BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date: October 31, 2005

To: Board of Governors

From: Donald L. Kohn

Subject: Proposed 2006 Fee Schedules for Priced Services

The Committee on Federal Reserve Bank Affairs has reviewed staff's recommendation that the Board approve the proposed 2006 earnings credit rate and the proposed fee schedules for priced services and electronic access. The Reserve Banks project a recovery rate of 102.5 percent of total expenses in 2006. The proposed 2006 fee schedules would become effective in January 2006.

The Committee is forwarding the attached staff memorandum to the Board for its consideration.

Attachment

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF RESERVE BANK OPERATIONS AND PAYMENT SYSTEMS

Date: October 31, 2005

To: Board of Governors

From: Staff[1]

Subject: Proposed 2006 Fee Schedules for Priced Services

ACTION REQUESTED

Staff recommends that the Board approve the 2006 earnings credit rate and the proposed 2006 fee schedules for priced services and electronic access, which are included in attachments I to VII.[2]

DISCUSSION

From 1995 through 2004, the Reserve Banks recovered 97.5 percent of their total expense (including special project costs and imputed expenses) and targeted after-tax profits or return on equity (ROE) for providing priced services.[3]

Table 1 summarizes 2004, 2005 estimated, and 2006 budgeted cost recovery rates for all priced services. Cost recovery is estimated to be 103.6 percent in 2005 and budgeted to be 102.5 percent in 2006. The performance of the check service heavily influences the aggregate cost recovery rates and accounts for approximately 80 percent of the total cost of priced services. The electronic services (FedACH℠, the Fedwire® funds service and national settlement service (NSS), and the Fedwire® securities service) account for approximately 20 percent of total costs.[4] The noncash collection service represents a *de minimis* amount of total costs and, by year-end 2005, the Reserve Banks will exit the service.

[1] Jeremy Mandell, James Carmody, Thomas Guerin, Ed Lucio, Jonathan Mueller, Travis Nesmith, Lauren Oriente, Paul Wong, Kent Owens, Brenda Richards, Stuart Sperry, Jeffrey Yeganeh, Gregory L. Evans, and Jack K. Walton II.

[2] Staff forwarded recommendations for the 2006 private sector adjustment factor (PSAF) to the Board under separate cover.

[3] These imputed expenses, such as taxes that would have been paid, and the return on equity that would have to be earned had the services been furnished by a private business firm, are referred to as the PSAF. The ten-year recovery rate is based upon the pro forma income statements for Federal Reserve Banks' priced services published in the Board's *Annual Report*.

[4] FedACH and Fedwire are registered servicemarks of the Reserve Banks.

Table 1

Aggregate Priced Services Pro Forma Cost and Revenue Performance[a] ($ millions)					
YEAR	1[b] REVENUE	2[c] TOTAL EXPENSE	3 NET INCOME (ROE) [1-2]	4[d] TARGET ROE	5 RECOVERY RATE AFTER TARGET ROE [1/(2+4)]
2004	914.6	842.6	72.0	112.4	95.8%
2005 (estimate)	958.2	821.8	136.4	102.9	103.6%
2006 (budget)	911.1	817.1	94.0	72.0	102.5%

[a] Calculations in this table and subsequent pro forma cost and revenue tables may be affected by rounding.
[b] Revenue includes net income on clearing balances (NICB). Clearing balances are assumed to be invested in a broad portfolio of investments, such as Treasury securities, government agency securities, commercial paper, municipal and corporate bonds, and money market and mutual funds. To impute income, a constant spread is determined from the historical average return on this portfolio and applied to the rate used to determine the cost of clearing balances. NICB equals the imputed income from these investments less earnings credits granted to holders of clearing balances. The cost of earnings credits is based on the discounted three-month Treasury bill rate.
[c] The calculation of total expense includes operating, imputed, and other expenses. Imputed and other expenses include taxes, FDIC insurance, Board of Governors' priced services expenses, the cost of float, and interest on imputed debt, if any. Credits or debits related to the accounting for pensions under FAS 87 are also included.
[d] Target ROE is the after-tax ROE included in the PSAF. The 2006 target return on equity is lower than it has been historically because of a Board-approved change to the method used to calculate the targeted return on equity.

Table 2 presents an overview of the 2004, 2005 budget, 2005 estimate, and 2006 budget cost recovery performance by priced service.

Table 2

Priced Services Cost Recovery (percent)				
PRICED SERVICE	2004	2005 BUDGET	2005 ESTIMATE	2006 BUDGET [a]
All services	95.8	100.1	103.6	102.5
Check	94.6	100.3	104.0	102.3
FedACH	103.0	100.4	102.2	101.0
Fedwire funds and NSS	99.4	100.1	101.4	105.6
Fedwire securities	102.6	102.8	101.3	105.9
Noncash collection	120.3	76.7	90.9	n.a.

[a] 2006 budget figures reflect the latest data from Reserve Banks. The Reserve Banks will transmit final budget data to the Board in November 2005, for Board approval in mid-December 2005.
n.a. – not applicable

2005 Estimated Performance

In 2005, the Reserve Banks estimate that they will recover 103.6 percent of the costs of providing priced services, including imputed expenses and targeted ROE, compared with a budgeted recovery rate of 100.1 percent, as shown in table 2. The Reserve Banks estimate that all services will achieve full cost recovery with the exception of the noncash collection service, from which the Reserve Banks will exit by year end. The Reserve Banks estimate that they will fully recover actual and imputed expenses and earn net income of $136.4 million compared with the target of $102.9 million. This greater-than-expected net income is largely driven by greater-than-expected 1) check volumes, 2) cost savings associated with the Reserve Banks' check restructuring efforts, and 3) net income on clearing balances.

