2001. MICR information is projected to decrease by 1.0 billion items or about 13 percent in 2001.

The Board believes that the costs of check modernization initiatives present the greatest risk to the cost projections for the check service. In particular, staffing costs may be greater than anticipated given the competitive labor markets that exist nationwide. Further, operational costs, productivity, and service quality are at risk if there are slippages in the transition schedules or unanticipated increases in the costs for the modernization initiatives.

D. Automated Clearinghouse (ACH) -- Table 9 presents the actual 1999, estimated 2000, and projected 2001 cost-recovery performance for the commercial ACH service.

Table 9

ACH Pro Forma Cost and Revenue Performance					
(\$ millions)					
YEAR	1 REVENUE	2 TOTAL EXPENSE	3 NET INCOME (ROE) [1-2]	4 TARGET ROE	5 RECOVERY RATE AFTER TARGET ROE [1/(2+4)]
1999	67.8	55.9	11.9	4.5	112.3%
2000 (Estimate)	70.5	61.4	9.1	8.0	101.6%
2001 (Budget)	75.5	66.4	9.1	8.9	100.2%

1. 1999 Performance — The ACH service recovered 112.3 percent of total expenses, including imputed expenses and targeted ROE, in 1999. Commercial ACH volume was 12.5 percent higher than 1998 volume, slightly greater than the 12.0 percent increase originally projected for 1999. During the year, ACH lowered all origination fees by \$0.0005.

2. 2000 Performance — Through August 2000, the ACH service recovered 103.4 percent of total expenses, including imputed expenses and target ROE. For the full year, Reserve Banks estimate that the service will recover 101.6 percent of total expenses compared with the target 2000 recovery rate of 100.0 percent. The estimated over-recovery is due to lower total expenses of 1.4 percent, which is being caused by a reduction in national support costs. The increase in total expenses since 1999 is mainly attributable to ACH's assuming a larger allocation of joint priced corporate overhead to support the check modernization initiatives.

Through August 2000, commercial ACH volume has increased 13.5 percent from the same period in 1999. For the full year, Reserve Banks expect commercial volume to increase 11.6 percent compared with the 13.9 percent increase originally projected for 2000. The Reserve Banks cite consolidation in the financial services industry as a partial driver for the lower-than-expected volumes and anticipate further volume reductions as competitive pressures increase. The Board questions whether the significantly slower growth rate that is expected through year-end reasonably reflects the effect of these competitive pressures. The Board believes that the expected growth rate may be understated.

3. 2001 Pricing — The Board recently approved modifications to the Reserve Banks' deposit deadlines and pricing practices for transactions they exchange with private-sector operators (PSOs). (65 FR 66249, November 3, 2000). The Reserve Banks are working collaboratively with ACH operators to establish interoperator deposit deadlines by which the Reserve Banks and the PSOs would exchange interoperator transactions. Further, the Reserve Banks are initiating discussions with the PSOs to

negotiate the structure and level of fees that will be charged by the Reserve Banks as well as those fees that the Reserve Banks will pay the PSOs. The new deadlines and price structure for PSOs are intended to address the competitive concerns that have been raised by industry representatives. The new deadlines will be implemented no later than June 2001 and the price structure modifications will be implemented no later than September 2001. The specific implementation date for each of these modifications will be announced well in advance of the effective dates. The Reserve Banks will also assess a monthly settlement fee of \$20 (per routing number), rather than the current monthly account-servicing fee, to depository institutions that send and receive all their transactions to and from the Reserve Banks through PSOs. The Reserve Banks no longer plan to assess origination or receipt fees directly to these depository institutions. Additionally, the Reserve Banks will charge ACH operators half the published electronic connection fee to reflect the use of the connection by both ACH operators and the Reserve Banks to send each other interoperator transactions. These changes will only apply to any intermediary that is defined as an operator under National Automated Clearing House Association (NACHA) rules. The Reserve Banks will retain the 2001 ACH prices at the current levels, except for the changes for interoperator transactions.

The Reserve Banks project that the ACH service will recover 100.2 percent of its costs in 2001, including imputed expenses and target ROE. Total expenses are projected to increase \$5.9 million, or 8.5 percent, from the 2000 estimate because of growth in support and overhead costs, particularly those related to business development. Total revenue in 2001 is projected to increase \$4.9 million, or 7.0 percent more than the 2000 estimate. The higher revenue is attributable to projected commercial volume growth and increased revenue from electronic connections, offset somewhat by lost revenue from the new pricing of interoperator transactions.

ACH volume in 2001 is projected to increase 12.1 percent from 2000 estimates. The 2001 volume projection assumes a rate of growth between the 12.5 percent experienced in 1999 and expected growth in 2000, which is estimated at 11.6 percent. This growth rate, revenues, and cost recovery, however, do not account for several risks in 2001. The major risks include the uncertain effects of price-structure and service-level changes being implemented for interoperator transactions, the increased competitive pressures from PSOs, and future consolidations in the financial services industry. The Board believes that a 12.1 percent growth rate may be difficult to achieve because this rate may not fully reflect these risks.

