

Friday
November 13, 1998

Part V

**Federal Reserve
System**

Federal Reserve Bank Services; Notice

**Department of the
Treasury**

Fiscal Service

Fee Structure for the Transfer of U.S.
Treasury Book-Entry Securities Held on
the National Book-Entry System; Notice

FEDERAL RESERVE SYSTEM

[Docket No. R-1023]

Federal Reserve Bank Services**AGENCY:** Board of Governors of the Federal Reserve System.**ACTION:** Notice.

SUMMARY: The Board has approved fee schedules for Federal Reserve priced services and electronic connections and a Private Sector Adjustment Factor (PSAF) for 1999 of \$115.8 million. These actions were taken pursuant to the requirements of the Monetary Control Act of 1980, which requires that, over the long run, fees for Federal Reserve priced services be established on the basis of all direct and indirect costs, including the PSAF.

DATES: The fee schedules become effective on January 4, 1999, with the exceptions noted below. For the Fedwire® funds transfer service, the volume-based transfer fees and off-line surcharges take effect on February 1, 1999. For the book-entry securities service, the new fee structure and levels become effective on February 1, 1999, and the change in the applicability of the account-maintenance fee takes effect on July 1, 1999. The PSAF becomes effective on January 4, 1999.

FOR FURTHER INFORMATION CONTACT: For questions regarding the fee schedules: Erik Kiefel, Financial Services Analyst, Check Payments, (202/721-4559); Wes Horn, Manager, ACH Payments, (202/452-2756); Stephen Cohen, Financial Services Analyst, Funds Transfer and Book-Entry Securities Services, (202/452-3480); Myriam Payne, Senior Financial Services Analyst, Multilateral Settlement Services, (202/452-3219); Michael Bermudez, Financial Services Analyst, Noncash Collection Service, (202/452-2216); Kate Connor, Senior Financial Services Analyst, Special Cash Services, (202/452-3917); or Anne Paulin, Senior Information Technology Analyst (electronic connections), (202/452-2560), Division of Reserve Bank Operations and Payment Systems. For questions regarding the Private Sector Adjustment Factor: Martha Stallard, Senior Accountant, Division of Reserve Bank Operations and Payment Systems, (202/452-3758). For users of Telecommunications Device for the Deaf (TDD) only, please contact Diane Jenkins (202/452-3749).

Copies of the 1999 fee schedule for the check service are available from the Board or the Reserve Banks.

SUPPLEMENTARY INFORMATION:**I. Priced Services**

A. *Overview*—The Federal Reserve Banks continue to meet the Monetary Control Act's requirement that the Federal Reserve recover, over the long run, its direct and indirect costs, including imputed costs and profits, of providing priced services.¹ Over the period 1988 through 1997, the Reserve Banks recovered 99.6 percent of their total costs for providing priced services, including imputed expenses, special project costs that were budgeted for recovery, and targeted after-tax profits, or return on equity (ROE).

For 1998, the Reserve Banks estimate that they will recover 102.2 percent of the costs of providing priced services, including imputed expenses and targeted ROE. Reserve Banks project that they will recover 101.0 percent of their costs of providing priced services in 1999. The primary risk to the 1999 projections lies in the uncertain cost to upgrade the security of electronic connections to the Federal Reserve.

In their 1999 fee schedules, the Reserve Banks include several changes that reduce fees to depository institution customers and provide a continued economic incentive for those customers to make greater use of electronic payment services. In particular, the price index for electronic payment services (automated clearing house, funds transfer, book-entry securities, and electronic check) and electronic connections is projected to decline by approximately 17.5 percent in 1999, and the index for paper-based payment services (check and noncash collection) is expected to increase 2.8 percent. The

¹ These imputed costs, such as taxes that would have been paid, and the return on capital that would have been earned had the services been provided by a private business firm are referred to as the Private Sector Adjustment Factor (PSAF). The PSAF is based on data developed in part from a model comprised of the nation's fifty largest (by asset size) bank holding companies (BHCs). Based on consolidated financial data for the holding companies in the model for each of the last five years, the targeted ROE is the budgeted after-tax profit that the Federal Reserve would have earned had it been a private business firm. In setting fees, certain costs or adjustments to costs are treated differently in the pro forma income statement for priced services that is published in the Board's Annual Report and the Board's annual **Federal Register** notice on priced service fees. In order to compare total expenses in the pro forma income statement with total expenses in Table 3 in this notice, the amortization of the initial retirement plan over funding required by Statement of Financial Accounting Standards No. 87, and the deferred costs of automation consolidation must be deducted from the pro forma expenses. These adjustments are detailed in Note 10 to the pro forma income statement in the Annual Report. Under the procedures used to prepare the pro forma income statement, the Reserve Banks recovered 100.4 percent of priced services expenses, including targeted ROE, for the period 1988 to 1997.

overall 1999 price index for Federal Reserve services is projected to decrease 3.5 percent, compared with an overall decline of 4.0 percent in 1998.²

The following are the key changes in fee structures and fee levels for priced services in 1999:

- The Reserve Banks will reduce the fee for a Fedwire funds transfer for the third consecutive year. The price index for a Fedwire funds transfer will decline by almost 30 percent from the 1998 level. (Including the reductions for 1999, the price index for Fedwire funds transfers has declined more than 40 percent since 1996. Including 1999, the average on-line transfer fee for a Fedwire funds transfer has declined 48 percent since 1996.) The 1999 fee reductions are expected to save depository institution customers approximately \$27.8 million next year. Reserve Banks will implement a volume-based pricing structure for the funds transfer service that recognizes the scale economies and differences in demand for large-value transfers. The funds transfer service's volume-based pricing structure will be similar to that employed by other domestic and international large-value transfer systems.

- The Reserve Banks will reduce the fee for an on-line Fedwire book-entry securities transfer almost 25 percent in 1999. (Including changes in other fees, the price index for the book-entry securities service has declined more than 15 percent since 1996.) The fee reduction is expected to save depository institutions approximately \$1.4 million in 1999. The Reserve Banks will implement a fee structure for the service that will split the transfer fee between the originator and receiver of a transfer (rather than charge the entire transfer fee to the originator), convert the off-line fee to a surcharge, and apply the existing account-maintenance fee more broadly.

- The Reserve Banks will implement an enhanced multilateral settlement service in 1999 that will offer finality characteristics similar to the Fedwire funds transfer service and provide settlement arrangements with an automated mechanism to submit settlement files to the Reserve Banks.³ The fees and fee structure for the new and existing multilateral settlement

² These estimates are based on a chained Fisher Ideal price index. This index was not adjusted for quality changes in Federal Reserve priced services.

³ The Board recently approved enhancements to the Reserve Banks' net settlement services. To better reflect the ability of these services to accommodate net and gross transactions, the Federal Reserve now refers to this service as the multilateral settlement service.

services have been revised by lowering the per-entry fee, introducing a settlement file fee, increasing the off-line surcharge, and introducing a minimum monthly fee.

- After several years of significant price reductions, Reserve Banks plan further, more modest price reductions in 1999 for the automated clearing house (ACH) service. (Including the reductions for 1999, the price index for the ACH service has decreased more than 40 percent since 1996.) The 1999 price reductions are expected to save depository institution customers approximately \$6.2 million next year. Working with other industry participants, the Reserve Banks also plan to expand their efforts to educate depository institutions and end users about the benefits of the ACH. This campaign, coupled with the fee decreases for 1999, is expected to spur commercial ACH growth and help broaden the use of electronic payment systems.

- Fees for paper check products, which include forward processed, fine sort, and returned checks, will increase about 2.6 percent on a volume-weighted basis (a 3.7 percent increase from January 1998 fee levels). (Including the fee increases in 1999, the price index for the paper check service has increased about 2 percent since 1996.) This increase will be driven primarily by increases in fine sort and returned check fees. Fees for forward-processed items will remain stable. Fees for payor bank services, which include electronic check products, will increase about 0.6 percent (a 1.2 percent increase from January 1998 fee levels). The check service has experienced dramatic growth in the electronic products it offers, and the Reserve Banks project continued robust growth during 1999. Electronic check presentment, truncation, and imaging volumes are each estimated to grow more than 20 percent in 1998 and projected to sustain similar rates of growth in 1999. Reserve

Banks now provide paying banks with electronic check data for approximately 25 percent of the checks they collect; of the checks collected through the Federal Reserve, 16.5 percent are presented electronically.

- Fee structures and schedules will take effect on January 4, 1999, with the following exceptions: The fee and fee structure changes for the Fedwire funds transfer and book-entry securities transfer services will take effect on February 1, 1999. (During January 1999, the basic transfer fee for the funds transfer service will be set at \$0.34, a \$0.06 reduction from the 1998 per-transfer fee.) The broader application of the existing book-entry account maintenance fee will become effective on July 1, 1999.

Table 1 presents an overview of the budgeted 1998, estimated 1998, and projected 1999 cost recovery performance for individual priced services.

