FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. **10592**
November 18, 1992]

1993 FEE SCHEDULES FOR PRICED SERVICES

— Check Collection, ACH, Funds Transfer and Net Settlement, Book-Entry Securities, Definitive Securities Safekeeping, Noncash Collection, Special Cash Services, and Electronic Connections

— Private Sector Adjustment Factor (PSAF)

To All Depository Institutions, and Others Concerned,
in the Second Federal Reserve District:

The Board of Governors of the Federal Reserve System has announced the adoption of new fee schedules for services provided by Federal Reserve Banks, effective January 1, 1993. Following is the text of a statement issued by the Board of Governors in that regard, including notice of the Board's approval of the 1993 Private Sector Adjustment Factor (PSAF) for Federal Reserve priced services:

> The Federal Reserve Board has announced the 1993 fee schedules for services provided by the Reserve Banks. The fees become effective January 1, 1993.
>
> The fee schedules apply to check collection, automated clearing house, funds transfer and net settlement, book-entry securities, definitive safekeeping, noncash collection, and special cash services, and for electronic connections to the Federal Reserve. The 1993 fee schedules are available from the Reserve Banks.
>
> In 1993, total costs for priced services, including float and the Private Sector Adjustment Factor (PSAF), are projected to be $773.3 million. Total revenue is projected to be $784.2 million, resulting in a 101.4 percent recovery rate. The fees for 1993 are based on total costs, including the PSAF, and a portion of special project costs.
>
> At the same time, the Board approved the 1993 PSAF for Reserve Bank priced services of $91.4 million, an increase of $11.5 million or 14.4 percent from the $79.9 million targeted for 1992.
>
> The PSAF is an allowance for the taxes that would have been paid and the return on capital that would have been provided had the Federal Reserve's priced services been furnished by a private business firm.

Printed on the following pages is the text of the Board's official notice in this matter, which has been reprinted from the *Federal Register* of November 12. Requests for additional information regarding our priced services may be directed to your Account Manager, Tel. No. 212-720-6600 (at the Head Office), or Tel. No. 716-849-5108 (at the Buffalo Branch).

New fee schedules for check services and revised fee schedules for certain other priced services offered by this Bank will be sent to you as soon as they are available.

E. GERALD CORRIGAN,
President.

FEDERAL RESERVE SYSTEM

[Docket No. R-0779]

Federal Reserve Bank Services

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice.

SUMMARY: The Board has approved a Private Sector Adjustment Factor (PSAF) for 1993 of $91.4 million, as well as 1993 fee schedules for Federal Reserve priced services. These actions were taken in accordance with the

requirements of the Monetary Control Act of 1980, which requires that fees for Federal Reserve priced services be established on the basis of all direct and indirect costs, including the Private Sector Adjustment Factor. The Board also has approved modifications to the check collection service by permitting depository institutions to deposit return items with forward collection items and revising the System's minimum service standards to accelerate interdistrict check collection as well as to provide a more uniform national check collection service. The Board also has authorized Reserve Banks to make certain minor price and service level changes for the check collection service within specified parameters without prior Board review.

DATES: The PSAF, the fee schedules, the modifications to the check collection service, and the price and service level change categories subject to the modified approval procedures become effective January 1, 1993.

FOR FURTHER INFORMATION CONTACT: For questions regarding the Private Sector Adjustment Factor: Gregory L. Evans, Senior Accounting Analyst (202/452–3945), or Gwendolyn Mitchell, Senior Accounting Analyst (202/452–3841), Division of Reserve Bank Operations and Payment Systems; for questions regarding fee schedules: Nalini Rogers, Senior Financial Services Analyst, Check Payments (202/452–3801), Darrell Mak, Financial Services Analyst, Automated Clearing House (202/452–3223), David Elkes, Financial Services Analyst, Fedwire (202/452–3341), Michael Bermudez, Senior Financial Services Analyst, Definitive Securities & Fiscal Agency (202/452–2216), or James Epps, Senior Financial Services Analyst, Cash (202/452–2222), Division of Reserve Bank Operations and Payment Systems; for the hearing impaired only: Telecommunications Device for the Deaf, Dorothea Thompson (202/452–3544).

Copies of the 1993 fee schedules for check collection, automated clearing house, funds transfer and net settlement, book-entry securities, definitive safekeeping, noncash collection, special cash services, and electronic connections to the Federal Reserve, are available from the Reserve Banks.

SUPPLEMENTARY INFORMATION:

Private Sector Adjustment Factor (PSAF)

The Board approved a 1993 Private Sector Adjustment Factor (PSAF) for Federal Reserve Bank priced services of $91.4 million. This amount represents an increase of $11.5 million or 14.4 percent over the PSAF of $79.9 million targeted for 1992.

As required by the Monetary Control Act, the Federal Reserve's fee schedule for priced services includes taxes that would have been paid and the return on capital that would have been provided had the services been furnished by a private business firm. These imputed costs are based on data developed in part from a model comprised of the nation's 50 largest (in asset size) bank holding companies (BHCs).

The methodology, which is unchanged from last year, first entails determining the value of Federal Reserve assets that will be used in producing priced services during the coming year. Short-term assets are assumed to be financed by short-term liabilities; long-term assets are assumed to be financed by a combination of long-term debt and equity.

Imputed capital costs are determined by applying related interest rates and rates of return on equity derived from the bank holding company model. The rates drawn from the BHC model are based on consolidated financial data for the 50 largest BHCs in 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.

The PSAF comprises capital costs, imputed sales taxes, expenses of the Board of Governors related to priced services, and an imputed FDIC insurance assessment on clearing balances held with the Federal Reserve to settle transactions.