E. Funds Transfer and Net Settlement -- Table 10 presents the actual 1999, estimated 2000, and projected 2001 cost-recovery performance for the funds transfer and net settlement services.

Table 10

Funds Transfer and Net Settlement Pro Forma Cost and Revenue Performance					
(\$ millions)					
YEAR	1 REVENUE	2 TOTAL EXPENSE	3 NET INCOME (ROE) [1-2]	4 TARGET ROE	5 RECOVERY RATE AFTER TARGET ROE [1/(2+4)]
1999	69.2	61.3	7.8	5.2	104.0%
2000 (Estimate)	65.1	57.6	7.5	7.5	100.0%
2001 (Budget)	63.1	55.6	7.5	7.5	100.1%

1. 1999 Performance — For 1999, the funds transfer and net settlement services recovered 104.0 percent of total costs, including imputed expenses and targeted ROE, compared with a targeted recovery rate of 102.0 percent. This over-recovery was primarily due to expenses \$3.2 million (4.5 percent) less than original budget projections; the decrease in expenses resulted from an 11.2 percent and a 3.2 percent decrease in direct and support costs, respectively. Service revenue for 1999 was approximately \$1.8 million (2.6 percent) less than original budget projections. A \$0.9 million (27.7 percent) decrease in net income on clearing balances accounted for almost half of the deficit. In addition, electronic connection revenue was \$0.6 million (6.2 percent) lower than anticipated due to fewer than anticipated customers signing on to services related to electronic access. The rest of the revenue shortfall was due to lower-than-anticipated volume in the highest-priced (low-volume) tier. Funds transfer volume increased 4.7 percent from the 1998 level, compared with a budgeted 5.8 percent growth.

2. 2000 Performance — Through August 2000, the funds transfer and net settlement services recovered 103.9 percent of total costs, including imputed expenses and target ROE. For full-year 2000, the Reserve Banks estimate that the funds transfer and net settlement services will recover 100.0 percent of total expenses, compared with a target recovery rate of 100.4 percent. The Board believes the Reserve Banks' estimated 2000 cost recovery is too low given year-to-date experience.

Funds transfer volume through August 2000 has increased 6.5 percent relative to the same period in 1999. For the full year, the Reserve Banks estimate a 5.7 percent volume increase compared with a budgeted increase of 6.0 percent.

3. 2001 Funds Transfer Pricing — The Reserve Banks will retain the current per-transfer fees and thresholds for volume-based discounts. The average (volume-weighted) per-transfer price would be \$0.223. In addition, the Reserve Banks will retain the off-line surcharge at its current level.

Reserve Banks project that the Fedwire funds transfer service will recover 100.1 percent of total costs, including imputed expenses and target ROE, in 2001. Total costs are expected to decline \$2.0 million (3.1 percent) from the 2000 estimate, primarily

due to reduced operating costs of \$1.4 million (2.4 percent) and a decrease in PSAF costs of \$0.5 million (3.6 percent). The reduction in operating costs is mainly due to staff reductions.

Funds transfer volume is expected to decrease 1.2 percent from 2000 estimated levels, due primarily to potential shifts in volume to CHIPS. In first quarter 2001, CHIPS will introduce a new intraday finality service that will provide more risk controls and thus reduce the impediments to the use of CHIPS for some payments that are currently processed via Fedwire. The Reserve Banks anticipate a 3.0 percent decline in funds transfer volume from high-volume customers that are also CHIPS participants, partially offset by increases in volume from middle-tier customers. Revenue is projected to decline \$2.0 million (3.1 percent) in 2001 compared with the 2000 estimate because of slightly lower 2001 volume and the full-year effects of the April 2000 on-line fee reductions.

4. 2001 Net Settlement Pricing — The Reserve Banks will retain the local and enhanced net settlement fees at the 2000 price levels. The enhanced net settlement service will be fully implemented during 2001 as local settlement services are phased out by year-end.

F. Book-Entry Securities -- Book-entry securities includes purchase and sale activity. Table 11 presents the actual 1999, estimated 2000, and projected 2001 cost-recovery performance for the book-entry securities service.⁷

Table 11

Book-Entry Securities Transfer Pro Forma Cost and Revenue Performance					
(\$ millions)					
YEAR	1 REVENUE	2 TOTAL EXPENSE	3 NET INCOME (ROE) [1-2]	4 TARGET ROE	5 RECOVERY RATE AFTER TARGET ROE [1/(2+4)]
1999	17.3	15.1	2.2	1.0	107.4%
2000 (Estimate)	18.0	15.7	2.3	1.9	102.4%
2001 (Budget)	19.9	18.6	1.3	2.3	94.9%

⁷ The Reserve Banks provide securities transfer services for securities issued by the U.S. Treasury Department, federal government agencies, government-sponsored enterprises, and certain international institutions. The priced component of this service, reflected in this memorandum, consists of revenues, expenses, and volumes associated with the transfer of all non-Treasury securities. For Treasury securities, the Treasury Department assesses fees for the securities transfer component of the service. The Reserve Banks assess a fee for the money settlement component of a Treasury securities transfer; this component is not treated as a priced service.