The decline in paper check volume continues to have a significant effect on the Reserve Banks priced services.[5] Check use nationwide has been declining, in part because of the increased use of debit and credit cards, as well as the growing trend for merchants, billers, and others to covert checks into automated clearinghouse (ACH) transactions. These factors have led to a general decline in the interbank clearing of checks, including clearings through the Reserve Banks. In this environment, to meet their cost recovery objectives, the Reserve Banks have undertaken efforts to reduce the costs associated with the check service, including reducing the number of check processing sites from forty-five in 2003 to twenty-two by the end of 2006.

2006 Projected Performance

For 2006, the Reserve Banks project a priced services cost recovery rate of 102.5 percent. The proposed 2006 fees for priced services are projected to result in a net income of $94.0 million, or $22.0 million more than needed to achieve full cost recovery. The major risks to the Reserve Banks' ability to achieve their budget targets are a greater decline in the Reserve Banks' check volume than the projected 13.8 percent, unanticipated problems with check office restructurings that could result in significant cost overruns, and greater-than-expected electronic payments volume loss to competitors. In light of these risks, the Reserve Banks will continue to refine their business and operational strategies to improve efficiency and reduce excess capacity and other costs. These strategies will position the Reserve Banks to achieve their financial and payment system objectives and statutory requirements over the long run.

[5] The Federal Reserve's 2004 retail payments research indicated that the total number of checks paid declined at an average annual rate of 4.3 percent from 2000 to 2003. This rate of decline is greater than the 3.3 percent average annual rate estimated to have occurred from 1995 to 2000. See Gerdes, Geoffrey R. and Jack K. Walton II, "Trends in the Use of Payment Instruments in the United States," Federal Reserve Bulletin, Spring 2005, pp. 180-201. (See http://www.federalreserve.gov/pubs/bulletin/2005/spring05_payment.pdf.)

2006 Pricing

The following summarizes the Reserve Banks' proposed changes in fee schedules for priced services in 2006:

Check

- The Reserve Banks propose to raise paper check fees for forward-collection check products 5.3 percent, return-check products 5.4 percent, and payor bank check products 5.3 percent.
- The Reserve Banks propose to decrease Check 21 fees for FedForward products 13.8 percent and to offer incentives to customers to use FedReceipt products.
- With the proposed fee change, the price index for the check service will have increased 49 percent since 1997.

FedACH

- The Reserve Banks propose to reduce the input file fee one-third and the FedLine Web origination returns and notification of change fee 40 percent.
- With the proposed fee change, the price index for the FedACH service will have decreased 63 percent since 1997.

Fedwire funds and national settlement

- The Reserve Banks propose to raise the surcharge for offline funds transfers by one-third.
- With the proposed fee change, the price index for the Fedwire funds and national settlement services will have decreased 57 percent since 1997.

Fedwire securities

- The Reserve Banks propose to raise the surcharge for offline securities transfers 51.5 percent and the joint custody fee 14.3 percent.
- With the proposed fee change, the price index for the Fedwire securities service will have decreased 47 percent since 1997.

