BANK ONE

January 15, 2004

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551

RE: Docket No. OP-1164

Dear Ms. Johnson:

Bank One Corporation ("Bank One") appreciates the opportunity to comment on the Federal Reserve Bank Currency Recirculation Policy (the "Policy") ordered for publication on October 7, 2003 by the Board of Governors of the Federal Reserve System.

Bank One is the nation's sixth largest bank holding company with assets of more than $285 billion. Bank One conducts its banking business through Bank One, N.A., Bank One, Delaware, N.A., and other affiliated national banks and operating subsidiaries throughout the United States. Bank One also operates numerous non-bank subsidiaries that engage in trust and investment management, brokerages, investment and merchant banking, venture capital, equipment leasing and data processing.

Attached is Bank One's detailed response to the Policy.

Throughout this response we discuss two key issues of concern to Bank One: (1) We believe that the deminimis exemption of 1,000 bundles is not equitable to larger DIs and should be a size relative to the DI. (2) We believe that the CI element of the Policy will aid the DIs in compliance; however, the cap of the CI must be set at a level that will not require DIs to increase cash levels to fund orders. The CI cap should be a size relative to the DI.

In addition, Bank One would be eager to participate in further discussions of the exemption and CI cap elements of the Policy with the Federal Reserve in an effort to determine specific and relative criteria.

Again, Bank One appreciates the opportunity to provide its views on the Policy. Should you have any questions about our response or would like additional information, please do not hesitate to contact the undersigned.

Sincerely,

Kevin P. Meyer, First Vice President
Bank One, Cash Services
312-732-4709

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BANK ONE

Federal Reserve Bank Currency Recirculation Policy

Docket No. OP-1164

Bank One Response: Request for Comment

January 15, 2004

BANK ONE

<u>Response</u>: Federal Reserve Bank Currency Recirculation Policy

This document contains Bank One's response to the proposed changes to the cash services "<u>Federal Reserve Bank Currency Recirculation Policy</u>" issued by the Board of Governors of the Federal Reserve System.

Included in this response is the intent of Bank One to be considered in the Custodial Inventory Proof of Concept Program. Once the application for POC is available, Bank One will complete the application and deliver it to the Federal Reserve, Financial Services no later than March 15, 2004.

<u>Response</u>: Federal Reserve Bank Currency Recirculation Policy

***<u>Additional questions that Bank One is requesting a response include</u>*:**

1. The Fed has calculated the recirculation fee on their current actual costs. If the desired results are achieved (as a result of evaluation of the CI POC) and the volume of notes cross-shipped is reduced it is assumed that the recirculation fee would also be reduced. How is the Fed going to reduce the overhead and additional capacity as a result of the reduction? When these costs are removed, and the actual costs are reduced, will the fee be reduced as well?

2. We foresee some DIs passing on counterfeit notes to the general public (if not discovered at the time they are processed within the commercial customer deposits) so they will not take a loss if unable to charge back the depositor. How will the Fed address this?

3. What is the Fed defining as success criteria for the CI POC program? What is the target for reducing Cross Shipping?

4. How will Fed closings affect the CI element of this policy? How will this affect the determination of zones and sub-zones?

5. Is there any flexibility in the addition of another Fed site to the CI POC, such as Phoenix, Arizona?

6. What is the process for approving additional sub-zone requests?

7. Can a DI combine the current requirements of bundle recirculation and bundles cross-shipped to meet the 200-bundle CI eligibility? (average bundles recirculated + average bundles cross shipped = CI eligibility)

8. It is the Bank's opinion that "outsourced" or "third-party" vendors (such as armored carriers) should not be eligible to hold custodial inventories for themselves. What role does the Fed anticipate that these vendors will play?

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Response: Federal Reserve Bank Currency Recirculation Policy

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

The proposed program and fee will be effective but only when depository institutions ("DI") can address their common practices in a cost-effective manner. If the cost to comply with the policy is greater than the fee, the effectiveness of the policy will be impacted. The Custodial Inventory ("CI") element will aid DIs in compliance; however, the CI cap will need to be set at a level that will not require DIs to increase cash levels to fund orders. The CI cap and its relevance to a specific DI will drive the program's effectiveness in reducing or eliminating cross shipping.

What are the major benefits and drawbacks of custodial inventories and the recirculation fee?

Current CI eligibility requirements will make (smaller) sites ineligible for CI. Reducing CI eligibility requirements (especially in non-Fed cities) will allow a greater number of depository institutions or sites to participate in CI, further reducing cross shipping. There is no benefit to the recirculation fee.

2. Are there effective alternate approaches that the Board should consider to increase depository institutions' recirculation of currency?

Offering the custodial inventory program to smaller depository institutions (or sites) would increase the recirculation of currency. Increasing the number of CIs and adjusting the CI cap relative to DI size will create a net benefit in reducing cross shipping.