1. 1999 Performance — The book-entry securities service recovered 107.4 percent of total costs in 1999, including imputed expenses, automation consolidation special project costs budgeted for recovery, and targeted ROE, compared with a targeted recovery rate of 105.2 percent.⁸ Service revenue for 1999 was approximately \$650,000 (3.9 percent) greater than original budget projections. Origination volume increased 0.6 percent from the 1998 level, compared with an expected decrease of 5.7 percent. The increase in volume resulted from a general increase in mortgage-debt refinancing and a higher-than-expected issuance of mortgage-backed securities.

2. 2000 Performance — Through August 2000, the book-entry securities service recovered 106.4 percent of total costs, including imputed expenses and target ROE. For full-year 2000, the Reserve Banks estimate that the book-entry securities service will recover 102.4 percent of total costs, compared with a target recovery rate of 101.3 percent. This higher-than-budgeted recovery rate reflects revenue that is 6.1 percent greater than budget. The increase in revenue is due to higher-than-expected volumes.

Book-entry securities transfer volume has increased 7.5 percent from February 2000 to August 2000 compared with the same period in 1999.⁹ The full-year growth rate for origination volume is expected to be 4.8 percent more than actual 1999 volumes, compared with the flat projections originally forecast at the beginning of the year. Like the increase in 1999, this volume increase is due to an increase in mortgage-debt refinancing and greater use of agency securities as a hedge against other investment risks.

3. 2001 Pricing — Except as noted below, the Reserve Banks will retain all fees in 2001 at their current levels. There will be a \$7 increase to the off-line surcharge to originate and receive a transfer, to \$25, to better reflect the costs of providing off-line transfers for book-entry securities.

The purchase and sale service represents less than 1 percent of the costs and revenues of the book-entry securities service line. Provision of this service, which facilitates the purchase and sale of Treasury and government agency securities by depository institutions on the secondary market, is consolidated at the Federal Reserve Bank of Chicago. The Reserve Banks will maintain the \$40 transaction fee for securities purchases and sales.

⁸ In 1999, the book-entry service recovered the last \$1.7 million remaining from the Reserve Banks' automation consolidation special project. All costs associated with this special project have now been fully recovered.

⁹ Before February 1999, the Federal Reserve did not charge customers for book-entry receipts. Therefore, the volume data before February 1999 includes only originations whereas the data after February 1999 includes both originations and receipts. A comparison of volumes using January 1999 data would skew the results.

The Reserve Banks project that the book-entry securities service will recover 94.9 percent of costs in 2001, including imputed expenses and target ROE. Excluding target ROE, expenses are projected to increase \$2.9 million (18.3 percent) from the 2000 estimate. This is primarily due to the implementation of the new book-entry cost allocation model that will shift more costs to the priced portion of the service.

Book-entry securities transfer volume is projected to increase 8.9 percent compared with the 2000 estimate. The 18.3 percent increase in total book-entry expenses is expected to be partially offset by a \$1.8 million (10.2 percent) increase in revenue from the projected start of the conversion of Government National Mortgage Association (Ginnie Mae) securities to the National Book-Entry System (NBES) during the fourth quarter of 2001. Full recovery under the new cost-allocation approach is expected in 2002 when the conversion of Ginnie Mae to NBES has been completed.

G. Noncash Collection -- Table 12 lists the actual 1999, estimated 2000, and projected 2001 cost-recovery performance for the noncash collection service.

Table 12

Noncash Collection Pro Forma Cost and Revenue Performance					
(\$ millions)					
YEAR	1 REVENUE	2 TOTAL EXPENSE	3 NET INCOME (ROE) [1-2]	4 TARGET ROE	5 RECOVERY RATE AFTER TARGET ROE [1/(2+4)]
1999	3.0	2.0	1.0	0.1	140.3%
2000 (Estimate)	2.4	2.0	0.4	0.2	110.8%
2001 (Budget)	2.0	1.7	0.2	0.2	102.2%

1. 1999 Performance — The noncash collection service recovered 140.3 percent of total expenses in 1999 (including imputed expenses and targeted ROE) compared with a targeted recovery rate of 118.6 percent. Volume for 1999 decreased 18.8 percent from 1998 levels compared with a 26.6 percent budgeted volume decline. The

volume decline was less than budgeted levels because of both unexpected called-bond activity and higher-than-expected coupon volume.