TABLE 1
[In percent]

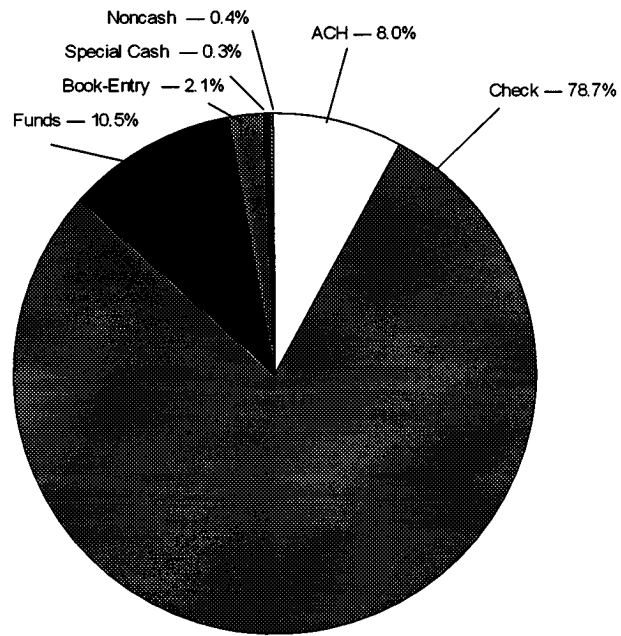
Priced service	1998 budget	1998 estimate	1999 budget
All Services	100.8	102.2	101.0
Check	100.4	100.9	100.4
ACH	100.4	103.9	104.6
Funds transfer	103.1	108.1	101.5
Book-entry	100.0	108.5	104.5
Noncash collection	126.8	130.0	117.3
Special cash	102.4	104.0	104.3

The aggregate cost-recovery rate is heavily influenced by the check service, which accounts for almost 80 percent of total priced services costs. The electronic services (ACH, Fedwire funds

transfer, and Fedwire book-entry securities transfer) account for 20 percent of costs. The noncash collection and special cash services represent a de minimis proportion of priced services

expenses. Figure 1 shows the proportion of 1998 estimated priced services costs attributable to each service.

Figure 1
1998 Estimated Priced Service Costs By Service



□ ACH ■ Check ■ Funds ■ BE ■ Cash ■ Non-Cash

1. *1999 Projected Performance*—In 1999, the Reserve Banks project that they will recover 101.0 percent of total expenses, including imputed expenses, targeted ROE, and full retirement of debt associated with the automation consolidation special project. The 1999 fees for priced services are projected to yield a net income of \$64.2 million, compared with a targeted ROE of \$56.0 million. The book-entry securities service will recover approximately \$1.7 million of automation consolidation special project expenses and financing costs, completing the debt retirement for this project.⁴

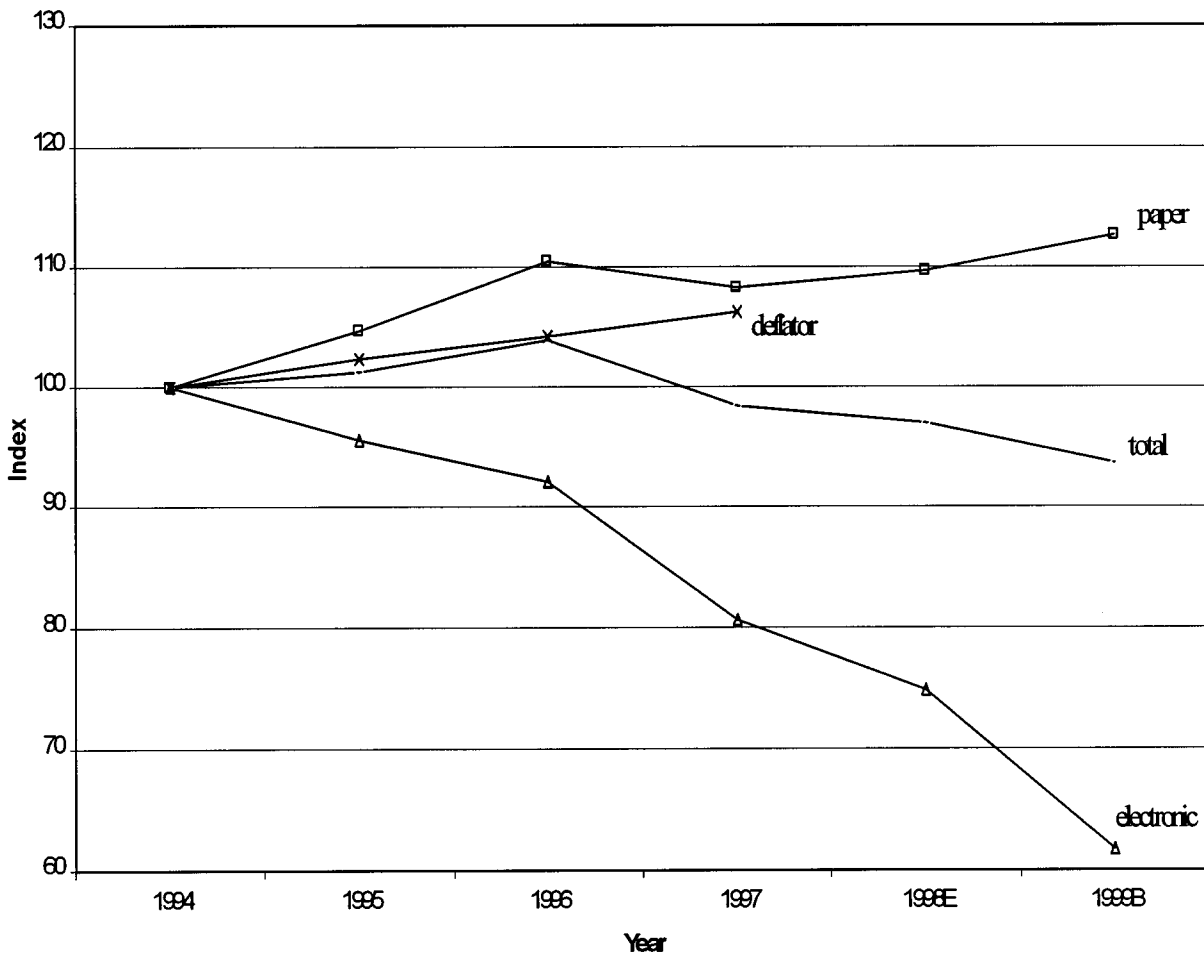
The price index for electronic payment services (automated clearing house, funds transfer, book-entry

securities, and electronic check) and electronic connections is projected to decline by approximately 17.5 percent in 1999, and the index for paper-based payment services (check and noncash collection) is expected to increase 2.8 percent. The overall 1999 price index for Federal Reserve services is projected to decrease 3.5 percent, compared with an overall decline of 4.0 percent in 1998. Figure 2 compares the Federal Reserve's price index for priced services with the gross domestic product price deflator.

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⁴ Under an existing Board policy, the Reserve Banks may defer and finance development costs if the development costs would have a material effect on unit costs, provided that a conservative period is set for full cost recovery and a financing factor is applied to the deferred portion of development costs. The financing rates represent the weighted-average imputed costs of the Federal Reserve's long-term debt and equity. This methodology is similar to the approach a private firm would use in financing such costs. Starting in 1992, the Reserve Banks deferred and financed the special project costs for automation consolidation that were associated with employee retention and severance benefits and excess mainframe computer capacity. By the end of 1999, priced services will have recovered fully their portion of these deferred expenses and accumulated finance charges. The deferred costs for the automation consolidation project have been financed at rates of 16.9 percent and 17.2 percent, respectively, in 1998 and 1999.

Figure 2—Federal Reserve Payment Services Price Index
Chained Fisher Ideal Index Compared With GDP Price Deflator



The significant decline in the price index for electronic payment services reflects, in large part, the increased ability of the Reserve Banks to capitalize on the scale economies inherent in providing payment services through centralized electronic payment processing applications. Between 1992 and 1998, the Reserve Banks' automated processing functions were consolidated into three sites, significantly reducing

the cost of providing electronic payment services.

2. *Allocation of Corporate Overhead Costs to Priced Services*—In 1997, the Reserve Banks changed the method used to allocate corporate overhead costs among the priced services.⁵ In 1997 and 1998, and to a much smaller extent in 1999, the Reserve Banks used their increased flexibility to allocate these costs among priced services to

accelerate the retirement of debt associated with the automation consolidation special project. For 1999, the allocation of corporate overhead costs largely returns to the expense-ratio methodology used to allocate these costs to priced services in total and to other Reserve Bank activities.⁶ Table 2 shows the allocation of corporate overhead costs to each priced service for the years 1997 through 1999.