Discussion

Asset Base

The estimated value of Federal Reserve assets to be used in providing priced services in 1993 is reflected in table 1. Table 2 shows that the assets assumed to be financial through debt and equity are projected to total $657.1 million. As shown in table 3, this represents a net increase of $93.5 million or 16.6 percent from 1992. This increase results primarily from assets acquired by the Federal Reserve for the automation consolidation initiative.

Cost of Capital Taxes and Other Imputed Costs

Table 3 shows the financing and tax rates as well as the other required PSAF recoveries proposed for 1993 and compares the 1993 rates with the rates used for developing the PSAF for 1992. The pre-tax return on equity rate decreased from 10.7 percent in 1992 to 8.6 percent for 1993. The decline is a result of a weaker 1991 BHC financial performance included in the 1993 BHC model, relative to the 1986 BHC financial performance, in the 1992 BHC model.

The increase in the FDIC insurance assessment from $11.4 million in 1992 to $21.3 million in 1993, as shown in table 3, is attributable to a higher premium rate and higher clearing balances held by depository institutions with Reserve Banks. Unlike past years, the FDIC will begin charging institutions at differing rates. The risk-based premium plan, scheduled for implementation on January 1, 1993, bases FDIC insurance premiums on bank capital ratios and management strength as measured by primary regulators. Banks can be assessed at premiums ranging from $0.23 to $0.31 per $100 in deposits. For purposes of imputing an FDIC assessment for the PSAF, the assessment rate for an adequately-capitalized, strong bank of $0.26 for every $100 in deposits is applied to Reserve Bank clearing balances.

Capital Adequacy

As shown on table 4, the amount of capital imputed for the proposed 1993 PSAF totals 29.2 percent of risk-weighted assets, well in excess of the 8 percent capital guidelines for state member banks and BHCs.

1993 Fee Schedules

Several significant changes are affecting the Reserve Banks' priced services performance for 1993. First, the Reserve Banks will continue their efforts to consolidate automation operations, resulting in significant expenditures to acquire equipment and to begin the transfer of operating systems to three automation consolidation sites. Pending final Board approval later this year, the Reserve Banks also plan to begin implementing Fednet, which will create a unified data communications network that will replace the current interdistrict data communications network, FRCS–80, and the 12 local networks that link depository institutions to the Reserve Banks. This project will also require the acquisition of new equipment and expenditures associated with implementation expenses.

These two major modifications to the Reserve Banks' automation environment will meaningfully enhance the quality and the reliability of Reserve Bank services in the future. At the same time, significant, one-time expenses will be incurred from 1992 through 1994. In establishing 1993 fees for priced services, the Reserve Banks plan to finance a portion of the automation consolidation expenses associated with the Federal Reserve Automation Service (FRAS) special project and plan to recover the costs by the end of 1999.[1]

All other costs associated with automation consolidation and all Fednet costs are expected to be recovered in the year that they are incurred. In setting prices for services, private-sector firms might cover such expenses through retained earnings or finance a greater portion of one-time expenses.

Second, the conversion to an all electronic ACH has been more successful than originally anticipated by the Reserve Banks and has resulted in a more rapid loss of revenue from non-automated transaction fees than expected. An all electronic ACH positions the ACH as a truly electronic payment service and should enable it to be used for a variety of new purposes that require more timely delivery than can be provided when transaction data are delivered using physical delivery methods. Moreover, in the long run, an all electronic ACH will reduce operating costs. Staffing levels, however, can only be reduced over time.

Third, on October 28, 1992, the Board approved the Reserve Banks' withdrawal from the definitive safekeeping service by the end of 1993 (See Docket R-0768 in the **Federal Register** of Friday, November 4, 1992). Unrecoverable expenses associated with shipping securities to other depositories will be incurred as a result of the withdrawal.

Because significant one-time costs will be incurred during the next several years, the Board believes that it is important to maintain price stability, to the extent possible, during this transition. The Monetary Control Act (MCA) mandates that, over the long run, fees should be established to recover all direct and indirect costs incurred in providing Federal Reserve priced services, including the PSAF, giving due regard to competitive factors and a adequate level of such services nationwide. The Board's pricing principles require the Federal Reserve to recover total costs, plus the PSAF, over the long run for each major priced service category.

Following the Federal Reserve's initial efforts to assess fees for its services in the early 1980s, the Reserve Banks' cost recovery performance, across all services and for individual services, comes very close to achieving full cost recovery. In fact, from 1986 through 1992 estimate, the Reserve Banks have accrued a net revenue surplus equal to $43.7 million.

For 1993, the Reserve Banks project a recovery rate of 99.1 percent across all services. Given the difficulty in projecting costs and revenues, the Board believes that this projected recovery rate reasonably satisfies the intent of the MCA. Three individual priced services—automated clearing house (ACH), noncash collection, and definitive safekeeping—are expected to recover less than 100 percent of total costs, plus the PSAF.

A recovery rate of 92.3 percent is projected for the ACH service, and all automation consolidation special project costs are being financed. Projections indicate that the ACH service will be able to recover 100 percent of its total costs, plus the PSAF, by 1995 and that all FRAS special project costs that will be financed can be fully recovered by 1999 throughout increasing ACH transaction fees.

For the noncash collection service, a recovery rate of 97.3 percent is projected. Volumes are continuing to decline due to the decline of outstanding bearer securities and the loss of customers. The Reserve Banks are consolidating noncash collection operations during 1993 and taking number of other steps to reduct costs. Once operations are consolidated, the Reserve Banks' goal is to achieve full cost recovery.

In the case of the definitive safekeeping service, a projected 50.2 percent recovery rate is expected, based on the Board's decision to withdraw from the service.