2. 2000 Performance — Through August 2000, the noncash collection service recovered 119.3 percent of its costs. For full-year 2000, the Reserve Banks estimate that the noncash collection service will recover 110.8 percent of costs, including imputed expenses and target ROE, compared with the target recovery rate of 108.5 percent. Through August, volume declined 15 percent compared with the same period in 1999, while the overall industry experienced a volume decline of 18 to 20 percent for the same period. The Reserve Banks estimate that full-year 2000 volume will decline 17.1 percent from 1999 levels compared with a 31.5 percent budgeted decline. Volume decline is expected to be lower than budgeted in part because the service received unexpected volume from existing and new customers as well as higher-than-budgeted bond collections from called and maturing securities. The estimated volume decline for the year is slightly greater than the actual decline for the first eight months of the year because of the recent withdrawal of volume by the System's largest depositor of noncash items.

3. 2001 Pricing — The Reserve Banks will increase one fee relative to 2000 fee levels. Specifically, the Reserve Banks will increase the return-item fee from \$15 to \$20 for items that are returned to the depositor as uncollected. The Reserve Banks project that the noncash collection service will recover 102.2 percent of total costs, including imputed expenses and target ROE, in 2001.

Total expenses are projected to decline approximately \$0.2 million, or 10.8 percent, in 2001. Despite the higher return-item fee, the Reserve Banks project that revenue will decline approximately \$0.4 million, or 17.7 percent, in 2001, because of a projected volume decline of 20.9 percent. The projection is based on the recent loss of the Reserve Banks' largest depositor, which has begun to process its own volume, and the overall industry volume decline.

New issues of bearer municipal securities effectively ceased in 1983 when the Tax Equity and Fiscal Responsibility Act of 1982 removed the tax advantage for investors. Volume declines will continue as the number of unmatured bearer municipal securities declines. The Reserve Banks' Cash Fiscal Product Office estimates that in a few years, the steadily declining number of bearer securities will make full cost recovery in this service unlikely. The Board is working with the Reserve Banks to determine the long-term strategy for this service.

H. Special Cash -- Priced special cash services represent a very small portion (less than one percent) of overall cash services provided by the Reserve Banks to depository institutions. Special cash services include the provision of wrapped coin, packaging of nonstandard currency orders and deposits as well as coin deposits, and shipping of currency and coin by registered mail. Table 13 presents the actual 1999, estimated 2000, and projected 2001 cost-recovery performance for the special cash service.

Table 13

Special Cash Pro Forma Cost and Revenue Performance					
(\$ millions)					
YEAR	1 REVENUE	2 TOTAL EXPENSE	3 NET INCOME (ROE) (1-2)	4 TARGET ROE	5 RECOVERY RATE AFTER TARGET ROE [1/(2+4)]
1999	3.0	2.9	0.2	0.0	103.8
2000 (Estimate)	2.2	2.1	0.2	0.1	103.4
2001(Budget)	1.8	1.7	0.1	0.1	100.6

1. 1999 Performance — In 1999, the special cash service recovered 103.8 percent of total expenses, including imputed expenses and targeted ROE, compared with a targeted recovery rate of 105.8 percent.

2. 2000 Performance — Through August 2000, the special cash service recovered 99.3 percent of total expenses, including imputed expenses and target ROE. For full-year 2000 the Reserve Banks estimate, however, that the special cash service will recover 103.4 percent of total expenses, compared with a target recovery rate of 101.6 percent. Revenue is estimated to decrease approximately \$0.8 million, or 26.1 percent, and total costs in 2000 are estimated to decrease slightly more than \$0.8 million, or 28.9 percent, compared with 1999 costs. The estimated revenue and cost decreases are due mainly to the elimination of the wrapped-coin business in Cleveland and of the registered mail business in the Dallas and San Francisco Districts.

3. 2001 Pricing — For 2001, the Reserve Banks project that the special cash service will recover 100.6 percent of costs, including imputed expenses and target ROE. Total costs in 2001 are projected to decline \$0.3 million, or 15.4 percent, from the 2000 level. Revenue in 2001 is expected to decline \$0.4 million, or 18.3 percent.

The anticipated revenue and cost reductions are due primarily to the full-year effects of the Fourth District's decision to exit the coin-wrapping business in April 2000 and the Eleventh and Twelfth Districts' decisions to exit the registered mail business in late August 2000.

Beginning in 2001, the El Paso office will increase the fee for Express Cash Orders from \$60.00 to \$80.00. Boston will increase the surcharge for registered mail from \$30 to \$45 and decrease the insurance fee from \$0.80 to \$0.50 per \$1,000 in excess of the first \$25,000. The Tenth District will increase the surcharge for registered mail from \$13 to \$16 and the insurance fee from \$0.27 to \$0.32.

II. PRIVATE-SECTOR ADJUSTMENT FACTOR

A. Background -- Each year, as required by the Monetary Control Act, the Reserve Banks set fees for “priced services” to depository institutions. These fees are set to recover all direct and indirect costs and imputed costs, such as financing costs, return on capital, taxes, and certain other expenses that would have been paid had the services been provided by a private business firm. These imputed costs are based on data developed in part from a model comprising consolidated financial data for the nation's fifty largest (asset size) bank holding companies (BHCs). The imputed costs and imputed profit are collectively referred to as the private-sector adjustment factor (PSAF).