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?

If the custodial inventory cap is set such that a DI will be required to hold additional cash on their books to fully fund their currency orders, DI's will look closely at the cost benefit of paying the fee. Fluctuations in both interest and investment rates will influence the DI's decision to pay a cross shipping penalty.

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Response: Federal Reserve Bank Currency Recirculation Policy

What are the benefits and drawbacks of allowing a de minimis exemption of 1,000 bundles of currency per depository institution per quarter for a zone or sub-zone?

The exemption criteria should be based on factors relative to the DI. Examples would include the DI's size, cash flow volume, or number of cash vault sites per Fed zone. The current de minimis exemption affords smaller DIs a greater benefit than larger. DIs with multiple cash vaults per Fed zone are at a disadvantage to DIs that have one vault per Fed zone. DIs with one cash vault in a zone are eligible for the 1,000-bundle exemption and yet a DI with multiple cash vaults in different cities within the same zone get the same exemption.

Bank One would be interested in further discussing the exemption definition with the Fed in an effort to determine specific and relative DI criteria.

Is there an alternative approach to administering the de minimis 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?

The de minimis exemption should be a factor relative to the DI size. DIs with a greater number of sites should be administered in relation to their size and volume. Larger DIs are penalized by being held at the 1,000 bundle limit. DIs with one cash vault in a zone are eligible for the 1,000-bundle exemption and yet a DI with multiple cash vaults in different cities within the same zone get the same exemption.

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Response: Federal Reserve Bank Currency Recirculation Policy

4. Under 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?

Very few circumstances would make it reasonable or practical for these or any other alternatives. In general, we would not pass currency to customers that was not sorted. Process changes and additional costs associated with operational changes impact our margin. Changing the service provided to our customers would leave us vulnerable. Our customers have a low tolerance for unfit currency.

5. Are there alternative approaches that could be used to improve the efficiency of handling one-dollar notes other than applying the cross shipping fee?

The initial thought is that additional costs to process the large volume of ones would be greater than the cross shipping fee. DIs would either accept the fee or pass "unfitness sorted" notes to customers, which would reduce the quality of the note in the market. The Fed needs to develop an exchange program with DIs so that they can swap out their unprocessed note for Fed fit notes or create a di minimis specifically for these notes.

What savings would an institution expect to realize from these alternative approaches?

There are no savings for the DI with these alternative approaches. Any process changes typically add more overhead to handling currency and increase costs.

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Response: Federal Reserve Bank Currency Recirculation Policy

6. What costs would a depository institution anticipate incurring for operating a custodial inventory?

It is expected that the Custodial Inventory program would increase resource needs related to managing and administering the inventory as it relates to calculating the CI on a daily basis entering information into the Fed system, and reconciling the inventory. Some locations may also incur costs for updating security features within the facility.

How should Reserve Banks calculate the cap on the amount of currency that a depository institution may deposit in a custodial inventory?

- The cap for custodial inventory should relate to a factor significant to the depository institution such as the size of the DI, transaction volume, and cash inflow/outflow.
- The cap should also include provisionalized deposits. Many DIs must provisionalize deposits for fine counting on days when incoming volume is less (to spread the work out over the week and balance staffing). These deposits contain unverified currency (the historical trend is known, but the denominational breakdown is not known).
- Not including these "significant" deposits in the calculation could have an adverse affect on DIs requiring DIs to hold additional currency on their books to fund their orders.
- The daily calculation of CI limits will be overly burdensome on DIs. There needs to be a less burdensome manner to set the limits.
- The CI cap should be set at the highest level based on a four-week running average (or similar formula). There should not be a continual calculation of CI cap. The cap should be set and maintained for a period of time (two weeks) and recalculated.

How many bundles of currency should Reserve Banks require a depository institution to recirculate per week to qualify for a custodial inventory?

The number of bundles should relate to a factor significant to the DI. Ideally, we would recommend recirculating 25-200 bundles of currency, relative to the size of the DI.

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Response: Federal Reserve Bank Currency Recirculation Policy

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

The resulting higher costs to depository institutions will make the cash services product more costly. These costs would be passed onto customers. To reduce their costs some customers may choose to keep higher cash balances in their stores, increasing their security risks and costs, as well as increasing their uninvestable balances. There may be an increase in counterfeit notes to the general public (if the DI is not catching the counterfeit at the time they are processing the commercial customers deposit). Armored carriers may see a reduction in their earnings with a decrease in transportation to and from the Fed. DI's may incur an increase in fees from armored carriers for additional currency verification. DI's may see an increase in transportation costs due to an increase in the number of armored carrier runs from CI location to delivery point. The need to provide fitness sorting capabilities will cause the vendors of currency counting equipment to re-engineer their products. Vendors unable to accommodate will lose market share.