Why GAO Did This Study

Federal Reserve Banks compete with private-sector entities to provide services while Federal Reserve Board staff also supervise the Reserve Banks and other service providers and financial institution users of these services. The Monetary Control Act requires the Federal Reserve to establish fees for its services on the basis of the costs incurred in providing the services and give due regard to competitive factors and the provision of an adequate level of services nationwide. GAO found the Federal Reserve had a detailed cost accounting system for capturing these costs that generally aligned with federal cost accounting standards. Although this system was evaluated and found effective by a public accounting firm in the 1980s, it has not undergone a detailed independent evaluation since then. In addition to the actual costs it incurs in providing services, the Federal Reserve also must include an allocation of imputed costs which takes into account the taxes that would have been paid and the return on capital that would have been provided if the services had been furnished by a private firm. Although its processes for simulating the imputed costs generally were reasonable, the Federal Reserve did not impute certain compliance costs private-sector firms can face—such as for planning for recovery and orderly wind down after financial or other difficulties. Including additional simulated costs competitors can incur and obtaining periodic external evaluations of its cost accounting practices would provide greater assurance that the Federal Reserve fully includes appropriate costs when pricing its services.

Since the mid-2000s, the effects of Federal Reserve participation in the payment services market have included lower prices for many customers; overall market share for competitors also increased. Although some competitors raised concerns about some Federal Reserve pricing practices, customers GAO interviewed generally were satisfied with its services and prices. The Federal Reserve also has a process for assessing its pricing and products to help ensure it is not unfairly leveraging any legal advantages. Since 2005, the Federal Reserve lowered prices for checks and smaller electronic payments while increasing prices for wire transfers. During this time, private-sector competitors’ market share expanded overall. But the Federal Reserve’s only competitor in small electronic payments and wire transfers told GAO that increased regulatory costs and competitive pressure from the Federal Reserve creates difficulties for the long-term viability of private-sector operators.

Most market participants GAO interviewed were satisfied with how the Federal Reserve performed various regulatory and service provider roles in the payments system. Most of the 24 participants GAO interviewed had no concerns over how the Federal Reserve separated its supervisory activities from its payment services activities. The Federal Reserve also has begun collaborating with market participants to pursue improvements to the safety, speed, and efficiency of the payment system. Although some competitors said the Federal Reserve should reduce its payment services role, many participants supported having the Federal Reserve remain an active provider. Federal Reserve staff indicated that these activities provide the Federal Reserve with sufficient revenue to enable it to provide ubiquitous access at affordable prices.

What GAO Found

The Federal Reserve Banks are authorized to provide payment services—such as check clearing and wire transfers—to ensure continuous and equitable access to all institutions. The Depository Institutions Deregulation and Monetary Control Act of 1980 (Monetary Control Act) requires the Federal Reserve to establish prices for its payment services on the basis of the costs incurred in providing the services and give due regard to competitive factors and the provision of an adequate level of services nationwide. GAO found the Federal Reserve had a detailed cost accounting system for capturing these costs that generally aligned with federal cost accounting standards. Although this system was evaluated and found effective by a public accounting firm in the 1980s, it has not undergone a detailed independent evaluation since then. In addition to the actual costs it incurs in providing services, the Federal Reserve also must include an allocation of imputed costs which takes into account the taxes that would have been paid and the return on capital that would have been provided if the services had been furnished by a private firm. Although its processes for simulating the imputed costs generally were reasonable, the Federal Reserve did not impute certain compliance costs private-sector firms can face—such as for planning for recovery and orderly wind down after financial or other difficulties. Including additional simulated costs competitors can incur and obtaining periodic external evaluations of its cost accounting practices would provide greater assurance that the Federal Reserve fully includes appropriate costs when pricing its services.

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What GAO Recommends

GAO recommends that the Federal Reserve consider ways to incorporate, where appropriate, additional costs faced by private-sector competitors in its simulated cost recoveries and periodically obtain an external audit that tests the accuracy of the methods it uses to capture and simulate its costs. The Federal Reserve noted steps they will take to address GAO’s recommendations.

View GAO-16-614. For more information, contact Lawrence Evans at (202) 512-8678 or evansl@gao.gov.

Highlights of GAO-16-614, a report to the Chairman, Committee on Financial Services, House of Representatives

PAYMENT SERVICES

Federal Reserve’s Competition with Other Providers Benefits Customers, but Additional Reviews Could Increase Assurance of Cost Accuracy

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