Historically, the Reserve Banks have attempted to recover all costs incurred in providing individual priced services in the year that the costs were incurred. Financing a portion of the FRAS special project expenses in a modest departure from earlier approaches to cost recovery and is a step toward adopting practices that are similar to those that would be used in private-sector firms. To address the issues that have arisen during the development of 1993 priced service fees, the Board believes that the methodology that has been used by the Federal Reserve for treating variations in recovery rates for priced services should be reviewed.

Discussion

The 1992 fees approved by the Board were expected to recover 100.6 percent of the costs of providing priced services in 1992, including the PSAF and the cost of float. Through the first nine months of 1992, the System recovered 101.6 percent of priced services costs, before costs associated with the automation consolidation special project. The Reserve Banks now estimate that 100.9 percent of total priced services costs, including PSAF, will be recovered in 1992. After including special project costs of $8.0 million, the 1992 recovery rate is expected to be 99.8 percent. Approximately $2.8 million of automation consolidation costs will be financed and recovered later.

Total priced services costs before special project costs are expected to be 2.6 percent below original projections and total revenue is estimated to be about 2.3 percent lower than original projections.

In 1993, total priced services costs, including the PSAF, are projected to increase 1.6 percent before special project costs.[2] The modest increase in costs reflects continued efforts to control costs by the Reserve Banks. Including the $18.2 million of special project costs that are projected to be recovered in 1993, total priced services costs will increase 2.9 percent. Appropriately, $11.6 million of accumulated automation consolidation special project costs will be financed.

[1] In 1981, the Board adopted a policy that permits the Reserve Banks to defer and finance development costs if the development costs would have a material affect on unit costs, provided a conservation time period is set for full cost recovery and financing factor is applied to the deferred portion of development costs.

[2] Effective January 1, 1993, the Reserve Banks will be adopting Financial Accounting Standards Board (FASB) Statement 106, Employers' Accounting for Postretirement Benefits Other Than Pensions. Because the FASB indicated one objective in developing Statement 106 was parallel accounting treatment for pensions and other postretirement employee benefits, the Federal Reserve determined to apply parallel treatment for Reserve Bank pricing purposes. Accordingly, credits arising from accounting for pensions (excluding those resulting from the amortization of the initial transition asset) are considered by each district and service when developing pricing recommendations. These credits largely offset the additional expense impact resulting from implementation of FASB Statement 106. Previously, the pension credits were recorded in the aggregate for priced services and were not considered in establishing fees.

COST AND REVENUE PERFORMANCE

[Dollars in millions]

Year	Revenue	Cost + PSAF	Percent recovery	Special project costs	Total cost + PSAF	Percent recovery after special project costs	Special project costs financed (cumulative)
1986	$627.7	$599.3	104.7	$0	$599.3	104.7	$0
1987	649.7	627.3	103.6	0	627.3	103.6	0
1988	667.7	674.7	99.0	2.5	677.2	98.6	0
1989	718.7	726.6	98.9	3.7	730.3	98.4	0
1990	746.5	733.4	101.8	2.0	735.4	101.5	0
1991	750.1	745.1	100.7	1.1	746.2	100.5	0
1992 (est)	767.6	761.1	100.9	8.0	769.1	99.8	2.8
1993 (bud)	784.2	773.3	101.4	18.2	791.5	99.1	11.6

Total revenue is projected to increase 2.2 percent compared with the 1992 level, reflecting only minor price changes. Based on cost and volume projections, a 99.1 percent recovery rate is anticipated. The above table highlights the cost recovery performance for priced services since 1986.

Check Collection

Estimated 1992 and projected 1993 cost recovery performance for the check collection service is shown in the table below.

PRO FORMA COST AND REVENUE PERFORMANCE

[Dollars in millions]

Year	Revenue	Cost+PSAF	Percent recovery	Special project costs	Total cost+PSAF	Percent recovery after special project costs	Special project costs financed (cumulative)
1992 (est)	$583.5	$579.5	100.7	$4.7	$584.2	99.9	$0
1993 (bud)	603.0	593.4	101.6	9.5	602.9	100.0	0

1992 Performance

The Reserve Banks' projections for 1992, are comparable to the original 1992 cost recovery projections. The check collection service recovered 100.9 percent of total costs, including PSAF, through September 1992. Thus, a recovery of 100 percent of total costs, including the PSAF and special project costs, may be realized in 1992.

1993 Projections

The Reserve Banks project that the check collection service will recover its total costs, including allocated costs for the automation consolidation special project and the costs of the check image special project [3] in 1993.

As a result of the Reserve Banks' ongoing cost containment efforts, operating expenses, before special projects, will increase a modest 2.4 percent, compared with 1992 costs.

Volume Projections

Reserve Banks project an increase in forward check collection volume—1.2 percent in processed volume and 1.4 percent in fine-sort volume—and a slight decrease of 0.9 percent in return-item volume for 1993. Attractive group sort products and improved weekend deadlines for mixed and other Fed products are the primary reasons for the projected increase in processed check volume. The Board's approval of amendments to Regulation CC, which require payor banks to pay collecting banks in same-day funds for check presentment, beginning January 3, 1994, may result in some bilateral agreements being negotiated during 1993. If such arrangements become widespread, the projected fine-sort volume increase might not be realized.

1993 Fees

The following table highlights selected 1993 price ranges and changes compared with 1992 check collection fees.

Overall, prices for both forward and return-items, including cash letter/package fees, will increase 2.6 percent on a weighted average basis. Systemwide, the majority—1,065—of forward collection and fine-sort fees will be retained, 428 will be increased, and 53 will be reduced. There will be an average increase of 1.4 percent in forward collection fees and 3.3 percent in fine-sort per-item fees. Return-item prices will increase an average of 8.0 percent, with 615 fees increased, 582 unchanged, and 10 reduced. The increased return-item prices more closely align fees with the cost of processing return-items. The Board also has approved an increase in off-line, large-dollar, return-item notification fees. The increase in designed to reflect more accurately the costs of providing these labor-intensive services and to encourage the use of electronic notifications.