1. Cost of Capital — The method for calculating the PSAF involves determining the value of Federal Reserve assets that will be used in providing priced services during the coming year, the financing mix used to fund them, and the rates paid for this financing. Assets are determined using Reserve Bank information on actual assets and projected disposals and acquisitions. The priced portion of mixed-use assets is determined based on the allocation of the related depreciation expense. Short-term assets are assumed to be financed with short-term liabilities and long-term assets are assumed to be financed with a combination of long-term debt and equity.

The long-term debt and equity rates are based on the average of these elements for BHCs in the model for each of the last five years. Because short-term debt, by definition, matures within one year, only data for the most recent year are used for computing the short-term debt rate.

2. Income Taxes — For simplicity, given that federal corporate tax rates are graduated, various credits and deductions can apply and state taxes vary, a specific tax rate is not calculated for Federal Reserve priced services. Instead, imputed taxes are captured by using a pretax return on equity (ROE). This result influences the dollar level of the PSAF and Federal Reserve price levels because this is the return a shareholder would expect in order to invest in a private business firm. The use of the pretax return on equity assumes a 100 percent recovery of expenses, including the target return on equity, will be achieved. The PSAF is, therefore, based on a precise matching of revenues and actual and imputed costs. Should the pretax earnings be over or under the target ROE, the PSAF is adjusted (“variable PSAF”) for the tax expense or savings associated with the adjusted recovery. The tax rate is the median of the rates paid by the BHCs over the past five years adjusted to the extent that BHCs are invested in municipal bonds.

3. Other — The PSAF also comprises the estimated expenses of the Board of Governors related to priced services. An assessment for FDIC insurance is imputed based on current FDIC rates and projected clearing balances held with the Federal

Reserve.

B. Discussion -- The increase in the 2001 PSAF is due to higher priced service asset levels, primarily the net pension asset. Partially offsetting the increase in asset levels is the inclusion of short-term payables as a source for financing short-term assets.

1. Asset Base — The total estimated value of Federal Reserve assets to be used in providing priced services in 2001 is reflected in Table 14. Table 15 shows that the assets assumed to be financed through debt and equity are projected to total \$1,162.4 million. This amount represents an increase of \$45.9 million, or 4.1 percent, from the assets financed in 2000. Growth of \$105.1 million in the net pension asset accounts for the majority of the increase, while higher Reserve Bank building and equipment assets account for an additional \$20.9 million.

Partially offsetting the increase in asset levels is a reduction of \$80.1 million resulting from the inclusion of short-term payables as a financing source. Only those short-term assets that cannot be financed with actual (rather than imputed) short-term liabilities, such as sundry items payable, earnings credits due depository institutions, and accrued expenses, are financed with short-term debt. This is a change for 2001, recognizing that these non-imputed liabilities could be used to finance assets, which resulted in a \$4.0 million decrease in PSAF.

2. Cost of Capital and Taxes — Table 15 also shows the financing and tax rates and the other required PSAF recoveries for 2001 and the rates used for developing the PSAF for 2000. The pretax ROE rate increased from 23.3 percent for 2000 to 24.0 percent for 2001. The effective tax rate to be used in 2001 remains unchanged from the 2000 rate at 31.5 percent.

3. Capital Adequacy and FDIC Assessment — As shown in table 16, the amount of capital imputed for the 2001 PSAF totals 30.8 percent of risk-weighted assets and 5.3 percent of total assets. The capital to risk-weighted asset ratio and the capital to total assets ratio both exceed regulatory guidelines for well-capitalized institutions and BHCs. As a result of these capital ratios, the FDIC assessment decreased from \$2.9 million for 2000 to zero for 2001.

III. ANALYSIS OF COMPETITIVE EFFECT

All operational and legal changes considered by the Board that have a substantial effect on payment system participants are subject to the competitive impact analysis described in the March 1990 policy statement “The Federal Reserve in the

Payments System.”¹⁰ Under this policy, the Board assesses whether the change would have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve in providing similar services because of differing legal powers or constraints or because of a dominant market position of the Federal Reserve deriving from such legal differences. If the fees or fee structures create such an effect, the Board must further evaluate the changes to assess whether their benefits — such as contributions to payment system efficiency, payment system integrity, or other Board objectives — can be retained while reducing the hindrances to competition.

The Board does not believe that these fees and fee structures will have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve in providing similar services. Assuming the Reserve Banks’ volume and cost projections are accurate, these fees are set to provide the Federal Reserve a return on equity similar to that earned by large BHCs and provide for full cost recovery over the long run.

¹⁰ FRRS 7-145.2.