2006 Price Index

Figure 1
Price Indexes for Federal Reserve Priced Services

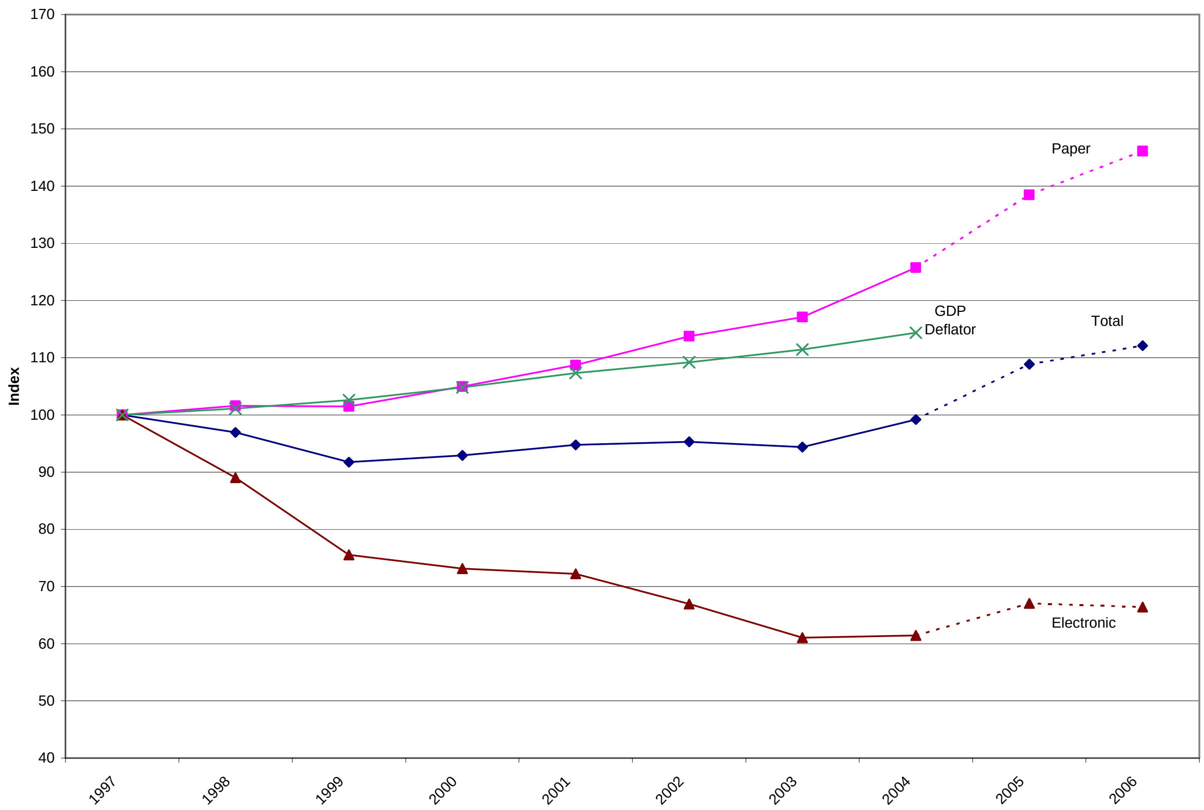

Figure 1 compares indexes of fees for the Reserve Banks' priced services with the GDP price deflator. Compared with the price index for 2005, the price index for all Reserve Bank priced services is projected to increase 3.0 percent in 2006. The price index for electronic payment services, as well as electronic access to Reserve Banks' priced services, is projected to decrease 1.0 percent in 2006. The price index for the paper-based payments services is projected to increase 5.4 percent in 2006. When projecting out to 2006, the price index for all priced services has increased a total of 12.1 percent since 1997. In comparison, from 1997 through 2004, the GDP deflator increased 14.4 percent.

Earnings Credits on Clearing Balances

The Reserve Banks propose to maintain the current rate of 80 percent of the three-month Treasury bill rate to calculate earnings credits on clearing balances. Reserve Banks will continue to calculate earnings credits for the marginal reserve requirement adjusted portion of clearing balances at the federal funds rate.[6]

ANALYSIS OF COMPETITIVE EFFECT

All operational and legal changes considered by the Board that have a substantial effect on payments system participants are subject to the competitive impact analysis described in the March 1990 policy, "The Federal Reserve in the Payments System."[7] Under this policy, staff assesses whether the proposed 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 deriving from such legal differences. If the proposed change creates such an effect, staff must further evaluate the change to assess whether its benefits — such as contributions to payment system efficiency, payment system integrity, or other Board objectives — can be retained while minimizing the adverse effect on competition.

Staff does not believe that the proposed 2006 fees, fee structures, or changes in service will have a direct and material adverse effect on the ability of other service providers to compete effectively with the Reserve Banks in providing similar services. The proposed fees should permit the Reserve Banks to earn an ROE that is comparable to the returns of the overall market.

RECOMMENDATION

The 2006 fees proposed by the Reserve Banks result in a projected net income somewhat higher than the target set using the revised PSAF methodology.[8] The Reserve Banks have successfully taken a number of steps to reduce priced services costs and thereby return to full cost recovery. Additionally, investments in security and technology are positioning the Reserve Banks to offer more efficient electronic payment services. The Reserve Banks are

[6] This calculation adjusts earnings credits as though account holders could adjust their reserve requirement for a "due from deduction" for clearing balances held with a Reserve Bank.

[7] Federal Reserve Regulatory Service (FRRS) 9-1558.

[8] In October 2005, the Board approved a revised method to calculate the PSAF and the targeted return on equity (70 FR 60341, October 17, 2005), which is used in setting fees for priced services provided to depository institutions. The revised method uses only a capital asset pricing model to determine a return on equity that reflects the return earned by private-sector service providers. See the Board's October 12, 2005 press release http://www.federalreserve.gov/boarddocs/press/other/2005/20051012/default.htm.

adjusting to the rapidly changing payments environment to recover fully total expenses and targeted net income over the long run.

Staff recommends that the Board approve the 2006 earnings credit rate and the proposed 2006 fee schedules for priced services and electronic access to priced services, which are included in attachments I to VII.

Attachments

Attachments

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Attachment I

Earnings Credits on Clearing Balances

The Reserve Banks propose to maintain the current rate of 80 percent of the three-month Treasury bill rate to calculate earnings credits on clearing balances.[9]

Clearing balances were introduced in 1981, as a part of the Board's implementation of the Monetary Control Act, to facilitate access to Federal Reserve priced services by institutions that did not have sufficient reserve balances to support the settlement of their payment transactions. Beginning in 2004, the earnings credit calculation was changed from using the federal funds rate to using a percentage discount on a rolling thirteen-week average of the annualized coupon equivalent yield of three-month Treasury bills in the secondary market to better align Federal Reserve policy with market practice. Earnings credits can be used only to offset charges for priced services, are calculated monthly, and expire if not used within one year.[10]

Staff recommends that the Board approve the proposed earnings credit rate.

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[9] Two adjustments are applied to the earnings credit rate so that the return on clearing balances at the Federal Reserve is comparable to what the DI would have earned had it maintained the same balances at a private-sector correspondent. The "imputed reserve requirement" adjustment is made because a private-sector correspondent would be required to hold reserves against the respondent's balance with it. As a result, the correspondent would reduce the balance on which it would base earnings credits for the respondent because it would be required to hold a portion, determined by its marginal reserve ratio, in the form of non-interest-bearing reserves. For example, if a DI held $1 million in clearing balances with a correspondent bank and the correspondent had a marginal reserve ratio of 10 percent, then the correspondent bank would be required to hold $100,000 in reserves, and it would typically grant credits to the respondent based on 90 percent of the balance, or $900,000. This adjustment imputes a marginal reserve ratio of 10 percent to the Reserve Bank.