[3] The check image special project involves research and development of the application of image technology to the check collection service in order to improve the efficiency of the payments mechanism.

PRICE RANGES

Products	1993 price ranges	Range of changes 1992-to-1993
Items:	(per item)	(per item)
Forward processed:		
City	$0.012 to 0.031	$−0.002 to +0.002.
RCPC	0.016 to 0.039	−0.001 to +004.
Fine sort:		
City	0.004 to 0.008	−0.003 to +0.002.
RCPC	0.003 to 0.012	−0.001 to +0.001.
Qualified return items:		
City	0.110 to 0.500	+0.010 to 0.100.
RCPC	0.120 to 0.500	+0.010 to 0.100.
Raw return items:		
City	0.800 to 1.680	+0.095 to 0.400.
RCPC	0.800 to 1.680	+0.095 to 0.400.
Cash Letters:	(per cash letter)	(per cash letter)
Forward processed	$0.50 to 4.50	$+0.25 to 1.00.
Forward fine-sort package	1.50 to 4.50	+0.25 to 1.00.
Return items: raw and qualified	0.50 to 4.50	+0.25 to 1.00.

Reserve Banks, for the most part, will not change payor bank services and truncation fees for 1993. Several districts made minor adjustments in selected product offerings, primarily decreases in MICR capture or truncation fees. Lower fees should promote electronic check services, particularly for smaller institutions.

Modest adjustments to the fees charged for the use of the Interdistrict Transportation System (ITS) were approved. The adjustments result in a weighted average increase of 1.1 percent for weekday service and constant weekend prices. (Weekend fees were decreased 7.7 percent in 1992.) Of the 2,256 weekday ITS fees, 2,035 were unchanged, 219 increased, and 2 were reduced. Weekday volume is projected to increase 2.5 percent, and weekend volume is projected to increase 5 percent.

Service Level Changes

The Board has approved two modifications to check service levels—a voluntary intermingled return check service and new minimum check service level standards.

Three Federal Reserve Districts have offered an intermingled returned check service on a pilot basis since 1989. Under this program, depository institutions agreeing to receive forward collection and qualified returned checks intermingled in one cash letter from the Federal Reserve may deposit forward collection and qualified returned checks intermingled. Results of the pilot indicate that the program contributes to cost savings and improved quality for both Reserve Banks and participating depository institutions. The Reserve Banks believe that the benefits of the service are sufficient to offer it on an on-going basis.

The cost of handling an intermingled, qualified returned check is slightly higher than the cost of processing a forward collection check due to higher reject and adjustment rates. Accordingly, the fee structure for the intermingled program includes a surcharge to the forward collection per-item fee for intermingled returned checks. Under the pilot program, the fee charged for intermingled returned checks was the same as the forward collection per-item fee. While only the three districts presently piloting the service plan to offer intermingling in 1993, the Board has approved this service as an on-going service, and has adopted the modified fee structure, effective January 1, 1993.

The 1993 check collection fee and deadline schedules also reflect new minimum check service level standards, which represent a variety of service level improvements. Specifically, the standards require Reserve offices to:

• Establish RCPC premium deadlines no earlier than 3 a.m. local time (Current deadlines range from 1 a.m. to 5 a.m.);

• Offer an RCPC group sort option with a deposit deadline no earlier than 3 a.m. (There are no current RCPC group sort requirements.);

• Offer mixed and other Fed deposit deadlines that are no more than two hours prior to the first ITS dispatch (Presently, there are no guidelines on the relationship between these deadlines and ITS dispatches);

• Offer weekday consolidated deadlines that are no more than 30 minutes before the corresponding ITS dispatch, unless an airport consolidation service is offered (The existing guideline is one hour.);

• Offer other Fed group sort products that include high-volume, other Fed endpoints with deadlines no more than two hours prior to the first and last ITS dispatch (Presently, other Fed group sorts are not mandatory service offerings.); and

• Cull high-dollar checks drawn on high-dollar group sort endpoints from mixed and other Fed deposits where $5 million per day can be expedited to another Fed office (This procedure is not currently in place in all Federal Reserve offices.)

The new minimum check service levels are designed to speed interdistrict check collection, to be responsive to depositors' needs for improved deadlines and availability, and to develop a more uniform national check collection service. Exemptions to selected minimum check service level standards may be granted in instances where an office demonstrates that circumstances, such as time zone differences or transportation schedules, adversely affect its ability to comply with a given standard. The Board has approved these standards for implementation January 1, 1993, and delegates to the Director of the Division of Reserve Bank Operations and Payment Systems, the authority to approve selected exemptions.

Automated Clearing House (ACH)

The table below presents the estimated 1992 and projected 1993 cost recovery performance for the commercial ACH service.

PRO FORMA COST AND REVENUE PERFORMANCE

[Dollars in millions]

Year	Revenue	Cost + PSAF	Percent recovery	Special project costs	Total cost + PSAF	Percent recovery after special project costs	Special project costs financed (cumulative)
1992 (est)	$60.3	$64.0	94.1	$0	$64.0	94.1	$2.6
1993 (bud)	61.6	66.8	92.3	0	66.8	92.3	10.3

1992 Performance

When the 1992 fee schedule for the ACH service was adopted, it was projected that the Reserve Banks would recover 100.1 percent of commercial ACH costs, including the PSAF but excluding special project costs, which are being financed. While the estimated recovery rate is now less than 100 percent, the Reserve Banks will recover all direct, support, and overhead cost, plus about 30 percent of the PSAF. It is also important to note that the Reserve Banks' estimates of current year cost recovery performance have historically been one to two percentage points below actual performance. (Through September 1992, the commercial ACH service has recovered 98.0 percent of costs, plus the PSAF.)