TABLE 2—CORPORATE OVERHEAD ALLOCATIONS TO PRICED SERVICES
[\$ millions]

Year	Check	ACH	Funds transfer	Book-entry	Noncash collection	Special cash	Total
1997 Actual	30.7	0.0	12.3	0.0	0.0	0.3	43.3
1998 (Est)	27.2	0.0	17.7	0.0	0.1	0.2	45.1
1999 (Bud)	37.2	3.9	6.0	0.0	0.1	0.2	47.4

3. *1998 Estimated Performance*—The Reserve Banks estimate that priced services revenue will yield a net income of \$70.3 million in 1998, compared with a targeted ROE of \$52.3 million. Revenue in 1998 is estimated to recover 102.2 percent of the costs of providing priced services, including imputed expenses, costs related to the automation consolidation special project, and targeted ROE, compared with a targeted recovery rate of 100.8 percent.⁷ The Reserve Banks recovered a larger percentage of costs than targeted primarily because of a larger-than-expected reduction in expenses related to the System's prepaid pension costs and higher-than-anticipated volume in the funds transfer and book-entry securities services. Approximately \$23.1 million in automation consolidation special project costs will be recovered in

1998, leaving \$1.6 million in accumulated costs to be financed and recovered.

4. *1997 Performance*—In 1997, the Reserve Banks' priced services revenue yielded a net income of \$47.3 million, compared with a targeted ROE of \$45.8 million. The Reserve Banks recovered 100.2 percent of total expenses, including imputed expenses, automation consolidation special project costs budgeted for recovery, and targeted ROE, compared with a targeted recovery rate of 100.5 percent.

5. *Long-Term Aggregate Cost Recovery*—Table 3 summarizes the cost and revenue performance for priced services since 1988. The costs recovered through 1999 include Reserve Banks' recovery of \$130.0 million in transition costs associated with the automation consolidation project (special project

costs) and \$11.8 million in deferred financing costs. In addition to fee reductions in electronic payment services, the consolidation initiative has dramatically improved the Reserve Banks' disaster recovery and information security capabilities, increased the System's responsiveness to change, and enhanced the central bank's management of payment system risk.

Because the revenue from the Reserve Banks' priced services recovers imputed profits and imputed costs that are not actually incurred, the Federal Reserve's provision of priced services has consistently had a positive effect on the level of earnings transferred by the Federal Reserve to the Treasury. Over the past ten years, priced services revenue has exceeded operating costs by more than \$900 million.

⁵ Certain corporate overhead costs are not closely related to any particular priced service; these costs include some or all of the following activities: Reserve Bank and System administrative functions, central mail operations, legal, budget preparation and control, expense accounting, records management and contingency planning, motor vehicles, and audit. Therefore, the Federal Reserve, consistent with industry practice, allocates these costs among priced services based on management

decision rather than fixed allocation rules. The Federal Reserve continues to allocate corporate overhead costs to priced services in total and to other Reserve Bank activities based on their proportion of total Reserve Bank costs.

⁶ The only exception to the expense-ratio methodology for allocating corporate overhead costs among priced services in 1999 is a shift of \$1.1 million in costs from the book-entry securities

service to the funds transfer service. The book-entry service is the only service that has not yet fully retired its automation consolidation special project costs.

⁷ Through August 1998, the Reserve Banks recovered 101.1 percent of total priced services expenses, including imputed expenses, automation consolidation special project costs, and targeted ROE.

TABLE 3.—PRO FORMA COST AND REVENUE PERFORMANCE (a) ⁸
[\$ millions]

Year	Revenue (b)	Operating costs and imputed expenses (c)	Special project costs recovered (d)	Total expense [2+3]	Net income (ROE) [1-4]	Target ROE (e)	Recovery rate after target ROE (percent)[1/(4+6)]	Special project costs deferred and financed (f)
	1	2	3	4	5	6	7	8
1988	667.7	641.1	3.2	644.3	23.4	32.7	98.6	0.0
1989	718.6	692.1	4.6	696.7	21.9	32.9	98.5	0.0
1990	746.5	698.1	2.8	700.9	45.6	33.6	101.6	0.0
1991	750.2	710.0	1.6	711.6	38.6	32.5	100.8	0.0
1992	760.8	731.0	11.2	742.2	18.6	26.0	99.0	1.6
1993	774.5	722.4	27.1	749.5	25.0	24.9	100.0	12.5
1994	767.2	748.3	8.8	757.1	10.1	34.6	96.9	33.9
1995	765.2	724.0	19.8	743.8	21.4	31.5	98.7	36.3
1996	815.9	736.4	26.8	763.2	52.7	36.7	102.0	30.1
1997	818.8	743.7	27.7	771.4	47.3	45.8	100.2	20.3
1998 (Est)	838.6	745.3	23.1	768.3	70.3	52.3	102.2	1.6
1999 (Bud)	843.5	777.6	1.7	779.4	64.2	56.0	101.0	0.0

a. The revenues and expenses for 1988 through 1993 include the definitive securities safekeeping service, which was discontinued in 1993.

b. Includes net income on clearing balances.

c. Imputed expenses include interest on debt, taxes, FDIC insurance, and the cost of float. Credits for prepaid pension costs under SFAS 87 and the charges for post-retirement benefits in accordance with SFAS 106 are included beginning in 1993.

d. Special project costs include research and development expenses for evaluating a different computer processing platform for electronic payments from 1988 through 1990, check image project costs from 1988 through 1993, and automation consolidation costs from 1992 through 1998.

e. Targeted ROE is based on the ROE included in the private sector adjustment factor (PSAF) and has been adjusted for taxes, which are included in column 2. Targeted ROE has not been adjusted to reflect automation consolidation special project costs deferred and financed.

f. Totals include financing costs.

B. Service-Specific Discussions

1. *Check*—Table 4 presents the actual 1997, estimated 1998, and projected 1999 cost recovery performance for the check service.

TABLE 4.—CHECK PRO FORMA COST AND REVENUE PERFORMANCE
[\$ millions]

Year	Revenue	Operating costs and imputed expenses	Special project costs recovered	Total expense [2+3]	Net income (ROE) [1-4]	Target ROE	Recovery rate after target ROE (percent) [1/(4+6)]	Special project costs deferred and financed
	1	2	3	4	5	6	7	8
1997	621.6	589.4	7.5	596.9	24.7	35.3	98.3	7.5
1998 (Est)	651.5	596.3	8.4	604.7	46.8	40.9	100.9	0.0
1999 (Bud)	685.3	637.1	0.0	637.1	48.2	45.1	100.4	0.0

a. *1997 Performance*—The check service recovered 98.3 percent of total expenses in 1997, including imputed expenses, automation consolidation special project costs budgeted for recovery, and targeted ROE. Higher-than-expected costs because of write-offs for adjustment problems associated with infrastructure changes at one Reserve Bank were largely responsible for this lower-than-expected recovery rate. The volume of checks collected increased 3.0 percent from 1996 levels because of several factors: (1) The exit of several correspondent banks from the interbank check market, (2) the introduction of new check products, and (3) increased reliance on Reserve Bank check processing by banks undergoing operational changes

resulting from merger and acquisition activity.

b. *1998 Performance*—Through August 1998, the check service has recovered 101.3 percent of total expenses, including imputed expenses, targeted ROE, and the completion of debt retirement related to automation consolidation special project costs. The Reserve Banks estimate that the check service will recover 100.9 percent of its costs for the full year compared with the targeted 1998 recovery rate of 100.4 percent. This estimated cost recovery rate, however, may be adversely affected by potential write-offs associated with adjustment and reconciliation problems

⁸ Calculations on this table and subsequent pro forma cost and revenue tables may be affected by rounding.

at one Reserve Bank. Even if the ultimate write-off is higher than currently estimated, the Reserve Banks expect that they would still be able to achieve full cost recovery in 1998.

For the first eight months of 1998, total forward-processed check volume has increased 5.2 percent over the year-earlier time period. The Reserve Banks estimate that the total volume of forward-processed checks collected during full-year 1998 will increase 5.1 percent over 1997 levels. Fine sort volume fell 0.5 percent through August 1998 compared with the same period in 1997 and is expected to decline further by the end of 1998. Total forward check collection volume (processed and fine sort) has increased 4.3 percent through August 1998, and is estimated to grow 2.5 percent for the full year.

Returned check volume has decreased by 3.6 percent through August 1998 compared with the first eight months of 1997 and is expected to decrease 4.1 percent for full-year 1998 as customers'

merger-related quality problems are resolved and greater competition erodes volume in several Districts. The check service has experienced substantial growth in electronic check products. Reserve Banks now provide

paying banks with electronic check data for approximately 25 percent of the checks they collect. Growth and penetration rates for electronic check products are summarized in table 5.

TABLE 5.—ELECTRONIC CHECK PRODUCT GROWTH AND PENETRATION RATES
[In percent]

	Penetration rate through August 1998	Year-to-date growth through August 1998	Estimated 1998 growth
Electronic Check Presentment	16.4	29.7	25.9
Truncation	4.1	28.4	33.0
Non-Truncation	12.3	30.1	23.5
Electronic Check Information	8.6	-4.7	-11.3

Beginning this year, all Reserve Banks provide check image services, and check image volumes are growing rapidly. Through August 1998, check image volume has grown 139.8 percent. For the remainder of the year, the growth in check image volume is expected to slow somewhat, with the year-over-year growth rate declining to approximately 105.6 percent. The Reserve Banks provide check image services for approximately 3.6 percent of all checks they collect; these services are generally provided as an adjunct to electronic check presentment.

c. 1999 Pricing—The Reserve Banks continue to improve operational efficiency in check processing through changes to their operating environment and new product offerings. For example, over the next several years, the Reserve Banks plan to implement an enterprise-wide adjustment system that will enable

them to process adjustment cases more efficiently. In addition, the Reserve Banks have adopted a new check automation strategy. Under this strategy, the Reserve Banks will consolidate check data processing at several sites, allowing them to improve efficiency and reduce costs over the long term. Also, by mid-year 1999, Reserve Banks expect to offer electronic deposit options for all major check products to improve internal processing efficiency.

