January 15, 2004

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

RE: Request for comment – Federal Reserve Bank Currency Recirculation Policy
Docket No. OP-1164

Dear Ms. Johnson:

KeyCorp, a financial services company with assets of approximately $83 billion, is pleased to comment on the proposed Recirculation Policy. KeyCorp provides retail and wholesale banking, investment, financing and money management services to individuals and companies across the U.S. Key companies have a presence in 45 states from Maine to Alaska, including its network of KeyCenters (branches), ATMs, affiliate offices, online banking services and telebanking centers.

We are responding to the Board's request for comment on the proposed Federal Reserve Bank Currency Recirculation Policy. KeyCorp's positions on the proposed changes and responses to the questions in the proposal are stated below:

III. Overview of Proposed Recirculation Policy:

In the proposal, the Board indicates "that to minimize the societal cost of providing currency to the public, depository institutions should resume their traditional role of supplying fit currency from their customers' deposits to meet other customers' needs before turning to the Federal Reserve Banks to obtain currency." Key's position is that substantial additional research regarding the dynamics of US currency as well as the potential impact of this policy on the industry should be completed and published prior to its implementation. The effect of this policy as published is that the banking industry overall, and banks with medium and large cash operations in particular, will incur substantial additional costs that will be passed back to the consumer. These expenses will primarily be in the form of infrastructure changes, including the purchase of high speed currency sorting equipment, third party vendor expenses, armored courier expenses, recirculation fees, custodial inventory expenses and increased losses for counterfeits. Note that many depository institutions have expanded their ATM coverage areas based upon the ability to obtain low cost, fit currency and consumers benefit greatly from these networks, particularly in remote areas. This policy will negatively impact banks serving these areas.

The ‘one size fits all’ approach that the Federal Reserve has used in the development of the policy unduly penalizes depository institutions with medium and large cash operations. Depository institutions with small cash operations will fall below the 1,000 bundle de minimus exemption for recirculation fees, while those with very large operations have already benefited from economies of scale and have the volumes necessary to support the expense of a high speed currency sorting infrastructure. The remaining depository institutions with medium and large operations will bear the expense of this policy, incurring recirculation fees, custodial inventory costs or the expense of purchasing high speed currency sorting equipment. Most depository institutions do not have the infrastructure necessary to remove counterfeit notes from the system, thus the overall quality of currency will degrade. The Federal Reserve system currently captures 80% of all counterfeits, and as most depository institutions do not have the equipment necessary for large scale identification and capture of counterfeits, the industry and consumers will bear the cost of this increased risk.

The projected costs to the industry and the consumer may well exceed the $20MM estimate for the private sector and possibly the $35MM the public sector is estimated to spend of the next 10 years. The primary expense to the private sector will be for the currency sorting and fitting equipment necessary to support ATM networks, which require large quantities of fit, low denomination notes (primarily twenty dollar notes) as the published fitness rate for Federal Reserve deposits from depository institutions is unacceptable for ATMs. However, substantial additional expenses may result from the industry practice of outsourcing ATM servicing. Most armored courier companies participate in shared liability agreements with first and second line maintenance contracts for ATM servicing. If the armored courier companies obtain currency from depository institutions, then they will increase ATM service fees for the additional handling of the currency that will be required, as Federal Reserve currency is viewed as 100% accurate due to the state of the art high speed currency sorting equipment which many depository institutions will not be able to afford.

Custodial Inventory Program

KeyCorp believes that the custodial inventory component of this program will have a limited impact on cross-shipping, especially with a cap of 25% of the closing balances of the $5 - $20 denominations, due to the small size of the cap in relation to net balances and the costs associated with implementation of the inventory, which will include space, camera coverage, security, management and inventory costs. Key requests that the Board consider a larger cap, or one tied to the activity of each institution, to serve as greater incentive for depository institutions to participate in this component. Additionally, many depository institutions will not have the ability to move a portion of their allowable 25%, since the present cut-off time is 4:00pm (local) and many cash operations are processing deposits after this time. A later cut-off for deposits and withdrawals from the inventory would provide more opportunity for recirculation of a depository institution’s currency. Finally, KeyCorp requests that the number of bundles of currency that a depository institution should be required to recirculate per week should be tied to some measure of the activity at that institution, such as currency ordering and depositing activity, as opposed to a set number of bundles, to enable depository institutions with medium and large cash operations to compete with depository institutions with small and very large cash operations. Key also requests that the Board consider increasing the number of custodial inventory proof-of-concept sites to more than 15 to enable solid statistical sampling of the effects of this component.

Recirculation Fee:

As stated earlier in this response, KeyCorp believes the de minimus exemption should be tied to an activity measure for each depository institution, as opposed to a set bundle count, to avoid targeting only the depository institutions with medium and large cash operations. Cost will determine whether depository institutions adopt 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 broader range in the quality of notes is acceptable, etc. Most cross-shipping of currency in our industry results from the need for currency fit enough for automation, such as for ATMs. Large scale need for this type of currency requires automated fitness processing to be cost effective, historically proven more cost effective in a centralized versus a decentralized environment. Additionally, the publication of fitness standards by the Federal Reserve will further encourage the use and requirement for automated fitness processing. As a result, manual alternatives to automated fitness sorting will not be widely used by the depository institutions most impacted by this policy.

Not enough research has been published regarding the one-dollar note to make an effective recommendation regarding alternatives to the cross-shipping fee for this denomination. However, the industry is dependent upon the Federal Reserve to cull unfit one dollar notes from the system. One alternative that has been recommended is to convert the one dollar note to a coin, however, coin is very expensive to handle – it is heavy and requires more processing time when compared to similar denomination notes. What limited research has been published regarding this note suggests that its use is extensive in the US and the industry and is growing, and that if converted to coin, most depository institutions would incur increased internal expenses and outsourced fees which would be passed to the consumer.

Comments:

KeyCorp requests that the Board consider the following questions and recommended changes to the policy as it is published:

- The published de minimus exemption of 1,000 cross-shipped fit bundles per quarter should scaled to the size of the institution or cash operation in that zone by tying it to some measure, such as cross-shipping activity at each depository institution, to avoid penalizing only depository institutions with medium and large cash operations.
- Would the Board consider recommending a tax exemption for depository institutions purchasing high speed currency processing equipment in response to this policy?

- The recirculation fee should be lowered from the proposed $5 - $6 per bundle in the policy, perhaps a tiered threshold based upon cross-shipping activity or some other measure.
- The 25% cap for the custodial inventory should be raised to serve as greater incentive for depository institutions to participate in this program. Additionally, the 4:00pm cut-off should be extended to 7:00pm as many depository institutions have cash operations that are multi-shift. Extending the cut-off will encourage participation.
- Exempt ATM activity from the policy. Enable depository institutions the opportunity for limited cross-shipping activity to support their ATM networks using a separate endpoint or other delimiter. This will minimize impact to the consumer by allowing institutions the opportunity to maintain existing ATM networks, especially those that are remote.

We appreciate the Board's invitation for comment on this proposal. We welcome the opportunity to discuss our comments further and to be of any assistance the Board may deem appropriate.

Very truly yours,

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