The variation from the original projection is attributable to higher than planned automation-related expenses and a more rapid conversion to an all electronic ACH than had been anticipated, which has reduced revenue received from non-automated fees.[4] As of September 30, 1992, 82 percent of depository institutions using commercial ACH services had installed electronic connections. It is now anticipated that by the end of 1992, 92 percent of commercial ACH endpoints will have installed electronic connections. The all electronic ACH initiative positions the ACH as a truly electronic payment service and should enable it to be used for a variety of new purposes that require more timely delivery than can be provided when transaction data are delivered using physical delivery methods. Moreover, in the long run, an all electronic ACH will reduce the Reserve Banks' operating costs by eliminating many current manual processes.

Additionally, it is now anticipated that the growth rate for commercial ACH transactions will be 16.8 percent, rather than the original projection of 17.6 percent. The slower growth rate that is now projected reflects a larger ACH volume base and increased competition from private-sector service providers.

[4] In June 1991, the Board determined that all depository institutions using the Reserve Banks' commercial ACH services should establish electronic connections to originate and receive transactions by July 1, 1993.

1993 Projections

The Reserve Banks' projection of a 92.3 percent recovery rate for 1993 reflects several significant factors. First, the conversion to an all electronic ACH will continue to affect revenues for the ACH service. For example, it is projected that the volume of tapes billed by the Reserve Banks will decline nearly 86 percent, compared with 1992 volume levels.

Second, the projected 16.3 percent increase for 1993 in commercial ACH transaction volume, reflects a modest decrease in volume growth compared with 1992.

Third, as discussed earlier, the Reserve Banks are implementing a new consolidated automation environment, as well as a new unified data communications network. Both of these efforts will improve the reliability and the quality of the ACH service. The conversion to FRAS and Fednet began in 1992 and should be completed by year end 1994. While some automation consolidation costs are being treated as special project costs that may be financed and recovered later, other costs will be recovered in the year they are incurred.

Finally, the Reserve Banks are developing new ACH application software, FedACH, which is designed to operate in a consolidated mode and to provide enhanced features, such as flow processing, to users of the Reserve Banks' ACH services. The development costs of the FedACH software are being expensed as they are incurred while the Reserve Banks continue to incur expenses to maintain the current ACH application software.

1993 Fees

The major initiatives being untertaken by the Reserve Banks are clearly investments, which will enable the Federal Reserve to provide high quality, reliable ACH services in the future. The costs that will be incurred over the next two to three years, are one-time expenses and the Board believes that such one-time expenses should be treated differently than on-going expenses. The Board, therefore, believes that the current ACH transaction fees should be retained during 1993. At the same time, to reflect the increased costs of providing non-automated services as volumes decline, the Board believes that fees for labor-intensive, non-automated services should be increased as indicated in the table below.

PRICE CHANGES

Products	1992	1993 (proposed)
Paper Output	$8.00	$15.00
Tape Onput/Output	15.00	25.00
Paper Returns and NOCs	5.00	10.00
Government Paper NOCs	1.00	5.00
Telephone Returns and Advices	5.00	10.00
Voice Response Returns and NOCs [1]	1.50	2.00

[1] Currently, voice response services are offered by the Chicago, St. Louis, Kansas City, and Dallas Reserve Banks. By December 31, 1992, all Reserve Banks will offer this service.

Not only do these increased changes reflect the costs of providing manual services, but they should also provide incentives for the continued migration to an all electronic ACH. In addition, to reflect more accurately the cost of processing ACH files, the Board believes that the fee for processing files should be increased from $1.25 to $1.50 per file.

The Board considered the following factors in recommending this strategy. First, the projected recovery rate for the commercial ACH service will recover all direct, support, and overhead costs, plus 20 percent of the PSAF allocated to the ACH service.

Second, the ACH service has fully recovered its total commercial costs, plus the PSAF since 1986, when the subsidy for the commercial ACH service was eliminated. Over this period, excess revenues amounted to $5.4 million. If these excess revenues had been retained, as they might have been by a private-sector firm, they would be available to cover about 60 percent of the projected 1992 and 1993 revenue shortfalls. Moreover, the Reserve Banks project that all commercial ACH costs, plus the PSAF, will be covered in 1995 and that, by the end of 1999, all FRAS-related special project costs that are being financed will be fully recovered.

Third, the Reserve Banks are undertaking a number of initiatives that may have the potential to reduce ACH costs during 1993 and 1994. Steps are being taken to reduce accounting support costs. In addition, a work group has been formed to identify methods for reducing direct expenses further and for using other support services more efficiently.

Fourth, to achieve a 100 percent recovery rate in 1993, the Reserve Banks would need to raise transaction fees approximately 20 percent and would have to lower them later. The Board believes that increasing ACH transaction fees would be disruptive and would have a negative effect on the continued growth of the ACH mechanism. Although the total costs of using the ACH are lower than the total costs of using checks, ACH processing fees are generally higher than check collection fees. This is one of the factors that affects the conversion of a variety of payment applications to the ACH. As the volume of ACH payment increases, studies have shown per-item processing costs will decline. Therefore, if the Federal Reserve were to raise ACH transaction fees for 1993 and 1994, the potential to realize the long-term benefits of this efficient payment mechanism could be diminished. Given the potential for future efficiencies associated with the conversion of paper-based payments to electronics, the Board believes that short-term price increases should be avoided to provide the opportunity for continued increases in the use of electronic payments.