In 1999, fees for paper-based check products, which include forward-processed, fine sort, and returned checks, are expected to increase on a volume-weighted basis about 2.6 percent over current prices and 3.7 percent over January 1998 prices, mainly because of a 25 percent increase in fine sort fees. (Including the fee increases in 1999, the price index for the paper check service has increased

about 2 percent since 1996.) Prices for forward-processed checks will decrease 0.3 percent from current fee levels, or 0.2 percent from January 1998 prices. Prices for return items will increase 2.8 percent from current fee levels, or 6.2 percent from January 1998 prices.

Prices for payor bank services would increase 0.6 percent over current prices and 1.2 percent over January 1998 levels. Payor bank services include electronic information, electronic check presentment, truncation, image products, and large dollar return notifications. Higher magnetic ink character recognition (MICR) information fees account for most of this fee increase. Prices for electronic check presentment products, which include both truncation and non-truncation products, would decrease 0.2 percent on a volume-weighted basis in 1999.

Table 6 summarizes key check fees.

TABLE 6.—SELECTED CHECK FEES

Products	1998 price ranges	1999 price ranges
Items:	(per item)	(per item)
Forward-processed		
City	\$0.002 to 0.080	\$0.002 to 0.080
RCPC	\$0.003 to 0.180	\$0.003 to 0.180
Fine Sort		
City	\$0.002 to 0.013	\$0.002 to 0.015
RCPC	\$0.003 to 0.018	\$0.003 to 0.018
Qualified returned checks		
City	\$0.065 to 1.110	\$0.065 to 1.110
RCPC	\$0.068 to 1.560	\$0.065 to 1.750
Raw returned checks		
City	\$0.90 to 5.00	\$0.90 to 5.75
RCPC	\$0.90 to 5.00	\$0.90 to 5.75
Cash letters:	(per cash letter)	(per cash letter)
Forward processed	\$1.50 to 9.00	\$2.50 to 9.00
Forward fine-sort	\$3.00 to 14.00	\$3.00 to 14.00
Returned checks: raw & qualified	\$1.75 to 12.00	\$1.75 to 12.00
Payor bank services:	(min.) (per item)	(min.) (per item)
MICR information	\$5-\$30 \$0.001-0.0060.	\$5-\$30 \$0.001-0.0060

TABLE 6.—SELECTED CHECK FEES—Continued

Products	1998 price ranges		1999 price ranges	
Electronic presentment	\$2—\$14	\$0.001—0.0045.	\$3—\$14	\$0.001—0.0045
Truncation	\$2—\$25	\$0.004—0.0170.	\$3—\$25	\$0.004—0.0170

For 1999, the Reserve Banks project that the check service will recover 100.4 percent of total costs, including imputed expenses and targeted ROE. Total expenses, excluding special project costs, are projected to increase approximately \$40.8 million, or 6.8 percent, from estimated 1998 expenses. The increased costs reflect the anticipated addition of staff and equipment to process increased check volume, the development and implementation of the enterprise-wide adjustment system, the implementation of the future check automation strategy, and a higher allocation of corporate overhead costs.

Total revenue is expected to increase approximately \$33.8 million, or 5.2 percent, in 1999. Forward check-collection revenue is projected to increase \$15.4 million, or 3.9 percent. Returned check revenue is expected to grow \$4.1 million, or 3.2 percent. Revenue from payor bank services is projected to increase \$9.2 million, or 15.0 percent. Other operating and imputed revenues account for the remaining increase in revenue. Paper-based check products—forward collection and returns—will account for

about 80 percent of total check revenues in 1999. The Reserve Banks expect payor bank services to account for about 10 percent of the check service's total revenues in 1999. Other operating and imputed revenues account for the remaining 10 percent.

The Reserve Banks expect a modest volume increase for paper-based check products in 1999. Total forward check collection volume (processed and fine sort) is projected to increase 1.4 percent in 1999, reflecting a projected increase of 3.1 percent in processed volume and a decrease of 9.5 percent in fine sort volume. Returned check volume is projected to increase 2.2 percent. Volumes for electronic check presentment with paper checks subsequently delivered, electronic presentment of truncated checks, and check imaging are expected to grow 28.7 percent, 19.2 percent, and 66.4 percent, respectively. Electronic check information volume is expected to decline 15.1 percent as volume continues to shift to electronic check presentment products.

The Reserve Banks view interstate branch banking and competition in the interbank check collection market as

important external factors affecting their volume projections for paper-based products. Although interstate branch banking may eventually reduce the size of the interbank check collection market, Reserve Bank check collection volumes may increase in 1999 as banks focus on resolving merger-related operational concerns. In addition, some Reserve Banks have seen increased check collection and returned check volumes as smaller third-party processors and correspondent banks have exited the interbank check collection market. Thus, the projected volume increase for paper-based products appears reasonable. The projection of substantially increased volumes and penetration rates for electronic and image services, however, may be optimistic given the level of resources that most banks are committing to year 2000 preparations.

2. *Automated Clearing House (ACH)*—Table 7 presents the actual 1997, estimated 1998, and projected 1999 cost recovery performance for the commercial ACH service.

TABLE 7.—ACH PRO FORMA COST AND REVENUE PERFORMANCE
[\$ millions]

Year	Revenue	Operating costs and imputed expenses	Special project costs recovered	Total expense [2+3]	Net income (ROE) [1 - 4]	Target ROE	Recovery rate after target ROE (percent) [1/(4+6)]	Special project costs deferred and financed
	1	2	3	4	5	6	7	8
1997	72.7	53.1	11.1	64.2	8.5	4.0	106.6	10.8
1998 (Est)	68.2	49.6	12.0	61.6	6.6	4.0	103.9	0.0
1999 (Bud)	65.1	57.8	0.0	57.8	7.4	4.5	104.6	0.0

a. *1997 Performance*—The ACH service recovered 106.6 percent of total expenses, including imputed expenses, automation consolidation special project costs budgeted for recovery, and targeted ROE, in 1997. ACH volume in 1997 was 9.7 percent higher than 1996 volume.

b. *1998 Performance*—Through August 1998, the ACH service recovered 105.3 percent of total expenses, including imputed expenses, targeted

ROE, and the completion of debt retirement related to automation consolidation special project costs. For the full year, Reserve Banks estimate that the service will recover 103.9 percent of total expenses, compared with the targeted 1998 recovery rate of 100.4 percent. The estimated overrecovery is due to lower-than-budgeted overhead and support costs. Through August 1998, commercial ACH volume has increased 13.2 percent over

the same period in 1997. For the full year, Reserve Banks expect commercial volume to increase 11.5 percent, compared with the 15.4 percent increase originally projected. Volume growth is projected to be lower than planned due to the aggressive 1998 volume target and consolidation in the banking industry.

c. *1999 Pricing*—After several years of significant price reductions, Reserve Banks plan further, more modest price reductions in 1999 for the automated

clearing house (ACH) service (see table 8). (Including the reductions for 1999, fees for ACH items have decreased more than 40 percent since 1996.) These changes support the System's strategic direction to encourage the migration from a paper-based to a more electronic payments system.

TABLE 8
[In dollars]

Fee category	1998 fee	1999 fee
Item originated in small file ⁹	0.008	0.007
Item received	0.008	0.007
Premium cycle surcharge	0.005	0.000
Return item surcharge	0.040	0.000

The Reserve Banks will reduce the fee for items originated in small files by one mill, generating \$0.2 million in aggregate savings to depository institutions in 1999. In addition, the Reserve Banks will reduce the fee for forward items received by one mill, saving customers \$3.4 million in 1999. Finally, the Reserve Banks will eliminate both the premium and return-item surcharges, generating an additional \$2.5 million in fee reductions. Based on 1998 volume

estimates, changes to the ACH fee schedule will reduce fees to depository institutions by a total of approximately \$6.2 million in 1999.

In addition to the fee changes, the Reserve Banks have received approval to no longer accept paper or telephone return items and paper notifications of change, beginning in January 1999. Instead, depository institutions will be expected to submit those items electronically (either through a computer connection or a voice response system). A facsimile service will be available in limited circumstances in which an item cannot be submitted electronically. This change is intended to expedite the return of items and help move the ACH service to a more electronic environment. In addition, the Reserve Banks now offer a new product to enable receiving depository financial institutions (RDFIs) that use a third-party processor for their ACH processing to receive a copy of their ACH items so that they can provide remittance information to their customers.

