January 15, 2004

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

Docket No. OP-1164

Re: Federal Reserve Bank Currency Recirculation Policy
68 FR 59176 (October 14, 2003)

Dear Ms. Johnson:

America's Community Bankers ("ACB")[1] is pleased to comment on the proposal to change the cash services policy of the Board of Governors of the Federal Reserve System (the "Board").[2] The proposal aims to reduce depository institutions' overuse of Federal Reserve Bank cash processing services by imposing a recirculation fee on institutions that deposit currency and order the same denomination within the same business week. Depository institutions could avoid the fee by using currency from their customers' deposits to meet the cash needs of other customers before turning to Federal Reserve Banks to obtain currency. Alternatively, institutions could elect to participate in a custodial inventory program as a way to manage excess currency.

ACB Position

ACB generally supports the Board's efforts to improve the cost efficiency of the Federal Reserve Bank cash processing services by discouraging large institutions from overusing this service. We also support exempting de minimis levels of cross-shipped currency from the proposed recirculation fee.

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[1] America's Community Bankers represents the nation's community banks. ACB members, whose aggregate assets total more than $1 trillion, pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities.
[2] 68 Fed. Reg. 59176 (October 14, 2003).

The proposed changes are designed to address the currency recirculation practices of 100 institutions with large cash businesses. However, we believe that community banks using correspondent banks for currency supply and return would be indirectly impacted by the proposal. The cost of sorting fit currency, maintaining separate cash inventories, and the possibility of incurring recirculation fees will increase the operating costs of institutions that provide currency services. These expenses likely will be passed to community banks that use correspondent banks to meet their currency needs.

Background

According to the Board, some institutions order currency from Federal Reserve Banks to fill their ATMs and meet the cash needs of large retail customers without first using currency that has accumulated from customer deposits within the same geographic area. Further, because vault cash holdings do not earn interest, institutions with currency holdings that exceed required reserves often deposit excess currency with a Federal Reserve Bank in order to earn interest income. It is not uncommon for these institutions to order the same currency denominations that were shipped to the Federal Reserve Bank just a few days earlier.

Existing Federal Reserve Bank rules prohibit bank branches from ordering currency within five business days prior to or after depositing the same denomination. While this practice, known as cross-shipping, is not permitted at the depository office level, no such prohibition exists at the institution level. Instead, depository institutions are instructed to minimize cross shipping at the institutional level “when practical.” Enforcing the rule has been difficult because the Federal Reserve Bank may penalize noncompliant institutions only by denying currency services.

Recirculation Fees

In order to recover Federal Reserve Bank operating costs for providing cash services, the Board proposes to impose a recirculation fee of $5 to $6 for each bundle of cross-shipped currency. However, institutions would not pay a recirculation fee for the first 1,000 bundles of currency cross-shipped in a zone each quarter. In addition, the fee would not apply to mutilated currency, nor would it apply to deposits of $50 and $100 notes. Initially, the Board proposes to exclude one-dollar notes from the recirculation policy.

Under normal circumstances, community banks do not ship enough currency to trigger the proposed recirculation fees. While the proposed de minimis threshold would allow for unanticipated swings in customer demand, we remain concerned that recirculation fees incurred by correspondent institutions would be passed on to community banks.

Custodial Inventory Program

Under the proposed custodial inventory program, a depository institution could keep in its custodial inventory currency that might otherwise be shipped to and then reordered from a Federal Reserve Bank during a business week. The Federal Reserve Bank would own the currency in a custodial inventory although it is located within a depository institution's facility.

Community banks are unlikely to join the proposed custodial inventory program because participation would require institutions to commit to recirculating substantial amounts of currency. Community banks report that they generally order more currency than they deposit with the Federal Reserve Bank and would not be able to commit to recirculating the 200 bundles of currency required for the proof of concept program. Furthermore, it is unlikely that community banks would realize enough benefit from maintaining a custodial inventory to justify modifying their facilities to segregate Federal Reserve Bank currency or enhance their physical security to comply with Federal Reserve Bank requirements.

Conclusion

ACB appreciates the opportunity to comment on this important matter. Should you have any questions or concerns, please contact the undersigned at 202-857-3121 or via email at cbahin@acbankers.org or Krista Shonk at 202-857-3187 or via email at kshonk@acbankers.org.

Sincerely,

Charlotte M. Bahin
Senior Vice President
Regulatory Affairs