Funds Transfer and Net Settlement

The following table presents the estimated 1992 and projected 1993 cost recovery performance for the funds transfer and net settlement service.

PRO FORMA COST AND REVENUE PERFORMANCE

[Dollars in millions]

Year	Revenue	Cost + PSAF	Percent recovery	Special project costs	Total cost + PSAF	Percent recovery after special project costs	Special project costs financed (cumulative)
1992 (est)	$86.6	$79.3	109.1	$22.7	$82.0	105.2	$0
1993 (bud)	90.6	83.1	109.0	7.5	90.6	100.0	0.5

1992 Performance

Original projections indicated that the funds transfer and net settlement service would recover 99.5 percent of total costs, plus the PSAF and allocated costs related to the FRAS special project. Due to lower than expected overhead allocations relating to data processing, estimates now indicate that the recovery rate will be 105.5 percent. Through September 1992, 110.0 percent of total costs, plus the PSAF and special project costs, have been recovered.

1993 Projections

Total costs, including the PSAF, are projected to increase about 4.7 percent in 1993, due principally to costs associated with Fednet's initial implementation. Funds transfer volume is expected to increase 4.7 percent in 1993, compared with a 5.1 percent increase in 1992. The anticipated growth rate is consistent with recent funds transfer volume trends. Shifts in volume to alternate payments mechanisms may begin in 1993, due to the Board's plan to assess fees for daylight overdrafts in 1994. As a result, the projected volume growth rate may not be achieved.

1993 Fees

Because the Reserve Banks will be able to recover total costs, plus the PSAF and the majority of FRAS special project costs without increasing on-line transfer fees, the Board believes that the current fees should be retained. The Board, however, believes that the fees associated with handling funds transfers for off-line institutions should be increased as indicated in the above table. Although the increased charges would not make a significant contribution to the 1993 revenues, they more accurately reflect the expense of continuing to provide labor-intensive off-line services.

PRICE CHANGES

Products	1992	1993 (proposed)
Funds Transfer:		
Off-line origination surcharge	$7.00	$10.00
Telephone advice surcharge	7.00	10.00
Net Settlement:		
Off-line settlement statement surcharge	8.00	10.00
Telephone advice surcharge	7.00	10.00

Book-Entry Securities

The following table presents the 1993 cost recovery performance for the book-entry securities service.[5]

[5] These financial data relate only to book-entry transfers of government agency securities, which are priced by the Federal Reserve. The U.S. Treasury establishes fees for book-entry transfers of Treasury securities.

PRO FORMA COST AND REVENUE PERFORMANCE

[Dollars in millions]

Year	Revenue	Cost + PSAF	Percent recovery	Special project costs	Total cost + PSAF	Percent recovery after special project costs	Special project costs financed (cumulative)
1992 (est)	$13.1	$12.5	105.0	$0.6	$13.0	100.5	$0
1993 (bud)	14.2	13.0	109.6	1.2	14.2	100.0	0.6

1992 Performance

The Reserve Banks originally projected that the book-entry service would recover 99.9 percent of total costs, plus the PSAF and FRAS special project costs. Government agency securities transfer volume has been higher than anticipated, due to the decline in mortgage interest rates, and has contributed to a somewhat improved cost recovery estimate. Through September 1992, the book-entry service has recovered 104.1 percent of total costs, plus the PSAF and special project costs.

1993 Projections

An increase of 4.1 percent in total costs is projected for 1993, reflecting increases associated with automation consolidation and the new book-entry application development project. Book-entry securities transfer on-line origination volume is estimated to increase by 9.7 percent in 1993, which is slightly lower than the estimated 13.0 percent growth rate for 1992.

1993 Fees

Because the Reserve Banks will be able to recover total costs, plus the PSAF and the majority of FRAS special project costs without raising fees, the Board believes that the current fees for the book-entry service should be retained. To ensure that only customers whose activities generate costs associated with the maintenance of collateral will be charged, the Board believes that all transfer and account/issue maintenance fees associated with collateral accounts used to secure book-entry securities daylight overdrafts should be explicitly priced.

Electronic Connections

The Federal Reserve charges fees for electronic connections to the Reserve Banks for priced services. The cost and revenue associated with electronic access are allocated to the various services based on usage.

As noted earlier, the Reserve Banks will begin implementing a new telecommunications network, Fednet, in 1993. Fednet will provide the current customer connection options as well as standardized higher-speed connections types. In addition, the new network will incorporate more robust uniform contingency back-up capabilities.

During the transition to Fednet, the Board believes that the current connection fees for standard connection types (i.e., connections with line speeds of 9600 bits per second or less), electronic access start-up fees, and gateway fees should be retained.

The implementation of Fednet will, however, result in some service level changes that will affect electronic access fees in a number of relatively minor ways. First, depository institutions currently either purchase modems or lease them from the Reserve Banks. Thus, the cost of this equipment is recovered separately from connection fees. As depository institutions with leased-line and high-speed dial connections are converted to the Fednet environment, they will be provided with primary and backup modems or digital service units (DSUs) owned by the Reserve Banks. In addition, in the Fednet environment, depository institutions with leased-line connections will be required to have a dial back-up capability.

The Board has approved that the cost for all *required* Fednet communication components, including modems/DSUs and back-up circuits, be recovered through the primary connection fee. Reserve Bank lease fees for modems would continue until, on a customer-by-customer basis, that equipment is replaced by the new Fednet equipment. In addition, as customers are converted to the new hardware that supports the new minimum back-up requirements, any fee associated with old back-up connections would be eliminated.