The Reserve Banks project that the ACH service will recover 104.6 percent of its costs in 1999, including imputed expenses and targeted ROE. Expenses in 1999 are projected to be \$8.2 million, or

16.5 percent, higher than 1998 estimated costs, excluding 1998 special project costs. Total expenses for 1999 are projected to decline \$3.9 million, or 6.3 percent, from their 1998 level when special project costs are included in the 1998 estimate. Total revenue in 1999 is projected to be \$65.1 million, or 4.4 percent less than the 1998 estimate. The lower revenue is attributable to 1999 price reductions and potential changes in the way the Reserve Banks provide services to private-sector ACH operators. The Reserve Banks are evaluating the way they treat private-sector ACH operators and their customers with respect to fees and deadlines to determine if an alternative approach would better promote competition in the market for ACH services.

ACH volume in 1999 is projected to increase 14.5 percent over 1998 estimates. This volume projection includes the expected effects of marketing and education initiatives that are planned for next year.

3. *Funds Transfer and Multilateral Settlement*—Table 9 presents the actual 1997, estimated 1998, and projected 1999 cost recovery performance for the funds transfer and multilateral settlement services.

TABLE 9.—FUNDS TRANSFER PRO FORMA COST AND REVENUE PERFORMANCE
[\$ millions]

Year	Revenue	Operating costs and imputed expenses	Special project costs recovered	Total expense [2+3]	Net income (ROE) [1-4]	Target ROE	Recovery rate after target ROE (percent) [1/(4+6)]	Special project costs deferred and financed
	1	2	3	4	5	6	7	8
1997	97.8	78.6	7.4	85.9	11.9	5.1	107.4	0.0
1998 (Est)	94.2	80.7	0.2	80.9	13.3	6.2	108.1	0.0
1999 (Bud)	71.2	65.0	0.0	65.0	6.2	5.2	101.5	0.0

a. *1997 Performance*—For 1997, the funds transfer and multilateral settlement services recovered 107.4 percent of total expenses, including imputed expenses, automation consolidation special project costs budgeted for recovery, and targeted ROE, compared with a targeted recovery rate of 104.3 percent. Operating costs were 2.1 percent lower than original budget estimates because of greater-than-expected efficiencies realized from processing funds transfers in a centralized processing environment and a decrease in overhead costs.

Funds transfer on-line volume increased 8.2 percent over the 1996 level, compared with a budgeted

increase of 4.2 percent. This volume increase was due to strong economic activity.

b. *1998 Performance*—Through August 1998, the funds transfer and multilateral settlement services recovered 110.9 percent of total expenses, including imputed expenses, targeted ROE, and the completion of debt retirement related to automation consolidation special project costs. For full-year 1998, the Reserve Banks estimate that the funds transfer and multilateral settlement services will recover 108.1 percent of total expenses, compared with a targeted recovery rate of 102.8 percent. The higher recovery rate is primarily attributable to a large increase in on-line transaction revenue and small increases in electronic

connection and off-line transaction revenues.

On-line funds transfer volume through August 1998 has increased 10.1 percent relative to the same period in 1997. This robust volume growth is above historical trend and is attributable mainly to sustained strong economic growth. For the full year, the Reserve Banks expect volume to increase 7.3 percent, compared with the more conservative original target of 3.8 percent.

c. *1999 Funds Transfer Pricing*—Starting in 1998 and continuing through first quarter 1999, the Reserve Banks are consolidating their off-line transfer processing functions at the Federal Reserve Banks of Boston and Kansas

⁹ Small files contain fewer than 2,500 items; large files contain 2,500 items or more.

City. By consolidating the off-line portion of the funds transfer business, the Reserve Banks expect to reduce total off-line processing costs, streamline off-line activity, and ensure uniform customer service levels nationwide.

The Reserve Banks will implement a block-declining price structure for the basic funds transfer fee on February 1, 1999. Under the new price structure, a per transfer fee of \$0.34 will be charged for the first 2,500 funds transfers originated and received by a depository institution each month; a per transfer fee of \$0.27 will be charged for additional transactions up to 80,000 transfers each month; and, for every transaction above 80,000 transfers each month, a per transfer fee of \$0.21 will be assessed. Prior to implementing the block-declining price schedule, the Reserve Banks will lower the basic funds transfer fee from \$0.40 to \$0.34 for January 1999.

On average, basic funds transfer fees will decline by 35.0 percent under the new structure compared with the current fee level. (Including the reductions for 1999, fees for Fedwire funds transfers have declined nearly 50 percent since 1996. Including 1999, the average on-line transfer fee for a Fedwire funds transfer has declined 48 percent since 1996.) This third consecutive reduction in the funds transfer fee will save depository institutions approximately \$27.8 million in 1999, reflecting both the continued benefit of scale economies from centralized processing and the reduction of corporate overhead allocations in 1999. The implementation of a volume-based pricing structure will bring Fedwire pricing in line with other funds transfer and payment messaging systems and is expected to increase the efficiency of the service.

The Reserve Banks will increase the off-line transaction surcharge from \$12.00 to \$13.00 to reflect more fully the costs of processing off-line transfers and to encourage off-line customers with higher transfer volume to install electronic connections. This increase will become effective on February 1, 1999.

Reserve Banks project that the Fedwire funds transfer service will recover 101.5 percent of total expenses, including imputed expenses and targeted ROE, in 1999. Total costs are expected to decline \$15.6 million, or 19.4 percent, from the 1998 estimate primarily because of a significant reduction in the allocation of corporate overhead to the service. Lower data processing costs associated with automation consolidation also contribute to the lower costs. Excluding

corporate overhead expenses, total costs for the funds transfer service are projected to decline \$3.9 million, or 6.2 percent, from 1998 to 1999. Service revenue is projected to decline \$23.0 million, or 24.4 percent, in 1999 compared with the 1998 estimate as a result of the lower fees contained in the volume-based pricing structure.

On-line funds transfer volume is expected to increase 5.8 percent over 1998 estimated levels. This volume projection is consistent with long-term historical trends for the service and reflects an anticipated slowdown in growth relative to the high volume growth over the last three years.

d. 1999 Multilateral Settlement Pricing—During the first quarter of 1999, the Reserve Banks will implement an enhanced multilateral settlement service that will allow participants in settlement arrangements to submit settlement files to them via a computer interface connection or a Fedline® terminal. The enhanced service will improve operational efficiency over current methods and reduce settlement risk to participants by granting settlement finality on the settlement day. It also enables Reserve Banks to manage and limit risk by incorporating risk controls that are as robust as those used currently in the Fedwire funds transfer service. The Reserve Banks will continue to offer the current "settlement sheet" and Fedwire-based multilateral settlement services.¹⁰ The settlement sheet service, however, will be phased out gradually and all participating arrangements will need to make plans to migrate to the enhanced service by year-end 2001.

The Reserve Banks will adopt a price structure for the enhanced service that is similar to the price structure for the current settlement sheet service. The new price structure will consist of a fixed charge for each settlement file and a fixed price for each settlement entry on the file. The Reserve Banks also will assess the same prices for the enhanced service and the current settlement sheet service. This approach will eliminate an economic incentive for clearing arrangements to postpone migrating to the enhanced service.

The Reserve Banks will implement a fee of \$0.95 for each settlement entry on a settlement file or settlement sheet submitted to the Reserve Banks. This is a reduction of \$0.05 from the current \$1.00 per entry fee. A \$12.00 fee will be charged for each settlement file or

settlement sheet submitted to the Reserve Banks. This is a new fee designed to recover the fixed costs associated with maintaining static settlement information for each arrangement and processing daily settlements. Each settlement arrangement that incurs total settlement charges of less than \$60 during a calendar month will pay a minimum fee that raises total charges for the month to \$60. This minimum fee is designed to recover the fixed costs of supporting arrangements that are not active users of the Reserve Banks' multilateral settlement services, including those arrangements that use Reserve Bank multilateral settlement services as contingency back-up to another settlement method.

The current off-line surcharge for arrangements that submit settlement information via non-electronic means (fax, phone, or paper) will increase from \$10.00 to \$13.00. The revised surcharge will be consistent with the Fedwire funds transfer and book-entry securities transfer off-line surcharges, and, similarly, it will reflect more fully the costs of processing off-line settlements. The higher fee will provide an additional economic incentive for settlement participants to migrate to the more efficient enhanced service. The off-line origination surcharge will be waived by Reserve Banks that do not provide an electronic submission capability for the settlement sheet service. The current \$10.00 surcharge for telephone notification will increase to \$13.00 in 1999.

Fees for the Fedwire-based multilateral settlement service used by national, small-dollar and large-dollar settlement arrangements will remain unchanged for 1999. A per transfer fee is also charged for each Fedwire funds transfer sent and received into or out of the settlement account for Fedwire-based arrangements.

4. Book-Entry Securities—Table 10 presents the actual 1997, estimated 1998, and projected 1999 cost recovery performance for the book-entry securities service.^{11 12}

¹¹ Includes purchase and sale activity.

¹² The Reserve Banks provide securities 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 notice, consists of the revenues, expenses, and volumes associated with the transfer of all non-Treasury securities. For Treasury securities, the Reserve Banks act as fiscal agents for the Treasury Department, which assesses fees for the securities transfer component of the service. The Reserve Banks assess a fee for the money settlement component of a Treasury securities transfer; this component is not treated as a priced service.