Table 14
Comparison of Pro Forma Balance Sheets
For Federal Reserve Priced Services
(millions of dollars – average for year)

	2001	2000
Short-term assets		
Imputed reserve requirement		
on clearing balances	\$742.4	\$762.2
Investment in marketable securities	6,681.9	6,859.5
Receivables ¹¹	77.3	74.2
Materials and supplies ¹¹	3.6	3.4
Prepaid expenses ¹¹	23.4	21.4
Items in process of collection	3,606.7	3,804.2
Total short-term assets	11,135.3	11,524.9
 Long-term assets		
Premises ^{11,12}	417.5	411.7
Furniture and equipment ¹¹	185.5	180.1
Leasehold improvements and long-term prepayments ¹¹	73.9	64.2
Prepaid pension costs ¹¹	718.5	599.8
Total long-term assets	1,395.4	1,255.8
 Total Assets	 \$12,530.7	 \$12,780.7

Short-term liabilities

¹¹ Financed through PSAF; other assets are self-financing.

¹² Includes allocations of Board of Governors' assets to priced services of \$0.7 million for 2001 and \$0.5 million for 2000.

Clearing balances and balances		
arising from early credit of uncollected items	\$7,424.3	\$7,621.7
Deferred credit items	3,606.7	3,804.2
Short-term debt ¹³	18.9	99.0
Short-term payables ¹⁴	<u>85.4</u>	<u>0.0</u>
Total short-term liabilities	11,135.3	11,524.9
Long-term liabilities		
Postemployment/retirement benefits ¹¹	251.9	238.3
Long-term debt ¹³	<u>479.1</u>	<u>400.9</u>
Total long-term liabilities	731.0	639.2
Total liabilities	11,866.3	12,164.1
Equity¹³	<u>664.4</u>	<u>616.6</u>
Total liabilities and equity	<u>\$12,530.7</u>	<u>\$12,780.7</u>

NOTE: Details may not add to totals due to rounding.

¹³ Imputed figures represent the source of financing for certain priced services assets.

¹⁴ For the 2001 PSAF, short-term payables attributable to priced services are included as a financing source for short-term assets such as receivables, materials and supplies, and prepaid expenses.

Table 15
Derivation of the 2001 and 2000 PSAF
(millions of dollars)

	<u>2001</u>	<u>2000</u>
A. Assets to be financed ¹⁵		
Short-term ¹⁶	\$18.9	\$99.0
Long-term ¹⁷	<u>1,143.5</u>	<u>1,017.5</u>
	\$1,162.4	
		\$1,116.5
B. Weighted average costs		
1. Capital Structure ¹⁸		
Short-term debt	1.6%	8.9%
Long-term debt	41.2%	35.9%
Equity	57.2%	55.2%
2. Financing rates/costs ¹⁸		
Short-term debt	4.7%	5.1%
Long-term debt	6.5%	6.6%
Pretax equity	24.0%	23.3%
3. Elements of capital costs		
Short-term debt	\$ 18.9 x 4.7% = \$ 0.9	\$ 99.0 x 5.1% = \$ 5.0
Long-term debt	479.1 x 6.5% = 31.1	400.9 x 6.6% = 26.5
Equity ¹⁹	664.4 x 14.0% = <u>159.5</u>	616.6 x 23.3% = <u>143.7</u>
	<u>\$191.5</u>	<u>\$175.2</u>

¹⁵ Priced service assets are based on the direct determination of assets method.

¹⁶ For 2001, short-term assets consist only of those short-term assets that are not financed with short-term payables.

¹⁷ Consists of total priced long-term assets less postretirement/postemployment benefit liabilities.

¹⁸ For 2001, net short-term assets are assumed to be financed with short-term debt, for 2000 all short-term assets are assumed to be financed with short-term debt. Of the total long-term assets for 2001, 41.9% are assumed to be financed with long-term debt and 58.1% with equity.

¹⁹ The pre-tax rate of return on equity is based on the average after-tax rate of return on equity, adjusted by the effective tax rate to yield the pre-tax rate of return on equity for each bank holding company for each year. These data are then averaged over five years to yield the pre-tax return on equity for use in the PSAF.

C. Other required PSAF recoveries

Sales taxes	\$ 10.5	\$10.4
Federal Deposit Insurance assessment	0.0	2.9
Board of Governors expenses	<u>4.9</u>	<u>4.2</u>
	<u>15.4</u>	<u>17.5</u>
D. Total PSAF recoveries	<u>\$206.9</u>	<u>\$192.6</u>
As a percent of assets	17.8%	17.3%
As a percent of expenses ²⁰	24.5%	28.5%
E. Tax Rate	31.5%	31.5%

NOTE: Details may not sum to totals due to rounding.

²⁰ System 2001 budgeted priced service expenses less shipping are \$842.8 million.

