The PNC Financial Services Group, Inc.
249 Fifth Avenue
One PNC Plaza, 21st Floor
Pittsburgh, PA 15222-2707

412 768-4251 Tel
412 705-2679 Fax
james.keller@pnc.com

James S. Keller
Chief Regulatory Counsel

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Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th and C Streets, NW
Washington, DC 20051
regs.comments@federalreserve.gov

Attention: Docket No. OP-1164

Re: Request for Comments Concerning Federal Reserve Bank Currency Recirculation Policy

Dear Ms. Johnson:

PNC Bank, National Association ("PNC Bank"), Pittsburgh, Pennsylvania, is pleased to submit comments on the proposal of the Board of Governors of the Federal Reserve System ("Board") to modify its cash services policy by adding two elements: (1) a custodial inventory program that provides an incentive to depository institutions to hold currency in their vaults to meet customers' demand, and (2) a fee to depository institutions that deposit currency to and order currency from Federal Reserve Banks ("Reserve Banks") within the same week instead of recirculating currency deposited with them among their customers (68 Fed. Reg. 59,176 (October 14, 2003)).

As of September 30, 2003, PNC Bank was the fifteenth largest bank in the United States, with approximately $65.2 billion in assets. PNC Bank maintains branches in Pennsylvania, New Jersey, Ohio, Kentucky and Indiana. PNC Bank also has two bank affiliates: PNC Bank, Delaware, which has branches in Delaware, and UnitedTrust Bank, which has branches in New Jersey and Pennsylvania. PNC Bank also maintains a national ATM network and is one of the nation's fifteen largest providers of cash services. PNC Bank's cash services operations are fully outsourced.

PNC Bank intends to complete and submit an application to participate in the proof-of-concept program, and would also be interested in participating in the custodial inventory program. Our only concern is that the information submitted by participants be treated as confidential, and disclosed only on an aggregate basis, inasmuch as such data has significant competitive value.

Set forth below in **bold** are the specific questions from the Federal Register notice, followed by PNC Bank's responses:

1) **How effective will the proposed custodial inventory program and the recirculation fee be in reducing or eliminating cross-shipping? What are the major benefits and drawbacks of custodial inventories and the recirculation fee?**

PNC Bank believes that the custodial inventory program will be effective only for the banks/bank vaults that qualify. Because some banks may have to incur an additional cost to “fitness sort” currency prior to recirculation, the expense to the financial institutions could exceed the anticipated benefits. Financial institutions may determine that paying a cross-shipping fee is more attractive than incurring the costs of internal fitness sorting, the cost of transporting currency between vaults and/or the cost of funds or excess cash balances. The costs that are being shifted from the Reserve Banks to the banks will ultimately fall on the banks’ customers. PNC believes that the end result will be an increase in costs to banks and their customers that is greater than the expense the Reserve Banks project they will incur.

2) **Are there effective alternate approaches that the Board should consider to increase depository institutions’ recirculation of currency?**

Recirculation of currency by financial institutions is a function of customer requirements and costs to the financial institutions. PNC Bank recommends the following: (1) standardize enforcement of the Circular 2 cross-shipping policy across all Reserve Bank districts; (2) identify efficiencies that will reduce the Reserve Banks’ cost of processing (for example, outsourcing cash processing for $1, $5, $10 and $20 denominations); and (3) include exemptions for release of new series notes and for increased currency needs during the holiday seasons. Because of advances in technology, such as ATM’s and cash vending equipment, financial institution customer cash requirements have substantially changed. In response to changing customer requirements, financial institutions have developed new cash products requiring “fit currency.” In our opinion, the Reserve Banks have not always been equally as responsive to the changing needs of their customers, the financial institutions.