¹⁰ The settlement sheet service refers to the transmission to a Reserve Bank of settlement information that is then posted to participants' accounts via the Reserve Banks' accounting system.

TABLE 10.—BOOK-ENTRY SECURITIES TRANSFER PRO FORMA COST AND REVENUE PERFORMANCE
[\$ millions]

Year	Revenue	Operating costs and imputed expenses	Special project costs recovered	Total expense [2+3]	Net income (ROE) [1-4]	Target ROE	Recovery rate after target ROE (percent)[1/(4+6)]	Special project costs deferred and financed
	1	2	3	4	5	6	7	8
1997	17.1	14.4	1.5	15.9	1.3	0.9	101.9	3.6
1998 (Est)	18.5	13.7	2.4	16.1	2.5	1.0	108.5	1.6
1999 (Bud)	16.7	13.2	1.7	15.0	1.8	1.0	104.5	0.0

a. *1997 Performance*—The book-entry securities service recovered 101.9 percent of total expenses in 1997, including imputed expenses, automation consolidation special project costs budgeted for recovery, and targeted ROE. On-line volume increased 0.3 percent from the 1996 level, compared with a budgeted decrease of 3.4 percent. This higher-than-budgeted volume may partially have been the result of increased securities movements associated with mergers and higher-than-expected mortgage refinancing activity, which affects activity in the mortgage-backed securities market.

b. *1998 Performance*—Through August 1998, the book-entry securities service recovered 104.3 percent of total expenses, including imputed expenses, automation consolidation special project costs budgeted for recovery, and targeted ROE. For full-year 1998, the Reserve Banks estimate that the book-entry securities service will recover 108.5 percent of total costs compared with a targeted recovery rate of 100.0 percent. This overrecovery is attributable to higher-than-expected transaction volume.

On-line volume has increased 17.5 percent through August 1998 compared with the same period in 1997. This large increase in volume is due to a significantly higher level of repackaging and new issuance of mortgage-backed securities. For the full year, the Reserve Banks estimate that on-line volume will increase 14.5 percent, which is significantly higher than the original budgeted 0.8 percent volume decline.

c. *1999 Pricing*—Starting in 1998 and continuing through first quarter 1999, the Reserve Banks are consolidating their off-line processing functions at the Federal Reserve Banks of Boston and Kansas City. By consolidating the off-line portion of the book-entry securities transfer service, the Reserve Banks expect to reduce total off-line activity costs, streamline off-line activity, and ensure uniform customer service levels nationwide.

Starting February 1, 1999, the Reserve Banks will split the current \$2.25 on-line origination fee into a basic transfer fee charged to the sending bank and receiving bank of both on-line and off-line transfers. The Reserve Banks will implement a \$0.85 fee for each securities transfer and reversal sent and received, a 24.4 percent fee decrease in the total fee per transfer. (Including changes in other fees, the price index for the book-entry securities service has declined more than 15 percent since 1996.) The Reserve Banks also will convert the current \$10 off-line fee into an off-line surcharge and raise this surcharge to \$13 to be consistent with the off-line surcharge in the Fedwire funds transfer and multilateral settlement services. An additional pricing change, applying the existing account-maintenance fee to all joint-custody collateral accounts, will be implemented on July 1, 1999. Delaying implementation of this change until mid-year 1999 will allow affected customers time to consolidate accounts, make any necessary system changes, and notify pledgees.

Changing the on-line transfer fee to a fee assessed to both senders and receivers more accurately aligns the costs and benefits to participants in a transfer. The new price structure promotes pricing consistency with other Federal Reserve electronic payment services and is consistent with practices in the securities industry. The decision to charge for all joint-custody accounts held by a customer, rather than just the first account, is intended to implement a consistent, cost-based, Systemwide pricing practice following the completion of the Reserve Banks' conversion to the centralized National Book-Entry System (NBES). Prior to the conversion of all Reserve Banks to NBES, account maintenance pricing for joint custody securities accounts was different across the Reserve Banks. During the transition to NBES, the interim pricing practice for these accounts was standardized to charge

one account-maintenance fee per customer regardless of the number of pledgees. This interim practice achieved consistency and minimized the effect on customers converting to the new system but resulted in reduced revenue and incomplete recovery of processing costs.

The Purchase and Sale service represents less than 3.0 percent of the costs and revenues of the book-entry securities service. Provision of the service is consolidated at the Federal Reserve Bank of Chicago. The Reserve Banks will increase the transaction fee for securities purchases and sales from \$34 to \$40 to recover the costs of providing the service.

The Reserve Banks project that the book-entry securities service will recover 104.5 percent of costs in 1999, including imputed expenses, targeted ROE, and the complete retirement of debt relating to automation consolidation special project costs. Total expenses, excluding special project costs, are projected to decrease \$0.5 million, or 3.6 percent, in 1999 versus the 1998 estimate because full implementation of NBES (the New York District was the last to convert in February 1998) and full consolidation at Federal Reserve Automation Services (FRAS) have created scale economies that lower per-item data processing costs.

Book-entry securities transfer service revenue is expected to decline \$1.8 million, or 9.9 percent, in 1999 compared with the 1998 estimate as a result of the fee levels contained in the new pricing structure and price levels. The reduced fees are expected to save depository institutions approximately \$1.4 million in 1999.

The Reserve Banks expect on-line book-entry securities transfer volume to decline 4.0 percent in 1999 from the 1998 estimated level. According to Reserve Bank projections, the unusually high volume growth rate in 1998 is an aberration and 1999 volume will likely decline from its 1998 level. In addition, some volume losses are expected as

large customers consolidate their operations.

5. *Noncash Collection*—Table 11 lists the actual 1997, estimated 1998, and projected 1999 cost recovery

performance for the noncash collection service.

TABLE 11.—NONCASH COLLECTION PRO FORMA COST AND REVENUE PERFORMANCE
[\$ millions]

Year	Revenue	Operating costs and imputed expenses	Special project costs recovered	Total expense [2+3]	Net income (ROE) [1 - 4]	Target ROE	Recovery rate after target (ROE) (percent) [1/(4+6)]	Special project costs deferred and financed
	1	2	3	4	5	6	7	8
1997	4.4	3.5	0.3	3.8	0.7	0.2	110.9	0.0
1998 (Est)	3.7	2.7	0.0	2.7	1.0	0.2	130.0	0.0
1999 (Bud)	2.6	2.0	0.0	2.0	0.5	0.1	117.3	0.0

a. *1997 Performance*—The noncash collection service recovered 110.9 percent of total expenses in 1997, including imputed expenses, automation consolidation special project costs budgeted for recovery, and targeted ROE, compared with a target recovery rate of 103.8 percent. Volume for 1997 decreased 17.1 percent from 1996 volumes compared with a 19.6 percent budgeted volume decline.

b. *1998 Performance*—Through August 1998, the noncash collection service recovered 135.0 percent of its costs. For full-year 1998, the Reserve Banks estimate that the noncash service will recover 130.0 percent of costs, including imputed expenses and targeted ROE, compared with the projected recovery rate of 126.8 percent. The higher recovery rate is attributable to higher-than-expected revenue from additional called bond activity generated by lower interest rates and

slightly higher-than-budgeted coupon volume. The higher recovery rate also reflects lower costs resulting from efficiencies gained from full-year centralized operations at the Jacksonville Branch.

Through August, volume has decreased 13.8 percent compared with the same period in 1997. The Reserve Banks estimate that full-year 1998 volume will decline 14.1 percent from 1997 levels compared with a 19.7 percent budgeted volume decline.

c. *1999 Pricing*—The Reserve Banks will retain 1999 fees at their 1998 levels. The Reserve Banks project that the noncash collection service will recover 117.3 percent of total costs, including imputed expenses and targeted ROE, in 1999. These fees will yield a ten-year recovery rate for the noncash collection service of approximately 96 percent. Total expenses are projected to decline \$0.6 million, or 23.0 percent, in 1999,

and total revenues are projected to decline \$1.1 million, or 30.3 percent, because of a projected volume decline of 26.0 percent. Volume declines will continue as the number of unmatured bearer municipal securities declines. New issues of bearer municipal securities effectively ceased in mid-1983 when the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) removed the tax advantage for investors.

6. *Special Cash*—Priced special cash services represent a very small portion (approximately 0.05 percent) of overall cash services provided by the Reserve Banks to depository institutions. Special cash services include wrapped coin, nonstandard packaging of currency orders and deposits, and registered mail shipments of currency and coin.

Table 12 presents the actual 1997, estimated 1998, and projected 1999 cost recovery performance for the special cash service.

