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January 15, 2004

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. OP-1164; Federal Reserve System; Federal Reserve Bank Currency Recirculation Policy; 68 Federal Register 59176, October 14, 2003.

Dear Ms. Johnson:

The American Bankers Association ("ABA") appreciates the opportunity to comment on the Federal Reserve Board's ("Board") proposed changes to its cash services policy. ABA's member banks serve as the Treasury Department's and the Federal Reserve System's primary mechanism to circulate notes and coin to the public. In doing so, banks through their 88,000 branches and 352,000 ATMs perform a significant public service in acting as the U.S. Government's conduit for the orderly and efficient dissemination of currency throughout the United States.

The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks—makes ABA the largest banking trade association in the country.

Background

The Board proposes to modify its existing cash services policy "to reduce depository institutions' overuse of Federal Reserve Bank cash processing services which will affect approximately 100 institutions with large cash businesses." The Board plans to accomplish this objective by establishing a custodial inventory program to encourage banks to retain currency in their vaults subject to specific Board imposed requirements and, in the alternative, by imposing a fee on banks that deposit currency in one denomination and order the same denomination within the same business week of its deposit. This activity is known as "cross-shipping." This newly imposed fee would not apply to \$50 and \$100 notes and, at least for an undetermined period, would not apply to \$1 notes.

The Board anticipates that the fee would be in the range of $5 to $6 for each bundle of currency subject to cross-shipping. A bundle of currency is defined as a package of 1,000 notes. Also, the Board proposes a *de minimis* exemption, which would exempt banks from recirculation fees for "the first 1,000 bundles of currency cross-shipped in a zone or sub-zone each quarter…." The Board indicates that the *de minimis* exemption would eliminate recirculation fees for many smaller banks, which do not have extensive currency needs. In terms of the application of the *de minimis* exemption, the Board intends that there be no carryover from quarter to quarter of bundles not cross-shipped to qualify for exemption and that the exemption apply to the total of all denominations cross-shipped and not to each denomination.

In terms of the operation of the custodial inventory program, the Board proposes that the currency transferred under this program would be owned by a Reserve Bank but be physically located in the vault of a bank participating in the program and segregated from the bank's own currency. Banks will be expected to use their own currency to meet their own needs and could not place in the inventory more than 25 percent of the value of their total holdings of $5, $10 and $20 notes.

In order to help determine the effectiveness of the custodial inventory program, the Board proposes a one-year 2004 proof-of-concept program. The Fed will select 15 sites for the program from high volume users of Reserve Bank cash services.

To participate in the proof-of-concept program, banks would apply to the Board between January 29, 2004 and March 15, 2004. The Board will determine whether the custodial inventory program should be made permanent based on responses to this proposal and the findings of the proof-of-concept program.

ABA Position

As the Board considers alternatives to address the perceived bank overuse of the Federal Reserve Bank cash processing system, the ABA urges the Board to place foremost in its policy deliberations the banking industry's historic service to the U.S. Government in the distribution of cash to the public. Banks are essential to the orderly, nationwide delivery of U.S. currency. Banks perform this function without direct compensation by the U.S. Government. At the same time, there are costs associated with the staffing, transportation, processing and protection of currency, which are absorbed by the banking industry. The Board should consider whether restrictions and additional fees should be imposed on banks for processing this essential and uncompensated national service.

In terms of the specifics of the proposal, the ABA urges the Board to make certain modifications to reduce additional burdens imposed on banks and to clarify its overall application to the banking industry.

As indicated above, the definition of cross-shipping, which triggers recirculation fees, mandates that in order to avoid these fees, banks cannot deposit and order the same denomination within the same business week. The ABA urges the Board to clarify through examples the application of the cross-shipping scenarios to practical situations. As an example, does the proposed regulation mean that a business week is five days in duration only within the same calendar week, or does the five days extend five business days forward and backward from the date of deposit? What is the application of the proposed rule on a bank that deposits on a Friday? Can it order the same denomination on Monday and avoid the recirculation fee? What is the definition of a "deposit" and when is an "order" placed?

In any case, the real deposit and order period, in practical terms, extends much beyond five days when ordering procedures, lead times, and transportation contingencies are taken into consideration. To better account for these issues, the ABA recommends that the cross-shipping definition be reduced to three business days.

The ABA urges the Board to consider the specific needs of the banking industry for "fit" currency to support the proper operation of ATMs. Many banks depend on the Federal Reserve System to provide the highest quality of notes exclusively for use in their ATMs.

Imposing recirculation fees for cross-shipping could result in additional financial and labor costs for banks to verify and "clean" notes from throughout their branch system to provide ATM cash. Also, using this customer deposit system for ATM cash would likely result in cash that would not meet customer expectations.

Although the Board indicates this proposed rule should only impact approximately 100 banks and provides for a *de minimis* exemption, the ABA is concerned that the application of the new policy and the *de minimis* exemption will periodically and inappropriately extend the reach of the recirculation fees to small, community banks. In our discussions with community bankers, it is clear that because of unique aspects of local economies, there can be periodic or seasonal spikes in currency needs, which could sweep community banks into the coverage of the proposal. The Board should closely monitor the application of the *de minimis* exception so as to ensure that community banks are not penalized for currency needs over which they have no direct control, and often cannot anticipate.

Additionally, particularly in rural areas, banks do not have ready access to armored car services to move customer cash from branch to branch in order to avoid the impact of this proposal. Bankers are also hesitant for safety reasons to transport cash between branches themselves. The only system that works for them involves ordering and depositing cash through the Federal Reserve System to accommodate cash needs throughout their extended branch system. The ABA urges the Board to ensure that this type of cash processing activity on the part of community banks will not trigger the recirculation fees associated with the proposal.

The custodial inventory program imposes initial and continuing significant costs on banks in order to accommodate the increased volume of cash and the Board's heightened security requirements. The proposal specifically identifies security procedures that banks must follow in order to participate in the program. These include compliance with Reserve Bank guidelines for vaults, access control and camera coverage, physical segregation of custodial currency from bank currency, unannounced access for U.S. Government audits and full indemnification for theft or loss. While the Board recognizes that banks "may incur some additional costs in operating a custodial inventory" there is no indication as to the extent of the costs. The ABA believes these costs may well be extensive and beyond what the Board anticipates. Along with the risks associated with retaining additional cash, this could discourage banks from participating in the program.

Conclusion

The ABA urges the Board to recognize the vital role banks play in the nationwide distribution of currency and take that into consideration when seeking to impose additional cash processing costs on the banking industry. Also, the ABA suggests various modifications to the proposal which, in particular, will clarify the application of the cross-shipping restrictions on banks, recognize the problem such a policy could impose on community banks, especially in rural areas, provide exemptions for periodic or seasonal spikes in currency needs and recognize the significant costs to banks participating in the custodial inventory program.

Thank you for the opportunity to comment on this proposed rule. If you have any questions regarding this letter or need additional information, please do no hesitate to contact the undersigned at (202) 663-5333.

Sincerely,

John C. Rasmus

John C. Rasmus