Table 16
 Computation of 2001 Capital Adequacy
 For Federal Reserve Priced Services
 (millions of dollars)

	<u>Assets</u>	<u>Risk Weight</u> <u>Assets</u>	<u>Weighted</u>
Imputed reserve requirement			
On clearing balances	\$742.4	0.0	\$0.0
Investment in marketable			
Securities	6,681.9	0.0	0.0
Receivables	77.3	0.2	15.5
Materials and supplies	3.6	1.0	3.6
Prepaid expenses	23.4	1.0	23.4
Items in process of collection	3,606.7	0.2	721.3
Premises	417.5	1.0	417.5
Furniture and equipment	185.5	1.0	185.5
Leases, leasehold improvements & long-term prepayments	73.9	1.0	73.9
Prepaid pension costs	<u>718.5</u>	1.0	<u>718.5</u>
 Total	 \$12,530.7		 \$2,159.2
 Imputed equity for 2001	 \$664.4		
Capital to risk-weighted assets	30.8%		
Capital to total assets	5.3%		

NOTE: Details may not sum to totals due to rounding.

Automated Clearing House Fee Schedule²¹

	<u>Fees</u>
Origination (per item or record)²²:	
Items in small files	\$0.0055
Items in large files	\$0.0045
Addenda record	\$0.0020
Receipt (per item or record):	
Item	\$0.007
Addenda record	\$0.002
Input file processing fees (per file):	
Small file	\$1.75
Large file	\$6.75
Monthly fees:	
Account servicing fee (per routing number)	\$25.00
Information extract file	\$10.00
Return item/notification of change (NOC) fees²³:	
Voice response return/NOC ²⁴	\$2.00
Nonelectronic input/output fees²⁵:	
Tape input/output	\$25.00
Paper output	\$15.00
Diskette output	\$15.00
Facsimile return/NOC ²⁶	\$15.00
Cross-border fees	
Cross-border item	\$0.037
Same-day recall of item at receiving gateway operator	\$3.50
Same-day recall of item not at receiving gateway operator	\$5.00
Item trace	\$5.00
Microfiche	\$3.00
Delivery by courier ²⁷	\$10.00

²¹ This fee schedule does not reflect the price changes for interoperator transactions.

²² Small files contain fewer than 2,500 items and large files contain 2,500 or more items.

²³ The Reserve Banks also assess a \$15 fee for every government paper return/NOC they process. This service is not considered a priced service. The fee includes the transaction fee and conversion fee.

²⁴ The fee includes the transaction fee in addition to the voice-response fee.

²⁵ These services are offered in contingency situations only.

²⁶ The fee includes the transaction fee in addition to the conversion fee.

Funds Transfer and Net Settlement Fee Schedule

Funds transfer:	<u>Fees</u>
Volume-based pricing fees (originations and receipts)	
Per transfer for the first 2,500 transfers per month	\$0.33
Per transfer for additional transfers up to 80,000 per month	\$0.24
Per transfer for every transfer over 80,000 per month	\$0.17
Surcharge	
Off-line transfer originated	\$15.00
Telephone notification	\$15.00
Net settlement:	
Basic fee (settlement sheet and enhanced NSS)	
Settlement charge per entry	\$0.95
Settlement file charge	\$12.00
Surcharge	
Off-line origination per file ²⁸ (settlement sheet)	\$15.00
Telephone notification per file (settlement sheet and enhanced NSS)	\$15.00
Minimum monthly fee	\$60.00
Fedwire-based, small-dollar arrangement per settlement day ²⁹	\$100.00
Fedwire-based, large-dollar arrangement per settlement day ²⁹	\$100.00 - \$175.00

²⁷ The courier charge is in addition to the fee charged by the Reserve Banks.

²⁸ The off-line origination surcharge will be waived by Reserve Banks that do not provide an electronic submission capability for the settlement sheet service.

²⁹ Participants in arrangements and settlement agents are also charged the applicable Fedwire funds transfer fee for each transfer into and out of the settlement account.

Book-Entry Securities Fee Schedule

Book-entry securities transfer:	<u>Fees</u>
Basic transfer fee	
Transfer originated	\$0.70
Transfer received	\$0.70
Reversal originated	\$0.70
Reversal received	\$0.70
Surcharge	
Off-line transfer originated or received	\$25.00
Off-line reversal originated or received	\$25.00
Monthly maintenance fees	
Account maintenance (per account)	\$15.00
Issues maintained (per issue/per account)	\$0.45
Purchase & sale:	
Transaction fee	\$40.00

Noncash Collection Fee Schedule

Coupon collection:	<u>Fees</u>
Cash letters	
with five or fewer coupon envelopes	\$7.50
with six to fifty coupon envelopes	\$15.00
Coupon envelopes	
with five or fewer coupon envelopes	\$4.75
with six to fifty coupon envelopes	\$2.50
Return items	\$20.00
 Bond collection (per bond):	 \$40.00 ³⁰

³⁰ Plus actual shipping costs.

Special Cash Services Fee Schedule

	<u>Fee</u>	
Wrapped coin (per box ³¹)		
All Fourth District offices.....		Discontinued April 2000
Helena	\$2.25	
Nonstandard packaging		
Seventh District offices		
(per currency order or deposit)	\$12.00 ³²	
Helena (per coin bag deposited).....	\$2.00	
El Paso (express cash orders)	\$80.00³³	
Registered mail fees ³⁴		
	<u>Surcharge</u>	<u>Insurance fee</u> ³⁵
First District	\$45.00	\$0.50
Helena ³⁶	\$14.00	
Tenth District offices	\$16.00	\$0.32
El Paso.....	Discontinued August 2000	
Twelfth District offices.....	Discontinued August 2000	

³¹ There are 50 rolls of coin in each box.