TABLE 12.—SPECIAL CASH PRO FORMA COST AND REVENUE PERFORMANCE
[\$ millions]

Year	Revenue	Operating costs and imputed expenses	Special project costs recovered	Total expense [2+3]	Net income (ROE) [1 - 4]	Target ROE	Recovery rate after target (ROE) (percent) [1/(4+6)]	Special project costs deferred and financed
	1	2	3	4	5	6	7	8
1997	5.1	4.7	0.0	4.7	0.4	0.3	102.5	0.0
1998 (Est)	2.6	2.4	0.0	2.4	0.2	0.1	104.0	0.0
1999 (Bud)	2.6	2.5	0.0	2.5	0.2	0.0	104.3	0.0

a. *1997 Performance*—In 1997, the special cash service recovered 102.5 percent of total expenses, including imputed expenses and targeted ROE, compared with a targeted recovery rate of 102.3 percent.

b. *1998 Performance*—Through August 1998, the special cash service recovered 101.8 percent of total

expenses, including imputed expenses and targeted ROE. For full-year 1998, the Reserve Banks estimate that the special cash service will recover 104.0 percent of total expenses, compared with a targeted recovery rate of 103.5 percent. Costs are lower than budgeted in most offices.

Revenue is estimated to decline approximately \$2.5 million, or 49.4 percent, in 1998 compared with 1997, due mainly to the reclassification of cash access as a nonpriced service. Before 1998, nonstandard access to cash services was treated as a priced service. In anticipation of implementing the uniform cash access policy in May 1998,

the Federal Reserve concluded that, due to the governmental nature of this function, the costs and revenue associated with nonstandard access should be treated as a nonpriced service.¹³

In June 1998, the Chicago office began offering a nonstandard packaging service for a fee of \$12.00 per order or deposit. The Detroit Branch offers this service for the same fee.

c. *1999 Pricing*—For 1999, the Reserve Banks project that the special cash service will recover 104.3 percent of costs, including imputed expenses and targeted ROE. Total costs in 1999 are projected to rise \$0.1 million, or 2.7 percent, from the 1998 level. Revenue in 1999 is expected to increase \$0.1 million, or 2.6 percent, from the 1998 level.

The Cleveland, Cincinnati, and Pittsburgh offices will implement a uniform District fee of \$1.80 per box for wrapped coin to replace the previous range of \$1.95 to \$2.25 per box. The Helena office will reduce its wrapped coin fee from \$2.90 to \$2.50 per box to reflect more accurately the cost of providing this service.

The El Paso and San Antonio offices will reduce the registered mail surcharge from \$100 to \$80 to reflect more accurately the costs of providing this service. The San Antonio office plans to discontinue this service in April 1999.

II. Private Sector Adjustment Factor

A. *Overview*—The Board has approved a 1999 PSAF for Federal Reserve priced services of \$115.8 million. This amount represents an increase of \$7.3 million, or 6.7 percent, from the 1998 PSAF of \$108.5 million.

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 comprising consolidated financial data for the

nation's fifty largest (in asset size) bank holding companies (BHCs).

The methodology for calculating the PSAF involves determining the value of Federal Reserve assets that will be used in providing priced services during the coming year. Short-term assets are assumed to be financed with short-term liabilities; long-term assets are assumed to be financed with a combination of long-term debt and equity derived from the BHC model.

Imputed capital costs are determined by applying related interest rates and rates of return on equity from the BHC model. The long-term debt and equity rates are based on BHCs in the model for each of the last five years. Because short-term debt, by definition, matures within one year, only data for the most recent year are used for computing the short-term debt rate.

The PSAF comprises these capital costs as well as 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 Banks to settle transactions.

B. *Asset Base*—The total estimated value of Federal Reserve assets to be used in providing priced services in 1999 is reflected in table 13. Table 14 shows that the assets assumed to be financed through debt and equity are projected to total \$651.4 million. This represents a net increase of \$35.1 million, or 5.7%, from 1998 assets of \$616.3 million, as shown in table 15. This increase results from a building project in one District, offset somewhat by a lower asset base associated with Federal Reserve Automation Services (FRAS).

C. *Cost of Capital, Taxes, and Other Imputed Costs*—Table 15 also shows the financing and tax rates and the other required PSAF recoveries approved for 1999 and compares the 1999 rates with the rates used for developing the PSAF for 1998. The pre-tax return on equity rate increased from 22.4% for 1998 to 23.5% for 1999. The increase is a result of stronger 1997 BHC financial performance included in the 1999 BHC model relative to the 1992 BHC financial performance used in the 1998 BHC model.

D. *Capital Adequacy*—As shown in table 16, the amount of capital imputed for the 1999 PSAF totals 27.2% of risk-weighted assets and 3.0% of total assets.

The capital to risk-weighted asset ratio well exceeds the 8% guideline for adequately capitalized state member banks and BHCs. The capital to total asset ratio meets the 3% guideline for adequately capitalized institutions that are rated composite 1 under the CAMELS rating system.

III. Analysis of Competitive Effect

All operational and legal changes considered by the Board that have a substantial effect on payment system participants are subject to the competitive impact analysis described in the March 1990 policy statement "The Federal Reserve in the Payments System." In this analysis, Board 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 of the Federal Reserve deriving from such legal differences. If the fees or fee structures create such an effect, the Federal Reserve must further evaluate the changes to assess whether their benefits—such as contributions to payment system efficiency, payment system integrity, or other Board objectives—can be retained while reducing the hindrances to competition.

The Board does not believe that the fees and fee structures will have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve in providing similar services. Assuming the Reserve Banks' volume and cost projections are accurate, the fees are set to provide the Federal Reserve a return on equity at least equal to that earned on average by large bank holding companies during the past five years. Moreover, the 1999 fee schedules enable the Reserve Banks to continue to recover all actual and imputed costs of providing priced services over the long run; these fees also provide for projected full cost recovery in 1999. Therefore, the Board believes the 1999 Reserve Bank price and service levels will not adversely affect the ability of other service providers to compete effectively with the Reserve Banks in providing similar services.

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¹³The uniform cash access policy provides for a base level of free currency access to all depository institutions but restricts the number of offices served and the frequency of access. Depository institutions that meet minimum volume thresholds can obtain more frequent free access. Fees are charged for additional access beyond the free level.

Table 13
 Comparison of Pro Forma Balance Sheets
 for Federal Reserve Priced Services
 (millions of dollars — average for year)

	<u>1999</u>	<u>1998</u>
Short-term assets		
Imputed reserve requirement on clearing balances	\$ 757.7	\$ 750.4
Investment in marketable securities	6,819.6	6,753.5
Receivables ¹⁴	69.1	69.0
Materials and supplies ¹⁴	4.1	4.3
Prepaid expenses ¹⁴	20.2	14.1
Items in process of collection	<u>3,470.7</u>	<u>2,922.8</u>
Total short-term assets	11,141.4	10,514.1
Long-term assets		
Premises ^{14,15}	386.6	360.4
Furniture and equipment ¹⁴	150.3	145.2
Leasehold improvements and long-term prepayments ¹⁴	<u>21.1</u>	<u>23.3</u>
Total long-term assets	558.1	528.9
Total assets	<u>\$11,699.5</u>	<u>\$11,043.0</u>
Short-term liabilities		
Clearing balances and balances arising from early credit of uncollected items	\$ 7,577.3	\$ 7,503.9
Deferred credit items	3,470.7	2,922.8
Short-term debt ¹⁶	<u>93.4</u>	<u>87.4</u>
Total short-term liabilities	11,141.4	10,514.1
Long-term liabilities		
Long-term debt ¹⁶	<u>207.6</u>	<u>185.1</u>
Total liabilities	11,349.0	10,699.2
Equity ¹⁶	<u>350.5</u>	<u>343.8</u>
Total liabilities and equity	<u>\$11,699.5</u>	<u>\$11,043.0</u>

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

¹⁴Financed through PSAF; other assets are self-financing.

¹⁵Includes allocations of Board of Governors' assets to priced services of \$0.4 million for 1999 and \$0.5 million for 1998.

¹⁶Imputed figures represent the source of financing for certain priced services assets.

Table 14
Derivation of the 1999 PSAF
(millions of dollars)

A. Assets to be financed ¹⁷		
Short-term	\$ 93.4	
Long-term ¹⁸	<u>558.1</u>	\$651.4
B. Weighted average cost		
1. Capital Structure ¹⁹		
Short-term debt	14.3%	
Long-term debt	31.9%	
Equity	53.8%	
2. Financing rates/costs ¹⁹		
Short-term debt	5.1%	
Long-term debt	6.6%	
Pre-tax equity ²⁰	23.5%	
3. Elements of capital costs		
Short-term debt	$\$ 93.4 \times 5.1\% = \$ 4.8$	
Long-term debt	$207.6 \times 6.6\% = 13.7$	
Equity	$350.5 \times 23.5\% = \underline{82.4}$	
		\$ 100.8
C. Other required PSAF recoveries		
Sales taxes	\$ 8.7	
Federal Deposit Insurance assessment	2.8	
Board of Governors expenses	<u>3.4</u>	
		<u>14.9</u>
D. Total PSAF recoveries		<u>\$ 115.8</u>
As a percent of capital	17.8%	
As a percent of expenses ²¹	18.2%	

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

¹⁷ Priced service asset base is based on the direct determination of assets method.

¹⁸ Consists of total priced long-term assets, including the priced portion of FRIT assets.

¹⁹ All short-term assets are assumed to be financed with short-term debt. Of the total long-term assets, 37.2% are assumed to be financed with long-term debt and 62.8% with equity.

