NAVY FEDERAL CREDIT UNION

Office of the President

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January 5, 2004

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

Re: Docket No. OP-1164

Dear Ms. Johnson

Navy Federal Credit Union provides the following comments in response to the Federal Reserve's proposed changes to its cash recirculation policy. Navy Federal is the nation's largest natural person credit union with over $20 billion in assets and 2.4 million members.

This proposal addresses a shift by certain depository institutions toward greater reliance on Reserve Bank cash processing services, which are currently provided at no charge. Navy Federal acknowledges the Federal Reserve's desire to reduce any overuse of its cash processing services, and to provide incentives for institutions to recirculate currency among their customers.

As a credit union, Navy Federal typically does not receive large cash deposits, and only occasionally dispenses cash in large amounts. Because of this transactional activity, cross-shipping is not a concern for us. We believe, however, that preservation of the Reserve Banks' processing services is vital, and offer our comments as a participant in the currency circulation system.

As a deterrent to cross-shipping, the Federal Reserve is proposing to charge a fee to depository institutions that deposit fit currency to, and order currency from, Reserve Banks within the same week. This fee would initially only apply to $5, $10, and $20 denominations. Navy Federal supports this fee in concept as an adequate deterrent to cross-shipping. We also believe, however, that imposing a flat per-bundle fee on all institutions engaged in such cross-shipping may not deter some of the largest institutions from possibly engaging in this practice. Instead, we believe an alternate tiered approach may be more effective. Recirculation fees could be tiered based on how many bundles of currency an institution cross-ships. For example, the fee could be $0 per bundle for 0-1000 bundles, $5 per bundle for 1001-2000 bundles, $8 per bundle for 2001-3000 bundles, etc. This tiered approach may encourage even the largest institutions to keep their cross-shipping volume to a minimum.

The Federal Reserve also proposes to exempt *de minimis* levels of cross-shipped currency from the recirculation fee. Depository institutions would not pay this fee for the first 1000 bundles of currency cross-shipped each quarter. Navy Federal strongly supports the proposed *de minimis* exemption. This type of exemption will allow for isolated cash order mistakes and unexpected volatility in customers' cash-related transactions. In addition, the exemption will likely exclude most small institutions from the fee, which is important because they are the institutions that would be least likely to be able to afford such a fee.

Although we support many aspects of the proposed recirculation fee in concept, we encourage the Federal Reserve to limit implementation of such a fee until the effects of the proposed custodial inventory program (discussed below) are determined. If the proposed custodial inventory program provides an adequate alternative to cross-shipping, Navy Federal would not support the imposition of a recirculation fee.

Navy Federal notes that the Federal Reserve has excluded $1 notes from its discussion of the proposed recirculation fee, mainly because the costs of sorting fit and unfit notes are higher for this denomination. An approach that could be used to improve the efficiency of handling $1 notes, other than applying the proposed cross-shipping fee, could be to replace $1 notes with coins. This would largely eliminate the need to consider fitness as a factor.

In addition to the recirculation fee, the Federal Reserve is also proposing to implement a custodial inventory program. One reason that depository institutions cross-ship is to avoid incurring opportunity costs of holding currency, which earns no interest. To mitigate these costs, the Federal Reserve proposes to allow eligible depository institutions to transfer into custodial inventories $5, $10, and $20 notes that they might otherwise cross-ship. A custodial inventory would be currency owned by a Reserve Bank but located within a depository institution's secured facility and separated from the institution's other currency. Navy Federal supports the implementation of such a custodial inventory program, and supports the proposed cap on the amount of currency that institutions may deposit into such an inventory.

We understand that the proposed rule would require a custodial inventory to be separate from an institution's other currency, but would not necessarily require an institution to purchase another safe, or build another vault, to maintain such an inventory. Instead, it is our understanding that the rule would simply require the institution to keep its custodial inventory in a separate area of its existing safe or vault. We encourage the Federal Reserve to clarify this aspect of the rule accordingly.

As a component of the custodial inventory program, the Federal Reserve proposes to also establish a "bundles per week" minimum of recirculated currency that a depository institution would have to meet to establish a custodial inventory. Navy Federal encourages the Federal Reserve to consider eliminating this proposed minimum, and instead allow each depository institution to determine whether it would be cost-effective to establish a custodial inventory program of its own.

Navy Federal appreciates the opportunity to comment on the Federal Reserve's proposed changes to its cash recirculation policy.

Sincerely,

Brian L. McDonnell
President/CEO

BLM/slb