The "marginal reserve requirement" adjustment accounts for the fact that the respondent can deduct balances maintained at a correspondent, but not the Federal Reserve, from its reservable liabilities. This reduction has value to the respondent when it frees up balances that can be invested in interest-bearing instruments, such as federal funds. For example, a respondent placing $1 million with a correspondent rather than the Federal Reserve would free up $30,000 if its marginal reserve ratio were 3 percent.

The formula used by the Reserve Banks to calculate earnings credits can be expressed as

$$e = [\, b * (1 - FRR) * r\,] + [\, b * (MRR) * f\,]$$

Where e is total earnings credits, b is the average clearing balance maintained, FRR is the assumed Reserve Bank marginal reserve ratio (10 percent), r is the earnings credit rate, MRR is the marginal reserve ratio of the DI holding the balance (either 0 percent, 3 percent, or 10 percent), and f is the average federal funds rate. A DI that meets its reserve requirement entirely with vault cash is assigned a marginal reserve requirement of zero.

[10] A band is established around the contracted clearing balance to determine the maximum balance on which credits are earned as well as any deficiency charges. The clearing balance allowance is 2 percent of the contracted amount, or $25,000, whichever is greater. Earnings credits are based on the period-average balance maintained up to a maximum of the contracted amount plus the clearing balance allowance. Deficiency charges apply when the average balance falls below the contracted amount less the allowance, although credits are still earned on the average maintained balance.

Attachment II

Check Service

The table below shows the 2004, 2005 estimate, and 2006 budgeted cost recovery performance for the check service.

Table 1

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)]
2004	760.2	709.6	50.2	93.6	94.6%
2005 (estimate)	786.4	673.9	112.5	82.0	104.0%
2006 (budget)	732.9	659.6	73.4	57.0	102.3%

2005 Estimate — For 2005, the Reserve Banks estimate that the check service will recover 104.0 percent of total expenses and targeted ROE, compared with the budgeted recovery rate of 100.3 percent. The Reserve Banks expect to recover all actual and imputed expenses of providing check services and earn net income of $112.5 million (see table 1).

The higher-than-budgeted cost recovery is the result of higher-than-expected revenue of $53.7 million that was partially offset by higher-than-expected expenses of $24.0 million. The higher revenue is due to greater-than-budgeted check volumes, customer use of a higher priced product mix, greater-than-expected NICB, and explicit float revenue. The higher costs were largely due to the cost of processing greater-than-expected paper check volume and higher personnel costs related to Check 21 substitute check printing.

The greater-than-expected paper check volume can be attributed to the slower-than-expected adoption of Check 21 products and lower-than-anticipated volume losses resulting from check office restructurings. For full-year 2005, the Reserve Banks estimate that paper forward-collection check volume will decline 12.0 percent, compared with a budgeted decline of 14.6 percent. The Reserve Banks expect that paper return check volume will decline 24.4 percent for the full-year, compared with a budgeted decline of 27.0 percent.

Table 2

Paper Check Product Volume Changes (percent)			
	BUDGETED 2005 CHANGE	ACTUAL CHANGE THROUGH AUGUST 2005	ESTIMATED 2005 CHANGE
Total forward-collection[a]			
Forward-processed	(14.7)	(11.2)	(10.9)
Fine-sort [a]	(10.1)	(21.6)	(31.9)
Returns	(27.0)	(19.5)	(24.4)

[a] These rates exclude electronic fine-sort volume. Including the electronic fine-sort product, fine-sort volume was budgeted to decline 42.6 percent in 2005 and is now estimated to decline 33.7 percent.

While electronic check presentment volumes are expected to decline for full-year 2005 (see table 3), the share of electronic checks that the Reserve Banks present is expected to increase. Through August 2005, the Reserve Banks presented approximately 26.2 percent of their checks electronically, which represents an increase from 24.6 percent in 2004. In addition to electronic check presentment, through August 2005, the Reserve Banks captured images for about 12.3 percent of all checks they collected.

Table 3

Electronic Check Product Share (percent)			
	2004	2005 ACTUAL THROUGH AUGUST	2005 ESTIMATED
Truncation [a]	5.8	6.7	6.2
Non-truncation (Electronic Check Presentment)[a]	18.8	19.5	19.3
Electronic check information	6.3	6.0	6.1
Images	11.0	12.3	12.1

[a] ECP consists of truncated and non-truncated checks. Non-truncated checks include checks presented through the MICR presentment and MICR presentment plus products.

2006 Pricing — In 2006, the Reserve Banks project that the check service will recover 102.3 of total expenses and targeted ROE.

The Reserve Banks plan to maintain full cost recovery by continuing to streamline check processing and administrative activities across the System as well as by increasing Check 21 volume. A number of cost reduction initiatives have been identified and are currently in various stages of implementation. These initiatives include eliminating six more check processing sites by the end of 2006 and working to reduce various check support functions such as check adjustments and check automation services in response to the declining volume.[11]

[11] In February 2003, the Reserve Banks announced an initiative to reduce the number of check processing locations from forty-five to thirty-two. In August 2004 and May 2005, the Reserve Banks announced two further rounds of restructurings. By the end of these announced restructurings in 2006, the Reserve Banks will have twenty-two check processing locations.