³² This service only applies to the \$1 through \$20 denominations.

³³ El Paso's Express Cash Order fee applies only to orders that need to be prepared on the same day as notice is received from depository institutions.

³⁴ Depository institutions also pay any postage fees incurred for registered mail. Postage fees are billed separately from Federal Reserve Bank surcharges and insurance fees.

³⁵ Insurance fees are based on every \$1,000 shipped via the registered mail service in excess of the first \$25,000, which is covered by the U.S. Postal Service.

³⁶ The Helena Office only ships registered mail packages valued up to \$25,000, so no additional insurance is needed in excess of the \$25,000 covered by the U.S. Postal Service.

Electronic Connection Fee Schedule³⁷

The Reserve Banks charge fees for the electronic connections used by depository institutions to access priced services and allocate cost and revenue associated with electronic access to the various priced services.

Current FEDNET network:

Dial – receive and send (FedLine®)	\$75.00 per month
Link encrypted dial	\$200.00 per month
High-speed dial @ 56 kbps	\$350.00 per month
Multi-drop leased line	\$500.00 per month
Dedicated leased line (to 9.6 kbps)	\$750.00 per month
High-speed leased line @ 19.2 kbps	\$850.00 per month
High-speed leased line @ 56 kbps	\$1,000.00 per month
High-speed leased line @ 128 kbps	\$1,800.00 per month
High-speed leased line @ 256 kbps	\$2,000.00 per month
Cross-District	Actual cost ³⁸

Frame Relay network:

Frame Relay-Fedline @ up to 19.2 kbps ³⁹	\$500.00 per month
Frame Relay-Computer Interface (CI) @ 56 kbps	\$1,000.00 per month
Frame Relay-CI @ 256 kbps	\$2,000.00 per month
Frame Relay-CI T1	\$2,500.00 per month

Test and Contingency Options⁴⁰:

³⁷ Installation, training, contingency hardware, and software certification are not considered priced services, and the fees for these services are not listed here. For a copy of the full electronic access fee schedule, contact the local Federal Reserve Bank.

³⁸ The customer will pay the actual costs of the circuit and a monthly surcharge to cover an equitable share of expenses associated with customer support, depreciation of hardware (that is, link encryption units), and other overhead expenses. This fee must be, at a minimum, equivalent to the standard fee for the particular type of leased line connection.

³⁹ The Frame Relay FedLine 19.2 kbps connection is identical to the Frame Relay 56 kbps connection except for the following: (a) redundant equipment is not included with the 19.2 kbps option; and (b) the speed limitation of 19.2 kbps is imposed by FedLine. This connection is otherwise capable of operating at 56 kbps.

⁴⁰ Test and contingency options, including redundant parts, are only available to customers with a primary connection.

CONNECTION TYPE	LOGICAL SPLIT	FULL CIRCUIT BACKUP	FRAME CONNECTION ONLY	REDUNDANT COMPONENTS
Fedline @ up to 19.2 kbps	No charge	\$500	\$420	N/A
CI @ 56 kbps	No charge	\$845	\$765	\$155
CI @ 256 kbps	No charge	\$1,750	\$1,585	\$250
CI T1	No charge	\$2,230	\$2,010	\$270

Logical split: Applies to production and test systems that are located together at the same facility. The institution could use the production equipment with a logical split (different port) in their router as a test or contingency facility. There is no additional cost for this option.

Full circuit backup: Applies to production and test systems, or production and contingency systems, that are located at separate facilities, including another bank office or a third-party contingency site.⁴¹ This option replicates full production technology and costs; only one set of equipment components is provided.

Frame connection only: Applies to production and test systems, or production and contingency systems, that are located at separate facilities. The institution uses a frame relay link connection with no ISDN dial-up backup. Only one set of equipment components is provided.⁴²

Redundant components: Includes a Cisco router, CSU/DSU, encryptor and rack.⁴³

⁴¹ Prices shown are for full circuit backup only located at the customer site. Multiple customers sharing a single disaster-recovery connection at a third-party provider will result in custom implementations. Districts will bill the vendor's bank for the contingency circuit.

⁴² Prices shown are for frame connection only located at the customer site. Multiple customers sharing a single disaster recovery connection at a third-party provider will result in custom implementations. Districts will bill the vendor's bank for the contingency circuit.

⁴³ Redundant components are available only for the following connections: CI 56 kbps, CI 256 kbps, and CI T1. Customers with FedLine 19.2 kbps connections that require redundant equipment will be obliged to upgrade their connection to CI 56 kbps.

By order of the Board of Governors of the Federal Reserve System, November 8, 2000.

(Signed) Jennifer J. Johnson

Jennifer J. Johnson,
Secretary of the Board.