Second, Fednet will offer institutions back-up options that may provide an even higher level of service during contingency situations. The Board has approved that these optional back-up services be priced on a discrete basis. Specifically, a depository institution would be charged $25 per month for an optional back-up modem/DSU. Institutions that request an optional back-up redundant circuit would be assessed the associated standard fee for that type of connection.

Finally, high-speed electronic connections (those with line speeds greater than 9.6 kbps) are not currently considered standard connection types and are priced on a discrete basis by each Reserve Bank. Some of these circuits are leased by the Reserve Banks and institutions are charged the actual circuit costs plus a share of intradistrict data communications overhead costs. In other cases, the institution itself leases the circuit. Beginning in 1993, all leased circuits, including the high-speed circuits, will be leased by the Reserve Banks. The Reserve Banks will charge the institution using the high-speed circuit the greater of the standard dedicated lease-line monthly fee of $700, or the actual circuit, modem/DSU, and overhead costs. For institutions that are not currently charged for high-speed circuits based on actual costs, the 1993 monthly connection fee would not exceed $1,400.

Definitive Safekeeping

The following table presents the estimated 1992 and projected 1993 cost recovery performance for the definitive safekeeping service. The 1993 projections assumed Board approval of the Federal Reserve's withdrawal fr[illegible] this service during 1993.

The 1992 recovery rate f[illegible] definitive safekeeping s[illegible] estimated to be lower than originally projected, due to greater than anticipated volume declines. Through September 1992, the definitive safekeeping service has recovered 80.8 percent of total costs, including PSAF.

PRO FORMA COST AND REVENUE PERFORMANCE

[Dollars in millions]

Year	Revenue	Cost + PSAF	Percent recovery	Special project costs	Total cost + PSAF	Percent recovery after special project costs	Special project costs financed (cumulative)
1992 (est)	$3.3	$4.1	80.2	$0	$4.1	80.2	$0
1993 (bud)	2.1	4.2	50.2	0	4.2	50.2	0

Based on withdrawal from the definitive safekeeping service by year-end 1993, accelerated revenue run off due to withdrawal, the absorption of associated shipping costs, and no fee changes, the 1993 cost recovery for the combined definitive safekeeping and purchases and sales service is projected to be 50.2 percent. The recovery rate for the purchases and sales service, with a fee increase at one Reserve Bank, is projected to be 93.9 percent and should improve if Reserve Banks are permitted to consolidate this service in 1993.

Noncash Collection

The following table presents the estimated 1992 and projected 1993 cost recovery performance for the noncash collection service.

The recovery rate for the noncash collection service is projected to fall below original estimates for 1992, due to greater than expected volume declines, despite aggressive cost containment efforts. The Noncash collection service has recovered 89.6 percent of total costs, including PSAF, through September 1992.

PRO FORMA COST AND REVENUE PERFORMANCE

[Dollars in millions]

Year	Revenue	Cost + PSAF	Percent recovery	Special project costs	Total cost + PSAF	Percent recovery after special project costs	Special project costs financed (cumulative)
1992 (est)	$7.8	$8.9	87.4	$0	$8.9	87.4	$0.2
1993 (bud)	5.9	6.1	97.3	0	6.1	97.3	0.2

The projected 97.3 percent recovery rate for 1993 reflects continued volume declines due to the decline of outstanding bearer securities, the loss of major customers to other service providers, and Federal Reserve consolidation initiatives. To control costs in this environment, the Reserve Banks plan to continue consolidating processing sites. During 1993, the remaining eight sites will be reduced to four.

The four Reserve Banks that will continue as noncash processors after 1993 are expected to recover approximately 100 percent of total costs, plus the PSAF. Three of these Banks will increase a total of six fees in 1993. Another Reserve Bank, expecting to consolidate by the end of 1993, will increase seven fees.

Cash Services

Cash services that are priced by the Federal Reserve Banks include cash transportation, coin wrapping, nonstandard packaging of currency orders and deposits, and nonstandard frequency of access to cash services.

Data on priced cash services are being included to provide a complete view of Reserved Bank priced service performance. Cash transportation fee changes do not require Board approval. The staff, however, is notified when changes occur. The fees for the other priced cash services have been approved by the Director of the Division of Reserve Bank Operations and Payment Systems under delegated authority.

The following table presents the estimated 1992 and projected 1993 cost recovery performance for the priced cash services.

PRO FORMA COST AND REVENUE PERFORMANCE

[Dollars in millions]

Year	Revenue	Cost + PSAF	Percent recovery	Special project costs	Total cost + PSAF	Percent recovery after special project costs	Special project costs financed (cumulative)
1992 (est.)	$13.0	$12.9	102.0	$0	$12.8	102.0	$0
1993 (bud.)	6.9	6.7	102.0	0	6.7	102.0	0

Although the estimated 1992 cost recovery rate for priced cash services is unchanged from the original projection of 102 percent, original cost and revenue projections of $15.1 and $15.4 million, respectively, declined to $12.8 and $13.0 million because the Cleveland office and the San Francisco District discontinued cash transportation services during 1992. Through September 1992, cash services has recovered 102.2 percent of total costs, including PSAF.

The 48 percent decline in projected 1993 costs and revenues compared with 1992 estimate, is the result of the full-year effect of the transportation services discontinued in 1992 and the withdrawal from transportation services by the Philadelphia office in 1993. Only the Pittsburgh, Cincinnati, Minneapolis, and Helena offices plan to continue the service in 1993.

Competitive Impact Analysis

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." In this analysis, 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 due to differing legal powers or constraints or due to a dominant market position of the Federal Reserve deriving from such legal differences.