Total expenses are projected to decline by $14.3 million, a decline of 2.1 percent when compared with the 2005 estimate. This decline is primarily attributable to lower local operating costs due to efficiency improvements at restructuring sites and declines in projected 2006 volumes. These lower costs are partially offset by higher temporary costs associated with further check restructuring and additional costs to support Check 21 products.

Revenue is projected to be $732.9 million, a decline of 6.8 percent compared to the 2005 estimate. This decline is driven by a $75.9 million, or 10.7 percent, decline in fee revenue that is offset by a $22.3 million increase in NICB. In 2006, the Reserve Banks project that paper check volume for forward products will decrease 13.9 percent, volume for return products will decrease 23.9 percent, and volume for payor bank products will decrease 20.4 percent. These expected volume declines will be partially offset by a projected increase in Check 21 volume.

Check 21 products have been offered for about one year, and the Reserve Banks anticipate significant growth in 2006 (see table 4).[12] The Reserve Banks project that FedForward volume will more than double, FedReturn volume will more than triple, and FedReceipt volume will increase almost twelvefold. The Reserve Banks have projected an increase in the 2006 Check 21 volume that will result in a doubling of Check 21 product revenue, to about $44 million. Board and Reserve Bank staff believe that the key to realizing Check 21 cost efficiencies for the System is the widespread acceptance of FedReceipt by paying banks.

Table 4

Check 21 Volume

	2006 Budgeted Volume (millions of items)	Growth from 2005 Estimate (percent)
FedForward	431.8	138.5
FedReturn	15.2	206.7
FedReceipt	57.5	1,084.3

In 2006, the Reserve Banks expect to continue to encourage the adoption of electronic check collection and presentment alternatives through modest price increases to paper check products and price reductions for some electronic products. The price increases for paper products generally are expected to be distributed across most product categories, with generally

[12] The Reserve Banks' Check 21 product suite includes FedForward, FedReturn, and FedReceipt. FedForward is the electronic alternative to forward check collection; FedReturn is the electronic alternative to return items; and FedReceipt is electronic receipt of Check 21 items.

higher price increases for nonstrategic product lines. The Reserve Banks also expect to narrow the price ranges for similar products across the System. In addition, the Reserve Banks propose to offer depository institutions (DIs) greater incentives to deposit checks electronically and to accept image presentments. Longer term, as the use of Check 21-related products increases, the pricing of paper products may be strategically raised to encourage further adoption of electronic check collection and presentment alternatives.

For 2006, the Reserve Banks are targeting an overall price increase for paper check services of 5.3 percent (see table 5). This increase consists of a 5.3 percent increase in forward check-collection fees, which is composed of a 4.9 percent increase in forward cash letter fees and a 5.4 percent increase in per-item fees. Fees for return services will increase by 5.4 percent, which is composed of a 5.9 percent increase in return cash letter fees and a 5.3 percent increase in per-item fees. The average volume-weighted fees for payor bank services will increase 5.3 percent.

Table 5

2006 Fee Changes
(percent)

Product	Fee Change
Paper Check	5.3
Forward-collection	5.3
Cash letter	4.9
Item	5.4
Returns	5.4
Cash letter	5.9
Item	5.3
Payor bank services	5.3
Truncation	1.8
Non-truncation (electronic check presentment)	14.5
Electronic check information	13.8
Images	(1.0)
Check 21	
FedForward	(13.8)
FedReturn	0.0
FedReceipt	($.002) [a]

[a] FedReceipt customers will receive a $0.002 discount per check presented. The discount can be used to offset other check service fees incurred by FedReceipt customers.

The primary risk to meeting the budgeted 2006 cost recovery is higher-than-expected paper check volume declines. Other risks include unanticipated problems with check office restructurings or other major initiatives that may result in significant cost overruns.

Staff believes that the 2006 cost, volume, and revenue projections are reasonable and recommends that the Board approve the proposed price changes for the Reserve Banks' check service. A full check service fee supplement is available upon request.

Attachment III

FedACH Service

The table below shows the 2004, 2005 estimate, and 2006 budgeted cost recovery performance for the commercial FedACH service.

FedACH 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)]
2004	75.1	64.0	11.1	8.9	103.0%
2005 (estimate)	84.7	72.8	11.8	10.0	102.2%
2006 (budget)	86.7	78.3	8.4	7.6	101.0%

2005 Estimate — For 2005, the Reserve Banks estimate that the FedACH service will recover 102.2 percent of total expenses and targeted ROE, compared with the budgeted recovery rate of 100.4 percent. Total revenue is estimated to be $2.6 million greater than the amount budgeted, and total expenses exceed budget by about $1.3 million. Through August, FedACH commercial origination volume is 14.5 percent higher than the same period last year. For full-year 2005, the Reserve Banks estimate that FedACH originations will grow 12.7 percent, compared with the budgeted growth of 7.7 percent.

2006 Pricing —The Reserve Banks propose to reduce the input file fee one-third, from $3.75 to $2.50. This change is consistent with the Reserve Banks' long-term strategy to decrease file fees. In addition, the Reserve Banks proposed to reduce the FedLine Web notification of change fee 40 percent, from $0.50 to $0.30, to better align the fee with that of similar products.