²⁰ 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.

²¹ Systemwide 1999 budgeted priced service expenses less shipping are \$636.9 million.

Table 15
Comparison of 1999 and 1998 PSAF Components

	<u>1999</u>	<u>1998</u>
A. Assets to be financed (millions of dollars)		
Short-term	\$ 93.4	\$ 87.4
Long-term	<u>558.1</u>	<u>528.9</u>
Total	\$651.4	\$616.3
B. Cost of capital		
Short-term debt rate	5.1%	5.1%
Long-term debt rate	6.6%	6.8%
Pre-tax return on equity	23.5%	22.4%
Weighted average long-term cost of capital	17.2%	16.9%
C. Tax rate	32.0%	32.1%
D. Capital structure		
Short-term debt	14.3%	14.2%
Long-term debt	31.9%	30.0%
Equity	53.8%	55.8%
E. Other required PSAF recoveries (millions of dollars)		
Sales taxes	\$ 8.7	\$ 9.1
Federal Deposit Insurance assessment	2.8	2.6
Board of Governors expenses	3.4	2.8
F. Total PSAF		
Required recovery	\$ 115.8	\$ 108.5
As percent of capital	17.8%	17.6%
As percent of expenses	18.2%	18.1%

Table 16
 Computation of 1999 Capital Adequacy
 for Federal Reserve Priced Services
 (millions of dollars)

	<u>Assets</u>	<u>Risk Weight</u>	<u>Weighted Assets</u>
Imputed reserve requirement on clearing balances	\$ 757.7	0.0	\$ 0.0
Investment in marketable securities	6,819.6	0.0	0.0
Receivables	69.1	0.2	13.8
Materials and supplies	4.1	1.0	4.1
Prepaid expenses	20.2	1.0	20.2
Items in process of collection	3,470.7	0.2	694.1
Premises	386.6	1.0	386.6
Furniture and equipment	150.3	1.0	150.3
Leases, leasehold improvements & long-term prepayments	<u>21.1</u>	1.0	<u>21.1</u>
Total	\$11,699.5		\$ 1,290.2
Imputed Equity for 1999	\$350.5		
Capital to Risk-Weighted Assets	27.2%		
Capital to Total Assets	3.0%		

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

AUTOMATED CLEARING HOUSE FEE SCHEDULE

	<u>Fees</u>
Origination (per item or record):	
Items in small files ²²	\$0.007
Items in large files ²²	\$0.006
Addenda record	\$0.002
[Return item surcharge	\$0.00]
[Premium cycle surcharge	\$0.00]
Receipt (per item or record):	
Item	\$0.007
Addenda record	\$0.002
[Return item surcharge	\$0.00]
Input file processing fees (per file):	
Small file	\$1.75
Large file	\$6.75
Monthly fees:	
Account servicing fee (per routing number)	\$25.00
Information Extract File	\$10.00
Return item/notification of change (NOC) fees ²³ :	
Voice response return/NOC ²⁴	\$2.00
[Telephone return	N/A]
[Paper return/NOC	N/A]
Nonelectronic input/output fees ²⁵ :	
Tape input/output	\$25.00
Paper output	\$15.00
Diskette output	\$15.00
Facsimile return/NOC ²⁶	\$15.00

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

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

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

²⁵ These services are offered in contingency situations only.

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

FUNDS TRANSFER AND MULTILATERAL SETTLEMENT FEE SCHEDULE

Funds transfer:	<u>Fees</u>
January 1999 basic transfer fee (originations and receipts)	\$0.34
Volume-based pricing fees (originations and receipts) ²⁷	
Per transfer for the first 2,500 transfers per month	\$0.34
Per transfer for additional transfers up to 80,000 per month	\$0.27
Per transfer for every transaction over 80,000 per month	\$0.21
Surcharge ²⁷	
Off-line transfer originated or received	\$13.00
Telephone notification	\$13.00
Multilateral settlement:	
Basic fee	
Settlement charge per entry	\$0.95
Settlement file charge	\$12.00
Surcharge	
Off-line origination per file ²⁸	\$13.00
Telephone notification per file	\$13.00
Minimum monthly fee	\$60.00
Fedwire-based, small-dollar arrangement per settlement day ²⁹	\$100.00
Fedwire-based, large-dollar arrangement per settlement day ²⁹	\$100.00 - \$175.00

²⁷ Effective February 1, 1999.

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

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

BOOK-ENTRY SECURITIES FEE SCHEDULE

Book-entry securities transfer:	<u>Fees</u>
Basic transfer fee ³⁰	
Transfer originated	\$0.85
Transfer received	\$0.85
Reversal originated	\$0.85
Reversal received	\$0.85
Surcharge ³⁰	
Off-line transfer originated or received	\$13.00
Off-line reversal originated or received	\$13.00
Monthly maintenance fees	
Account maintenance (per account) ³¹	\$15.00
Issues maintained (per issue/per account)	\$0.45
Purchase & sale:	
Transaction fee	\$40.00

³⁰ Effective February 1, 1999. The 1998 fees and fee structure will remain in effect during January 1999.

³¹ Through June 30, 1999, the current practice of charging a monthly account maintenance fee to the customer's first priced custody account will remain in effect. Starting July 1, 1999, each book-entry securities priced collateral account will be charged the monthly maintenance fee.

NONCASH COLLECTION FEE SCHEDULE

Coupon collection:	<u>Fees</u>
Cash letters:	
with five or fewer coupon envelopes	\$7.50
with six to fifty coupon envelopes	\$15.00
Coupon envelopes:	
five or fewer	\$4.75
six to fifty	\$3.00
Return items	\$15.00
 Bond collection:	 \$50.00 ³²

³² Plus actual shipping expense.

SPECIAL CASH SERVICES FEE SCHEDULE

	<u>Fees</u>	
Wrapped coin (per box):		
All Fourth District offices		\$1.80
Helena		\$2.50
Nonstandard Packaging:		
All Seventh District offices (per order or deposit) ³³		\$12.00
Helena (per coin bag)		\$3.00
Registered Mail Fees: ³⁴		
	<u>Surcharge</u>	<u>Insurance Fee</u> ³⁵
Boston	\$30.00	\$0.45
[Cleveland	N/A]	
[Cincinnati	N/A]	
Helena	\$8.50	\$0.37
All Tenth District offices	\$12.00	\$0.26
El Paso and San Antonio ³⁶	\$80.00	\$0.24
All Twelfth District offices	\$14.00	\$0.20 (Continental U.S.) \$0.30 (Other locations)

³³ \$1s to \$20s only. This service only applies to customers ordering in excess of \$50,000 per week.

³⁴ Depository institutions also pay all postal fees and any insurance charges (provided through the U.S. Postal Service) in addition to Federal Reserve Bank charges.

³⁵ Per \$1,000 being shipped using registered mail service. This insurance charge applies only to shipments over \$25,000 for all Tenth District offices, the El Paso and San Antonio offices, and all Twelfth District offices.

³⁶ The San Antonio office will no longer offer the registered mail service effective April 1, 1999.

ELECTRONIC CONNECTION FEE SCHEDULE³⁷

The Reserve Banks charge fees for the electronic connections used by depository institutions to access priced services and allocate the cost and revenue associated with electronic access to the various priced services. The Reserve Banks will maintain 1999 electronic access fees at their 1998 levels.

Connection types:	<u>Fees</u>
Dial - receive only (FLASH-Light) ³⁸	\$30.00 per month
Dial - receive and send (Fedline)	\$75.00 per month
Link encrypted dial	\$200.00 per month
High-speed dial @ 56 kbps	\$350.00 per month
Multi-drop leased line	\$450.00 per month
Dedicated leased line (to 9.6 kbps)	\$750.00 per month
High-speed leased line @ 19.2 kbps	\$850.00 per month
High-speed leased line @ 56 kbps	\$1,000.00 per month
High-speed leased line @ 128 kbps	\$1,800.00 per month
High-speed leased line @ 256 kbps	\$2,000.00 per month
Cross-district	Actual cost ³⁹
Contingency testing options: ⁴⁰	
Premium dedicated dial test connection	\$500.00 per month
Basic dedicated dial test connection	\$250.00 per month
Shared dial test connection	\$150.00 per month
Third-party contingency site dial test connection	\$45.00 per month

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

³⁸ FLASH-Light support will be discontinued on March 31, 1999.

³⁹ The customer will pay the actual costs of the circuit and a monthly surcharge to cover an equitable share of expenses associated with customer support, depreciation of hardware (that is, link encryption units), and other overhead expenses. This fee must be, at a minimum, equivalent to the standard fee for the particular type of leased line connection.

⁴⁰ Use of Dial Test connections should not exceed 60 hours per month for the Premium service and 120 hours per year for the Basic and Shared services. Customers exceeding this guideline should establish a Dedicated Leased Line connection for testing.

By order of the Board of Governors of the
Federal Reserve System, November 4, 1998.

Jennifer J. Johnson,

Secretary of the Board.

[FR Doc. 98-30338 Filed 11-12-98; 8:45 am]

BILLING CODE 6210-01-C