3) **Are there factors not described in this notice that would affect a depository institution’s decision to pay a recirculation fee or undertake greater recirculation of currency within its organization? What are the benefits and drawbacks of allowing a <u>de</u> <u>minimis</u> exemption of 1,000 bundles of currency per depository institution per quarter for a zone or sub-zone? Is there an alternative approach to administering the <u>de</u> <u>minimis</u> exemption that would address identified drawbacks and still achieve the intended objectives of reducing the burden of complying on depository institutions with small currency operations while ensuring that most cross-shipping activity is governed by the policy?**

A decision either to pay a recirculation fee or increase internal recirculation will depend upon customer requirements and financial institution costs. PNC Bank questions how one could determine whether or not the de minimis exemption is equitable. We ask the Board to consider whether a percent of bundles, up to a predefined limit, would be more equitable. Such a predefined exemption could be higher for larger banks since smaller banks would be sharing the cost. In our view, smaller institutions could circumvent the Board's proposed cross-shipping policy by either ordering and depositing with a larger institution or ordering directly from the Reserve Banks and depositing to larger institutions with which they have correspondent relationships. Since such a practice would increase recirculation costs for the larger institution, the larger institution in turn would have to develop a program to monitor these increased expenses and either impose deposit restrictions or charge for such activity.

4. U nder what circumstances would it be reasonable and practical for depository institutions to adopt lower-cost alternatives to the recirculation fee, such as having tellers manually sort currency at the point of receipt, paying currency to customers without fitness sorting when a range in quality of notes is acceptable to customers, or obtaining currency processing services from other local institutions or armored carriers able to offer prices that reflect economies of scale?

In PNC Bank's opinion, manual fitness sorting is not efficient because it will require additional staff at a time when financial institutions are looking for ways to reduce the time tellers spend handling currency so they can concentrate on customer service and sales of additional bank products. We also believe that putting currency-sorting equipment in branches is not cost effective. The effectiveness of a program to supply "Fed-like Fit" currency will depend upon the fitness calibrations established by the Reserve Banks. (PNC Bank has not yet had an opportunity to evaluate the effect of the equipment calibration standards and fitness sorting guidelines published by the Reserve Banks on December 24, 2003.) If the calibration requirements result in slower machines, the time required before currency can be recirculated or shipped to the Reserve Banks will be increased.

5. Ar e there alternative approaches that could be used to improve the efficiency of handling one-dollar notes other than applying the cross-shipping fee? What savings would an institution expect to realize from these alternative approaches?

One-dollar notes are low value and minimal risk to institutions. As a result, it is not effective to fitness sort this denomination. PNC Bank proposes the following alternatives: (1) exempt one-dollar notes; (2) during the verification process destroy all one-dollar notes deposited to the Reserve Banks and recommend to the U.S. Treasury that dollar notes no longer be printed; (3) outsource the processing of one-dollar notes; or (4) add a separate de minimis exemption for one-dollar notes.

6. What costs would a depository institution anticipate incurring for operating a custodial inventory? How should Reserve Banks calculate the cap on the amount of currency that a depository institution may deposit in a custodial inventory? How many bundles of currency should Reserve Banks require a depository institution to recirculate per week to qualify for a custodial inventory?

We concur with the proposed requirements for the custodial inventory. However, we recommend that the Board clarify the process for monitoring, auditing and evaluating holdings. One problem may be the limited financial institution vault storage spaces available for the custodial inventory program.

7. What w ould be the effects of the program, if any, on depository institutions' customers, or armored carriers, or on other parties?

PNC Bank believes that the costs of the program will inevitably be passed from outsource vendors to the banks and, in turn, to the banks' customers. In addition to the proposed fees such costs will include increased administration and monitoring costs. It appears to us that the methodology favors some institutions.

PNC Bank expresses its appreciation for the opportunity to comment on the proposed recirculation policy. We hope our comments are helpful in formulating the final bank currency recirculation policy.

Sincerely,

James S. Keller

cc: Joseph J. Abdelnour

Douglas R. Arnold
Robert Blackburn
Gwendolyn P. Gray
Barbara J. Moran
Karen S. Morgan
Regis F. Reinersmann
John J. Wixted, Jr.