The Reserve Banks project that the FedACH service will recover 101.0 percent of total expenses and targeted ROE in 2006. Total revenue is budgeted to increase $2.1 million from the 2005 estimate, despite $1.6 million less in fee revenue. The decrease in fee revenue is offset by NICB revenue, which is $3.2 million larger than the 2005 estimate. Based on industry projections, the Reserve Banks estimate national ACH commercial origination volume will grow approximately 18 percent in 2006. This growth is largely attributable to volume increases associated with electronic check conversion applications, including checks converted at lockboxes, and internet initiated payments. The Reserve Banks, however, have projected

FedACH commercial origination volume growth of 7.6 percent in 2006 to reflect continued volume shifts to the private-sector ACH operator.

Total expenses and targeted ROE are budgeted to increase $3.1 million over the 2005 estimate. The Reserve Banks have budgeted increased costs for product development and service initiatives, such as FedACH risk management services.

Staff believes that the 2006 cost, volume, and revenue projections are reasonable and recommends that the Board approve the proposed price changes for the Reserve Banks' FedACH service.

FEDACH 2006 FEE SCHEDULE

EFFECTIVE JANUARY 3, 2006. BOLD INDICATES CHANGES FROM 2005 PRICES.

	Fee
Origination (per item or record):[13]	
Items in small files	$0.0030
Items in large files	$0.0025
Addenda record	$0.0010
Input file processing fee (per file):	**$2.50**
Receipt (per item or record):[14]	
Item	$0.0025
Addenda record	$0.0010
Risk Product:	
Risk service subscription	**$20.00**
Risk origination monitoring criteria	**$15.00**
Risk origination monitoring batch	**$0.0025**
Monthly fee (per routing number):	
Account servicing fee[15]	$25.00
FedACH settlement[16]	$20.00
Information extract file	$10.00
FedLine Web origination returns and notification of change (NOC) fee:[17]	**$0.30**
Voice response returns/NOC fee:[18]	$2.00
Non-electronic input/output fee:[19]	
Tape input/output	$25.00
Paper output	$15.00
Facsimile exception returns/NOC[20]	$15.00

[13] Small files contain fewer than 2,500 items and large files contain 2,500 or more items. These origination fees do not apply to items that the Reserve Banks receive from the other private-sector ACH operator.

[14] Receipt fees do not apply to items that the Reserve Banks send to the other private-sector ACH operator.

[15] The account-servicing fee applies to routing numbers that have received or originated FedACH transactions. Institutions that receive only U.S. government transactions or that elect to use the other operator exclusively are not assessed the account-servicing fee.

[16] The FedACH settlement fee is applied to any routing number with activity during a month. This fee does not apply to routing numbers that use the Reserve Banks for government transactions only.

[17] The fee includes the transaction and addenda fees.

[18] The fee includes the transaction fee in addition to the voice-response fee.

[19] These services are offered for contingency situations only.

[20] The fee includes the transaction fee in addition to the conversion fee.

Canadian cross-border fee:	
Cross-border item surcharge[21]	$0.039
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
Mexico service fee:	
Cross-border item surcharge[21]	$0.67
Return received from Mexico	$0.69
Item trace	$11.50
Transatlantic service fee:	
Cross-border item surcharge[21]	
Austria	$2.00
Germany	$2.00
The Netherlands	$2.00
Switzerland	$2.00
United Kingdom	$2.00
Return received from[22]	
Austria	$5.00
Germany	$8.00
The Netherlands	$5.00
Switzerland	$5.00
United Kingdom	$8.00

[21] The cross-border item surcharge is assessed in addition to the standard item, addenda, and file-processing fees.

[22] This per-item surcharge is in addition to the standard receipt fees.

Attachment IV

Fedwire Funds and National Settlement Services

The table below shows the 2004, 2005 estimate, and 2006 budgeted cost recovery performance for the Fedwire funds and national settlement services.

Fedwire Funds and National Settlement Services 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)]
2004	57.1	50.6	6.5	6.8	99.4%
2005 (estimate)	64.9	56.1	8.8	7.9	101.4%
2006 (budget)	69.3	60.0	9.3	5.6	105.6%

2005 Estimate — For 2005, the Reserve Banks estimate that the Fedwire funds and national settlement services will recover 101.4 percent of total expenses and targeted ROE, compared with a 2005 budgeted recovery rate of 100.1 percent. Fedwire funds achieved full cost recovery despite lower-than-budgeted fee revenue. Although the Reserve Banks have experienced higher-than-expected growth for online funds volume for 2005, most of the growth has been in the lowest-priced tier. Through August, online funds volume is 5.7 percent higher than it was for the same period last year. For full-year 2005, the Reserve Banks estimate that online funds volume will grow 5.3 percent, compared with a budgeted growth of 2.8 percent. Also offsetting the lower-than-budgeted fee revenue is higher electronic connection revenue and NICB, as well as lower operating costs. With respect to the national settlement service, the Reserve Banks estimate that the volume of settlement entries processed during 2005 will be 1.4 percent higher than the 2005 budget projection.

2006 Pricing — The Reserve Banks propose to raise the surcharge for offline transfers one-third, from $15 to $20. The proposed surcharge increase will more closely align the fee with the costs of providing offline access to the Fedwire funds service.