The Board believes that the price and service level changes would not have a substantial effect on payments system participants and would not have a direct and material effect on the ability of other service providers to compete effectively with the Federal Reserve in providing similar services. The Board recognizes that the divergence of the recommended recovery rate for the ACH service from 100 percent may appear to have competitive implications. The Board believes, however, that the approach that is being recommended for setting ACH transaction fees is consistent with the approach that would be used by a private-sector firm, which would likely cover one-time transition costs through the use of retained earnings or finance the costs and repay them later. Therefore, the Board does not believe that maintaining the current ACH transaction fees would have an adverse impact on competitors.

By order of the Board of Governors of the Federal Reserve System, November 3, 1992.

William W. Wiles,

Secretary of the Board.

TABLE 1.—COMPARISON OF PRO FORMA BALANCE SHEETS FOR FEDERAL RESERVE PRICED SERVICES

[In millions of dollars—average for year]

	1993	1992
Short-term assets:		
Imputed reserve requirement on clearing balances	534.8	372.0
Investment in marketable securities	5,465.2	2,728.0
Receivables [1]	32.6	32.7
Materials and supplies [1]	5.4	5.6
Prepaid expenses [1]	9.3	11.2
Items in process of collection	3,826.4	2,868.1
Total short-term assets	9,873.7	6,017.6
Long-term assets:		
Premises [1] [2]	359.0	341.0
Furniture and equipment [1]	201.0	139.2
Leasehold improvements and long-term prepayments [1]	49.8	33.9
Capital leases	0.0	0.1
Total long-term assets	609.8	514.2
Total assets	10,483.5	6,531.8
Short-term liabilities:		
Clearing balances and balances arising from early credit of uncollected items	6,652.4	3,511.4
Deferred credit items	3,174.1	2,456.7
Short-term debt [3]	47.3	49.5
Total short-term liabilities	9,873.7	6,017.6
Long-term liabilities:		
Obligations under capital leases	0.0	0.1
Long-term debt [3]	201.8	170.4
Total long-term liabilities	201.8	170.5
Total liabilities	10,075.5	6,188.1
Equity [3]	408.0	343.7
Total liabilities and equity	10,483.5	6,531.8

[1] Financed through PSAF; other assets are self-financing.

[2] Includes allocations of Board of Governors' assets to priced services of \$0.4 million for 1993 and \$0.3 million for 1992.

[3] Imputed figures represent the source of financing for certain priced services assets.

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

TABLE 2.—DERIVATION OF THE 1993 PSAF

[Dollars in millions]

A. Assets to be Financed [1]			
Short-term	\$47.3		
Long-term [2]	609.8		\$657.1
B. Weighted Average Cost			
1. Capital Structure [3]			
Short-term Debt	7.2%		
Long-term Debt	30.7%		
Equity	62.1%		
2. Financing Rates/Costs [3]			
Short-term Debt	6.2%		
Long-term Debt	9.0%		
Pre-tax Equity [4]	8.6%		
3. Elements of Capital Costs			
Short-term Debt	\$47.3	× 6.2% =	\$2.9
Long-term Debt	201.7	× 9.0% =	18.2
Equity	408.1	× 8.6% =	35.3
			\$56.4
C. Other Required PSAF Recoveries			
Sales Taxes	\$11.4		
Federal Deposit Insurance Assessment	21.3		
Board of Governors Expenses	2.3		35.0
D. Total PSAF Recoveries			\$91.4
As a percent of capital			13.9%
As a percent of expenses [5]			15.1%

[1] Priced service asset base is based on the direct determination of assets method.

[2] Consists of total long-term assets, including the priced portion of FRAS assets, less capital leases, which are self financing.

[3] All short-term assets are assumed to be financed by short-term debt. Of the total long-term assets, 33 percent are assumed to be financed by long-term debt and 67 percent by equity.

[4] 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.

[5] Systemwide 1993 budgeted priced service expenses less shipping are \$604.8 million.

TABLE 3.—COMPARISON BETWEEN 1993 AND 1992 PSAF COMPONENTS

	1993	1992
A. Assets to be Financed (millions of dollars):		
Short-term	$47.3	$49.5
Long-term	609.8	514.1
Total	657.1	563.6
B. Cost of Capital:		
Short-term Debt Rate	6.2%	7.9%
Long-term Debt Rate	9.0%	9.2%
Pre-tax Return on Equity	8.6%	10.7%
Weighted Average Long-term Cost of Capital	8.8%	10.2%
C. Tax Rate	29.5%	29.4%
D. Capital Structure:		
Short-term Debt	7.2%	8.8%
Long-term Debt	30.7%	30.2%
Equity	62.1%	61.0%
E. Other Required PSAF Recoveries (millions of dollars):		
Sales Taxes	$11.4	$10.2
Federal Deposit Insurance Assessment	21.3	11.4
Board of Governors Expenses	2.3	1.9
F. Total PSAF:		
Required Recovery	$91.4	$79.9
As Percent of Capital	13.9%	14.2%
As Percent of Expenses	15.1%	13.2%

TABLE 4.—COMPUTATION OF CAPITAL ADEQUACY FOR FEDERAL RESERVE PRICED SERVICES

[Dollars in millions]

	Assets	Risk weight	Weighted assets
Imputed reserve requirement on clearing balances	$534.8	0.0	$0.0
Investment in marketable securities	5,465.2	0.0	0.0
Receivables	32.6	0.2	6.5
Materials and supplies	5.4	1.0	5.4
Prepaid expenses	9.3	1.0	9.3
Items in process of collection	3,826.4	0.2	765.3
Premises	359.0	1.0	359.0
Furniture and equipment	207.4	1.0	207.4
Leases & long-term prepayments	43.4	1.0	43.4
Total	10,483.5		1,396.3
Imputed equity for 1993	408.0		
Capital to risk-weighted assets	29.2%		