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Formulating the Imputed Cost of Equity Capital for Priced Services at Federal Reserve Banks

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Abstract

According to the 1980 Monetary Control Act, the Federal Reserve Banks must establish fees for their priced services to recover all operating costs as well as the imputed costs of capital and taxes that would be incurred by a profit-making firm. Since 2002, the Federal Reserve has made fundamental changes to the calculations used to set the imputed costs. This article describes and analyzes the current approach, which is based on a simple average of three methods as applied to a peer group of bank holding companies. The methods estimate the cost of equity capital from three perspectives - the historical average of comparable accounting earnings, the discounted value of expected future cash flows, and the equilibrium price of investment risk as per the capital asset pricing model. The authors show that the current approach also provides stable and sensible estimates of the cost of equity capital over the past twenty years.

Keywords: priced services, Federal Reserve Banks, cost of equity, asset pricing**JEL Classification:** E5, G2, G3, G12[Suggested Citation](#) >[Show Contact Information](#) >[Download This Paper \(Delivery.cfm/SSRN_ID789825_code387943.pdf?abstractid=789825&mirid=1\)](#)[Open PDF in Browser \(Delivery.cfm/SSRN_ID789825_code387943.pdf?abstractid=789825&mirid=1&type=2\)](#)

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