In 2006, the Reserve Banks project that Fedwire funds and national settlement services will recover 105.6 percent of total expense and targeted ROE. The Reserve Banks project 2006 total revenue to increase by $4.4 million over the 2005 estimate primarily because of the projected higher funds transfer volume and higher NICB and electronic connection revenue. Total expenses for 2006 are expected to increase $3.9 million from the 2005 estimate primarily because of security and technology investments, including the cost to migrate from legacy systems to Internet protocol-based systems, and further enhance resiliency. Online funds transfer volume for 2006 is expected to increase 3.0 percent compared with the 2005 estimate. National settlement service volume for 2006 is expected to remain flat compared with the 2005 estimate.

Staff believes that the 2006 cost, volume, and revenue projections are reasonable and recommends that the Board approve proposed price changes for the Reserve Banks' Fedwire funds and national settlement services.

FEDWIRE FUNDS AND NATIONAL SETTLEMENT SERVICES 2006 FEE SCHEDULE

EFFECTIVE JANUARY 3, 2006. BOLD INDICATES CHANGES FROM 2005 PRICES.

Fedwire Funds Service

	Fee
Basic volume-based transfer fee (originations and receipts)	
Per transfer for the first 2,500 transfers per month	$0.30
Per transfer for additional transfers up to 80,000 per month	$0.20
Per transfer for every transfer over 80,000 per month	$0.10
Surcharge for offline transfers (originations and receipts)	**$20.00**

National Settlement Service

Basic	
Settlement entry fee	$0.80
Settlement file fee	$14.00
Surcharge for offline file origination	$25.00
Minimum monthly charge (account maintenance)[23]	$60.00
Special settlement arrangements[24]	
Fee per day	$100.00

[23] This minimum monthly charge will only be assessed if total settlement charges during a calendar month are less than $60.

[24] Special settlement arrangements use Fedwire funds transfers to effect settlement. 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.

Attachment V

Fedwire Securities Service

The table below shows the 2004, 2005 estimate, and 2006 budgeted cost recovery performance for the Fedwire securities service.[25]

Fedwire Securities Service 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)]
2004	20.4	17.0	3.4	2.9	102.6%
2005 (estimate)	21.0	17.9	3.1	2.9	101.3%
2006 (budget)	22.1	19.1	3.0	1.8	105.9%

2005 Estimate — For 2005, the Reserve Banks estimate that the Fedwire securities service will recover 101.3 percent of total expenses and targeted ROE, compared with a 2005 budgeted recovery rate of 102.8 percent. The lower-than-budgeted recovery is primarily attributable to $0.6 million in lower-than-expected fee revenue associated with lower-than-expected transaction volume. Through August, online securities volume was flat compared to the same period last year. For full-year 2005, the Reserve Banks estimate that online securities volume will grow 1.1 percent, compared with a budgeted growth of 2.0 percent. The shortfall in fee revenue was offset by higher-than-expected NICB revenue.

2006 Pricing — The Reserve Banks propose raising the offline transfer origination and receipt surcharge from $33 to $50, and the joint custody origination surcharge from $35 to $40. The Reserve Banks propose retaining all other fees at their current levels. The proposed surcharge increases will more closely align the fees with the costs of processing these transactions.

The Reserve Banks project that the Fedwire securities service will recover 105.9 percent of total expense and targeted ROE in 2006. Total revenue is projected to increase $1.1 million from the 2005 estimate primarily because of higher NICB. Online securities volume in 2006 is budgeted to be flat against the 2005 estimate. Offline securities volume is projected to

[25] The Reserve Banks provide transfer services for securities issued by the U.S. Treasury, 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 U.S. Treasury assesses fees for the securities transfer component of the service. The Reserve Banks assess a fee for the funds settlement component of a Treasury securities transfer; this component is not treated as a priced service.

fall 9.0 percent against the 2005 estimate. Total expenses are expected to increase $1.2 million from the 2005 estimate. In 2006, the Reserve Banks plan to continue to invest in security and technology projects to enhance resiliency, migrate from legacy systems to Internet protocol-based systems, and implement changes in payment system risk policy.

Staff believes that the 2006 cost, volume, and revenue projections are reasonable and recommends that the Board approve proposed price changes for the Reserve Banks' Fedwire securities service.

FEDWIRE SECURITIES SERVICE 2006 FEE SCHEDULE (NON-TREASURY SECURITIES)

EFFECTIVE JANUARY 3, 2006. BOLD INDICATES CHANGES FROM 2005 PRICES.

	Fee
Basic transfer fee	
Transfer or reversal originated or received	$0.32
Surcharge	
Offline transfer or reversal originated or received	**$50.00**
Monthly maintenance fees	
Account maintenance (per account)	$15.00
Issues maintained (per issue/per account)	$0.40
Claim adjustment fee	$0.30
Joint custody fee	**$40.00**

Attachment VI

Noncash Collection Service

The table below shows the 2004 and 2005 estimated cost recovery performance for the noncash collection service.

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)]
2004	1.9	1.4	0.5	0.2	120.3%
2005 (estimate)	1.2	1.1	0.1	0.2	90.9%

2005 Estimate — For 2005, the Reserve Banks estimate that the noncash collection service will recover 90.9 percent of total expenses and targeted ROE, compared with the budgeted recovery rate of 76.7 percent. This greater-than-expected recovery is due to lower-than-expected costs of withdrawal. The Reserve Banks estimate that, in 2005, noncash collection volume will be 16.1 percent lower than expected. Effective September 30, 2005, the Reserve Banks stopped accepting deposits of definitive municipal securities from DIs. The Reserve Banks plan to complete withdrawal from the service effective December 30, 2005.

