

(which accounts for 2 percentage points of that decline) and price increases. Fine-sort check volume is expected to decline by 8.1 percent from the 2003 estimate. Return volume is projected to decrease by 7.0 percent compared with the 2003 estimate, a somewhat slower rate than forward volume. The difference in the rates of decline for forward and return volumes is a result of an increase in the Reserve Banks' share of the market for returned check processing in 2003 that is expected to continue into 2004.

The Reserve Banks expect a slight decrease in payor bank service volumes. Electronic presentment volume is expected to decline 0.8 percent in 2004. Image volume is projected to grow 5.1 percent in 2004, compared with estimated 2003 volumes. Image volume growth is expected to be driven by the increased functionality of FedImage services (for example, electronic access to archived check images using web technology).

The Board believes that the greatest risks to achieving the projected cost recovery rate for the check service are

volume declines and associated revenue losses beyond System budget projections, and greater-than-expected costs associated with the check restructuring initiative.

The Board believes that the cost, volume, and revenue projections are reasonable and has approved the price changes for the Reserve Banks' check service.

D. *Automated Clearinghouse (FedACH)*—Table 9 below shows the 2002, 2003 estimate, and 2004 budgeted cost recovery performance for the commercial FedACH service.

Table 9

| FedACH Pro Forma Cost and Revenue Performance (\$ millions) | | | | | |
|----------------------------------------------------------------|--------------|-----------------------|-----------------------------------|--------------------|--------------------------------------------------------|
| YEAR | 1 REVENUE | 2 TOTAL EXPENSE | 3 NET INCOME (ROE) [1-2] | 4 TARGET ROE | 5 RECOVERY RATE AFTER TARGET ROE [1/(2+4)] |
| 2002 | 71.8 | 62.5 | 9.3 | 6.5 | 104.1% |
| 2003 (Estimate) | 68.6 | 60.0 | 8.6 | 7.5 | 101.6% |
| 2004 (Budget) | 74.8 | 64.5 | 10.2 | 8.9 | 101.8% |

1. *2002 Performance*—In 2002, the FedACH service recovered 104.1 percent of total costs, including imputed expenses, and targeted ROE, compared with a targeted recovery rate of 101.4 percent. The greater-than-budgeted cost recovery was due mainly to higher-than-expected volume. The commercial ACH origination volume processed by the Reserve Banks was 12.1 percent higher than in 2001, compared with the 7.3 percent decrease reflected in the 2002 budget. This reflects lower-than-expected volume shift to a private-sector ACH operator.

2. *2003 Estimate*—The Reserve Banks estimate that the FedACH service will recover 101.6 percent of total expenses in 2003, compared with the budgeted recovery rate of 100.3 percent. The greater-than-budgeted cost recovery is attributable mainly to lower-than-expected information technology support costs. Although the Reserve Banks estimate that 2003 volume will be

13.7 percent higher than in 2002, they estimate that revenue will be \$3.2 million lower, primarily because of price reductions that became effective January 2, 2003. Through August 2003, the Reserve Banks' FedACH volume has increased 13.2 percent over the same period in 2002.

3. *2004 Pricing*—The Reserve Banks project that the FedACH service will recover 101.8 percent of its costs in 2004, including imputed expenses, and targeted ROE. The Reserve Banks are keeping fees unchanged except for a decrease in the input file processing fee from \$5.00 to \$3.75. *Ceteris paribus*, the lower per-file fee would reduce the Reserve Banks' FedACH revenue by about \$4 million annually. The budgeted \$6.2 million increase in revenue reflects 8.7 percent growth in anticipated FedACH processed origination volume, increased electronic connection revenue, and increased NICB as a result of the Reserve Banks'

change in the NICB computation methodology. The year-over-year cost increase is due primarily to projects related to FedLine® for the Web and to the development of new FedACH services, including risk management and international ACH services. The Reserve Banks generally believe that nationwide ACH volume will grow somewhat faster than FedACH volume as large depository institutions continue to shift their volume to the other ACH operator.

The Board believes that the cost, volume, and revenue projections are reasonable and has approved the price changes for the Reserve Banks' FedACH service.

E. *Fedwire Funds and National Settlement Service*—Table 10 below shows the 2002, 2003 estimate, and 2004 budgeted cost recovery performance for the Fedwire funds and national settlement service.