

1. *2003 Estimated Performance*—In 2003, the Reserve Banks estimate that they will recover 85.6 percent of the costs of providing priced services, compared with the budgeted recovery rate of 93.7 percent. The Reserve Banks do not expect to recover fully actual and imputed expenses, incurring an overall net loss of \$44.4 million, which is \$87.3 million less than the budgeted net income of \$42.9 million. This shortfall is largely driven by lower-than-expected net income from clearing balances (NICB) and increased pension costs, as well as lower-than-expected check service revenues and one-time costs associated with check restructuring.²

Two primary factors are contributing to the check service's underrecovery. First, higher-than-anticipated volume declines, as well as a shift by customers to lower priced check products as a result of low interest rates, have resulted in check service operating revenues in 2003 running \$26.9 million below budget. The Federal Reserve System's recent retail payments research, along with more recent anecdotal information from the industry, indicates that check use in the United States is continuing to decline.³ The deterioration in the Reserve Banks' check volume is consistent with this nationwide trend. Second, while the Reserve Banks have reduced operating costs in response to the volume declines, one-time costs associated with the check restructuring initiative have contributed to significantly lower-than-budgeted check service cost recovery.

2. *2004 Projected Performance*—For 2004, the Reserve Banks project a priced services cost recovery rate of 93.6

percent, with net income of \$48.2 million, as compared to target net income of \$112.4 million. The primary factors affecting 2004 cost recovery are the one-time costs associated with planned and potential further restructuring of the Reserve Banks' check operations and the continued decline in check volume.

The primary risks to the Reserve Banks' ability to achieve their budget targets are greater-than-expected costs associated with the restructuring initiative and a steeper decline in the Reserve Banks' check volume than the projected 8.9 percent decrease. Additionally, the Check Clearing for the 21st Century Act (Check 21) presents risk to existing volumes, pricing, and product strategies. To address the continuing decline in check volumes, the Reserve Banks will continue to implement a business and operational strategy that will improve efficiency, reduce excess capacity and other costs, and position the service to achieve its financial and payment system objectives over the long term.

3. *2004 Pricing*—The following summarizes the Reserve Banks' changes in fee structures and levels for priced services in 2004, along with an indication of overall experience with prices in each service line since 1996:⁴

Check

- The Reserve Banks will raise fees for forward-collection check products 5.8 percent, return check products 6.1 percent, and payor bank check products 0.7 percent compared with January 2003 fees.
- The price index for the check service has increased about 37 percent since 1996.

⁴ Data elements used in calculating the price index for 2002 and prior years include explicit fee revenue from priced services and volumes associated with those services. For 2003 and 2004, the year-over-year percentage changes are based on comparisons of the 2002 results, 2003 estimates, and 2004 projections.

FedACH

- The Reserve Banks will reduce the input file processing fee from \$5.00 to \$3.75, and will retain all other fees at their current levels.
- The price index for the FedACH service has decreased about 66 percent since 1996.

Fedwire Funds and National Settlement

- The Reserve Banks will retain fees at their current levels.
- The price index for the Fedwire funds and national settlement service has decreased about 62 percent since 1996.

Fedwire Securities

- The Reserve Banks will reduce the on-line transfer origination and receipt fee from \$0.40 to \$0.32 and will reduce the claim adjustment fee from \$0.38 to \$0.30. The Reserve Banks will increase the off-line surcharge from \$25 to \$28 and will increase the joint custody surcharge from \$22 to \$30. The Reserve Banks will retain all other fees at their current levels.
- The price index for the Fedwire securities service has decreased about 39 percent since 1996.

4. *2003 Price Index*—Figure 1 compares indices of fees for the Federal Reserve's priced services with the GDP price deflator. Since 1995, the price index for all priced services has increased a total of about 3.6 percent. The price index for electronic payment services (FedACH, Fedwire funds and national settlement, Fedwire securities, and electronic check products), as well as electronic access to Federal Reserve Banks' priced services, is projected to decrease 1.2 percent in 2004. The price index for paper-based payment services (check and noncash collection) is expected to increase about 5.9 percent in 2004. Compared with the price index for 2003, the price index for all Federal Reserve Bank priced services is projected to increase approximately 3.9 percent in 2004.

² The Reserve Banks' check restructuring initiative will reduce Federal Reserve check processing locations from 45 to 32 sites and will streamline check adjustments by 2004. (See <http://www.frbsservices.org/Retail/pdf/CheckRestructure-CustomerLetter.pdf>.)

³ See Gerdes, Geoffrey R. and Jack K. Walton II, "The Use of Checks and Other Noncash Payment Instruments in the United States," Federal Reserve Bulletin, August 2002, pp. 360–374. (See <http://www.federalreserve.gov/pubs/bulletin/default.htm>.)