2006 Pricing — The Reserve Banks will no longer offer the noncash collection service in 2006.

Attachment VII

Electronic Access

The Reserve Banks allocate the costs and revenues associated with electronic access methods to the Reserve Banks' priced services.[26] There are four types of electronic access methods through which DIs can access the Reserve Banks' priced services: FedLine®, FedMail®, FedPhone®, and computer interface (mainframe to mainframe).[27] There are three ways DIs currently use FedLine to access the Reserve Banks' services: FedLine Web, FedLine Advantage, or FedLine DOS. Information services are available through FedLine Web, while transaction services are available through FedLine Advantage or FedLine DOS. For 2006, the Reserve Banks have proposed changes to the FedLine DOS connection fees as well as ancillary changes to frame relay spare parts and training fees.

The Reserve Banks will discontinue access to their services via FedLine DOS effective September 30, 2006. The Reserve Banks are migrating their customers to a tiered, web-based access structure. This migration is scheduled to be completed by September 30. At that time, FedLine customers will only be able to access Reserve Banks services via FedLine Web or FedLine Advantage. In the interim, those customers that have not yet migrated to web-based access can continue to use FedLine DOS. For those customers, the Reserve Banks bundle a FedLine DOS connection and a FedLine Web connection into a single FedLine Select package. In this arrangement, customers use their FedLine DOS connection to access transaction services and FedLine Web to access information services. The Reserve Banks propose increasing the fee for FedLine Select from $200 to $400 per month, beginning April 1, 2006, to encourage customers to move to FedLine Advantage before the September 30, 2006, sunset date.

The Reserve Banks also propose increasing the frame relay spare parts set fee and in-person and over-the-phone training fees. The fee increase for the frame relay spare parts set, from $155 to $175, is intended to ensure fee consistency with the complete 56 kbps frame relay product.[28] The fee increase for over-the-phone and in-person training, from $100 to $150 per

[26] Certain electronic access fees are recorded as recoveries that offset the cost of providing these services. These fees are for ancillary services, such as training and vendor pass-through charges. Therefore, these fees are not listed in the electronic access 2006 fee schedule below.

[27] FedLine, FedMail, and FedPhone are registered servicemarks of the Reserve Banks. These connections may also be used to access non-priced services provided by the Reserve Banks.

[28] The fee for the computer interface frame relay 56 kbps product is $1,000 per month. The fee for the full circuit backup single equipment set is $825 per month which, when combined with the $175 per month spare parts set fee, is consistent with the complete frame relay product.

session and $800 to $1,000 per session respectively, is intended to encourage the use of online training options that are offered at no cost.

Staff believes that the proposed 2006 electronic access fee schedule is reasonable and recommends that the Board approve the proposed price changes for the Reserve Banks' electronic access.

ELECTRONIC ACCESS 2006 FEE SCHEDULE

EFFECTIVE JANUARY 3, 2006 (UNLESS OTHERWISE INDICATED). BOLD INDICATES CHANGES FROM 2005 PRICES.

FedLine

FedLine Select Package (monthly)		$200.00 (until 3/31/05)
		$400.00 (effective 4/1/05)
Includes:	One dial – DOS-based FedLine	
	FedLine Web institution fee	
	Three individual subscriptions	
	Additional FedLine Web individual subscriber fee (monthly)	$15.00
	Additional DOS-based FedLine – dial (monthly)	$100.00
	Additional DOS-based FedLine – frame relay less than 56 kbps (monthly)	$825.00
	Test and contingency options for frame relay:	
	Full circuit backup[29] – single equipment set (monthly)	$825.00
	Frame connection only[30] – single equipment set (monthly)	$693.00
	Spare parts set[31] (monthly)	**$175.00**
FedLine Web (monthly)		$50.00
	Set-up fee (one time)	$50.00
	Individual subscriber fee (monthly)	$15.00
FedLine Advantage (monthly)		$250.00
Includes:	One FedLine Advantage institution fee	
	Three FedLine Advantage individual subscriber digital certificates	
	Set-up fee (one time)	$400.00
	VPN (monthly)	$50.00
	Individual subscriber fee beyond first three (one time)	$100.00
	Individual subscriber fee (monthly)	$20.00

[29] Prices shown are for full circuit backup of equal speed to the production circuit. Multiple customers sharing a single disaster recovery connection at a third-party provider require custom arrangements.

[30] Prices shown for a frame relay link connection with no ISDN dial-up backup. Multiple customers sharing a single disaster recovery connection at a third-party provider require custom arrangements.

[31] The redundant component set includes a Cisco router, a digital service unit, and a link encryptor.

FedMail[32]

FedMail Fax (monthly per fax line)	$15.00

Computer Interface

Frame relay-computer interface (CI) @ 56 kbps (monthly)	$1,000.00
Frame relay-CI @ 256 kbps (monthly)	$2,000.00
Frame relay-CI T1 (monthly)	$2,500.00

Test and contingency options for frame relay:[33]

Connection type	Full circuit backup	Frame connection only
CI @ 56 kbps	$845	$765
CI @ 256 kbps	$1,750	$1,585
CI T1	$2,230	$2,010

[32] FedPhone and FedMail e-mail are free options.

[33] Some large CI customers are required to ensure that their contingency connections to the Federal Reserve are diversely routed. These customers are charged an additional $1,000 per month to recover the Federal Reserve's cost of providing this network diversity.