

SUPPLEMENTARY INFORMATION:

I. Priced Services

A. Discussion—From 1993 through 2002, the Reserve Banks recovered 98.8 percent of their total costs for providing priced services, including special project costs, imputed expenses, and targeted after-tax profits or return on equity (ROE).¹

Table 1 summarizes the priced services' actual, estimated, and budgeted cost recovery rates for 2002, 2003, and 2004, respectively. Cost recovery is estimated to be 85.6 percent in 2003 and budgeted to be 93.6 percent in 2004. The aggregate cost recovery rates are heavily influenced by the performance of the check service, which accounts for approximately 83 percent

of the total cost of priced services. The electronic services (FedACH, Fedwire funds and national settlement (NSS), and Fedwire securities) account for approximately 17 percent of costs, while noncash and special cash services represent a *de minimis* amount.

Table 1

Pro Forma Cost and Revenue Performance (\$ millions)					
YEAR	1 ^a REVENUE	2 ^b TOTAL EXPENSE	3 NET INCOME (ROE) [1-2]	4 ^c TARGET ROE	5 RECOVERY RATE AFTER TARGET ROE [1/(2+4)]
2002	918.3	891.7	26.6	92.5	93.3%
2003 (Estimate)	889.0	933.4	-44.4	104.7	85.6%
2004 (Budget)	934.5	886.3	48.2	112.4	93.6%

^a Revenue includes net income on clearing balances (NICB). For 2002 and 2003, clearing balances, net of imputed reserve requirements and balances used to finance priced services assets, are assumed to be invested in three-month Treasury bills. For 2004, net clearing balances are assumed to be invested in a broader portfolio of investments. Based on the historical average return on the portfolio, income is imputed as a constant return over the rate used to determine the cost of clearing balances. NICB equals the imputed income from these investments less earnings credits granted to holders of clearing balances. For 2002 and 2003, the cost of clearing balances was based on the federal funds rate and for 2004 the cost is based on the discounted three-month Treasury bill rate.

^b The calculation of total expense includes operating, imputed, and other expenses. Imputed and other expenses include taxes, FDIC insurance, Board of Governors' priced services expenses, and the cost of float and interest on imputed debt, if any. Credits or debits related to the accounting for pensions under FAS 87 are also included.

^c Target ROE is the after-tax ROE included in the PSAF.

Table 2 presents an overview of the 2002, 2003 budget, 2003 estimate, and

2004 budget cost recovery performance by category of major priced service.

Table 2

Priced Services Cost Recovery (percent)				
PRICED SERVICE	2002	2003 BUDGET	2003 ESTIMATE	2004 BUDGET
All services	93.3	93.7	85.6	93.6
Check	91.7	92.5	83.2	91.9
FedACH	104.1	100.3	101.6	101.8
Fedwire funds & NSS	99.6	101.8	98.0	103.3
Fedwire securities	100.1	100.6	106.0	104.7
Noncash collection	100.6	110.9	118.9	113.3
Special cash	94.8	77.3	71.9	n.a.

n.a. – Not applicable

¹ These imputed expenses, such as taxes that would have been paid, and the return on equity that would have to be earned had the services been furnished by a private business firm, are referred to as the private-sector adjustment factor (PSAF). The ten-year recovery rate is based upon the pro forma

income statements for Federal Reserve Banks' priced services published in the Board's Annual Report. Beginning in 2000, the PSAF has included additional financing costs associated with pension assets attributable to priced services. This ten-year cost recovery rate has been computed as if these

costs were not included in the PSAF calculations prior to 2000. If these costs were included in the calculations, and assuming that the Reserve Banks would not have made any contemporaneous cost or revenue adjustments, the 10-year recovery rate would be 97.8 percent.