

# Currency Recirculation Policy

**On March 17, 2006, the Board of Governors of the Federal Reserve System revised the policy framework governing the provision of cash services. The policy revisions are intended to reduce overuse of Federal Reserve Bank services, motivate recirculation best practices and reduce the societal cost of providing fit currency. These revisions consist of two inter-related components: a Custodial Inventory program and a fee that will be assessed on cross-shipped currency.**

The principal role of the Federal Reserve System's cash function is to ensure institutions have sufficient supplies of currency and coin to meet public demand, to accept deposits of excess and unfit currency and process orders for currency and coin. These free services are sometimes used inappropriately. In 2004, deposits of 7.2 million bundles of fit \$10s and \$20s were followed or preceded by orders of the same denomination by the same institution in the same business week in the same geographic area. This practice, known as "cross-shipping," suggests that some institutions are relying on Federal Reserve Banks to process a substantial amount of currency that the institutions could otherwise recirculate to their customers. This behavior causes Reserve Banks to incur unnecessary processing costs. The revisions to this policy will assist in returning the Federal Reserve System to its primary cash function and thereby reduce the societal cost of providing cash services to customers. As the nation's Central Bank, the Federal Reserve will continue to play an active role in the provision of cash services to institutions, and also will continue to ensure the integrity of our nation's currency as deposits and orders are processed through our Federal Reserve Banks.

## **Custodial Inventory Program**

The Federal Reserve Banks have created a Custodial Inventory program that will help offset the opportunity costs associated with holding additional currency in vaults long enough to facilitate its recirculation. An institution that is eligible for and participates in the Custodial Inventory program is allowed to transfer currency to the Federal Reserve Bank's books, but continue to physically hold the currency within the institution's secured facility.

Custodial Inventory participants are required to hold one day of average daily payments in \$10 and \$20 notes on their own ledger accounts, and are allowed to transfer up to the equivalent of four days of average daily payments in \$10 and \$20 notes to the Custodial Inventory, to be held on the ledger accounts of the Federal Reserve Banks.

An institution must demonstrate that it can recirculate a minimum of 200 bundles of \$10 and \$20 notes per week in a Federal Reserve Bank zone or sub-zone to qualify for a Custodial Inventory. This threshold can be met in one of the following three ways:

- An institution that cross-ships at least 200 bundles of \$10 and \$20 notes combined per week at the prospective Custodial Inventory site in a Federal Reserve Bank zone or sub-zone would meet the recirculation threshold.

## **Key Policy Points**

- The policy will apply to the \$10 and \$20 denominations.
- The Federal Reserve Banks will allow eligible institutions to keep \$10 and \$20 notes in a Custodial Inventory.
- Applications to hold Custodial Inventory will be accepted starting in May 2006.
- To ensure that currency in circulation remains fit for commerce, a quality program will be implemented by the Federal Reserve Banks prior to the implementation of fees.
- A fee will be assessed on cross-shipped fit currency in \$10s and \$20s beginning in July 2007.

- An institution could provide deposit and payment records for the prospective Custodial Inventory vault demonstrating that it recirculates among its customers at least 200 bundles of \$10 and \$20 notes weekly in the Federal Reserve Bank zone or sub-zone.
- An institution could also meet the threshold through a combination of cross-shipping activity and recirculation among its customers totaling at least 200 bundles of \$10 and \$20 notes per week in the Federal Reserve Bank zone or sub-zone.

In addition to meeting the recirculation threshold requirement, a potential Custodial Inventory site must comply with physical and operational security requirements. In addition, a potential site must be deemed financially sound by the Federal Reserve Banks and be in compliance with the Bank Secrecy Act, OFAC and anti-money laundering regulations to participate in the program.

### Quality Policy

The Federal Reserve Banks will implement a currency quality policy before the cross-shipping fee takes effect. The Quality Policy will define the threshold level of quality for each denomination that is “fit for commerce;” identify a framework for monitoring quality; and specify actions the Reserve Banks would take to adjust the quality of currency in circulation, should that become necessary to avoid significant inconvenience to the public or increased risk of recirculating counterfeit notes.

### Cross-shipping

If an institution deposits fit \$10 and \$20 notes and orders the same denomination in a given Federal Reserve Bank zone or sub-zone within one business week, the cross-shipped volume is the lesser of the institution’s fit deposits or orders.

*Example: In the first week of March, Bank X deposits 500 bundles of fit \$10s to the Boston Federal Reserve Bank. In that same week, Bank X orders 230 bundles of \$10s from the Boston Federal Reserve Bank. Bank X cross-shipped 230 bundles.*

Fit currency is currency that the Federal Reserve has deemed suitable for further circulation. The Federal Reserve Banks identify and destroy notes that are soiled, worn or have defects such as holes, tears and graffiti, leaving only fit notes to be packaged and returned to circulation. Reserve Banks will determine the number of fit notes processed from each institution’s deposits as a percentage of total notes deposited by that institution during each month. Reserve Banks

will then apply this monthly average fitness rate by Federal Reserve Bank zone or sub-zone to an institution’s weekly deposits to determine how much currency it cross-shipped. The Federal Reserve Bank’s fitness standards are available at: [http://www.frbservices.org/Cash/pdf/FRB\\_Fitness\\_Standards.pdf](http://www.frbservices.org/Cash/pdf/FRB_Fitness_Standards.pdf)

Beginning in July 2007, the Federal Reserve Banks will assess a fee to institutions for every bundle of \$10 and \$20 notes cross-shipped above a de minimis exemption level of 875 bundles of \$10s and \$20s combined per Federal Reserve Bank zone/sub-zone per quarter. The exemption is not transferable between Federal Reserve Bank zones or institutions and unused portions of the exemption do not carry forward. The fee will be standard nationally and will reflect the Reserve Banks’ costs that vary with the quantity of currency processed. Reserve Banks will review changes to those costs annually to ensure that the fee reflects the Reserve Banks’ costs.

Cash Services produces monthly cross-shipping reports that will help you to keep track of your institution’s potential fees. To sign-up to receive cross-shipping reports, complete and submit the form located at <http://www.frbsf.org/forms/index.html>.

### Federal Reserve Financial Services

The Federal Reserve offers a full range of financial services to assist depository institutions in achieving a sustainable competitive advantage. We provide innovative and progressive services that enable you to capitalize on growth and revenue opportunities. Our services are designed to provide the accessibility and flexibility you need to compete in a dynamic and evolving industry.

As the nation’s Central Bank, the Federal Reserve will continue to play a vital role in offering cash services to depository institutions, and also will continue to ensure the integrity of our nation’s currency as deposits and orders are processed through our Banks.

### Where can I get more information?

*For more information, please review the frequently asked questions available at <http://www.frbservices.org/Cash/CurrencyRecirculationPolicy.html>.*

*In addition, sign up for e-alerts at <http://www.frbservices.org/HomePage/EASubsMgr.html> to receive information updates regarding the currency recirculation policy.*

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