

**Presentation to the European Security Transport Association
2007 Conference – Tallinn, Estonia**

The Demand for Cash – an international perspective

**K Paul Blond
Director, Strategic Planning &
Consultancy**



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Introduction

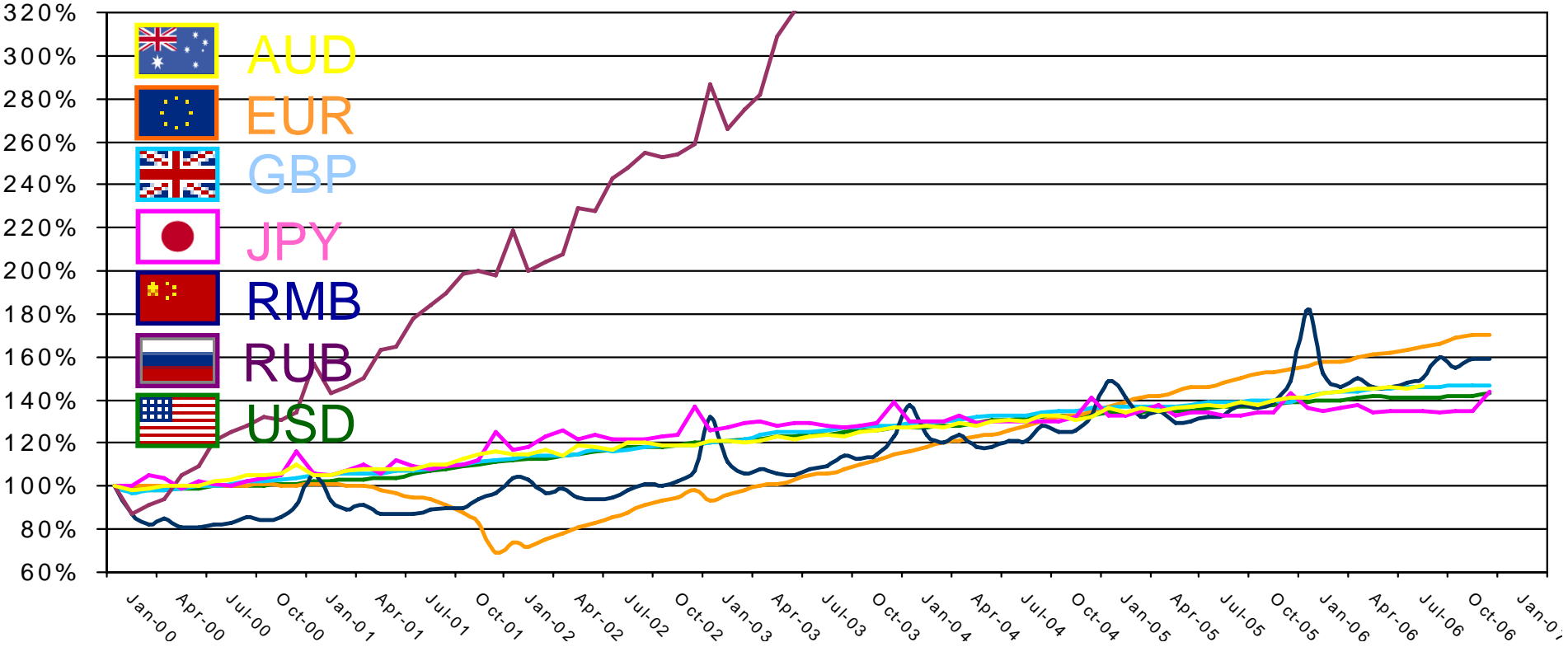
- Growth of currency in circulation
- Anonymity
- Central Bank Considerations
- Seignorage
- Changing Models in Wholesale Cash Management
- Two examples - United States & Australia



Growth of selected currency in circulation

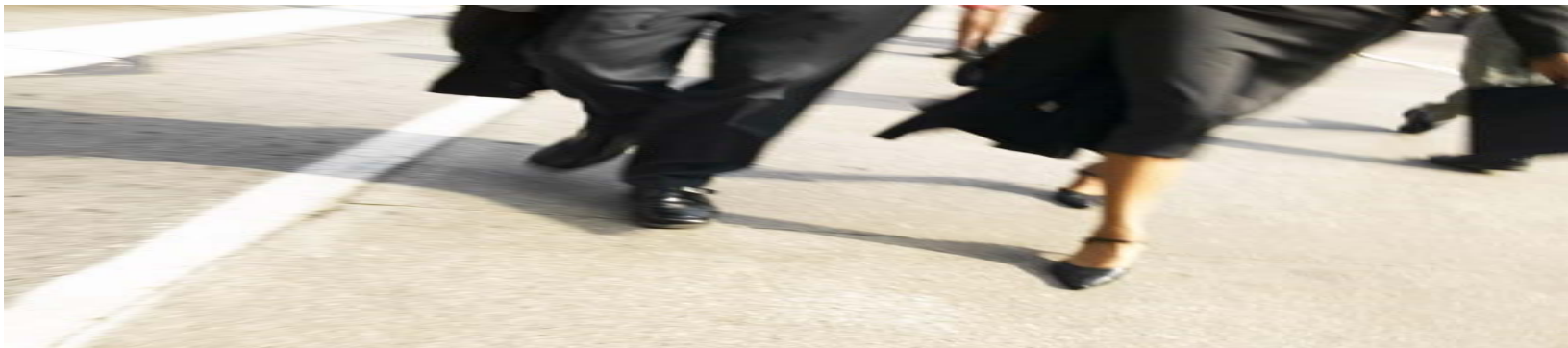


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Anonymity

- Currency remains a **preferred payment mechanism worldwide** since it is **anonymous, simple to use** and does not require the user to participate in **systems** to record or monitor the transaction
- With **no audit trail privacy is assured**, but there is of course also the **opportunity for illicit use**
- With no audit trail accurate currency **usage (and therefore cost of use) is difficult to measure**
- Unlike other payment methods usage – particularly person to person – is often **not or under** reported



Central Bank Considerations

- Central Bank intervention and currency management policies **heavily influence** the development of commercial sector cash handling activities
- In general, the larger the existing Central Bank cash handling infrastructure and the more fragmented the commercial sector is the **less likely** the Central Bank is to delegate cash handling to the commercial sector
- Most Central Banks are **highly risk adverse** and will set reputation considerations ahead of financial concerns

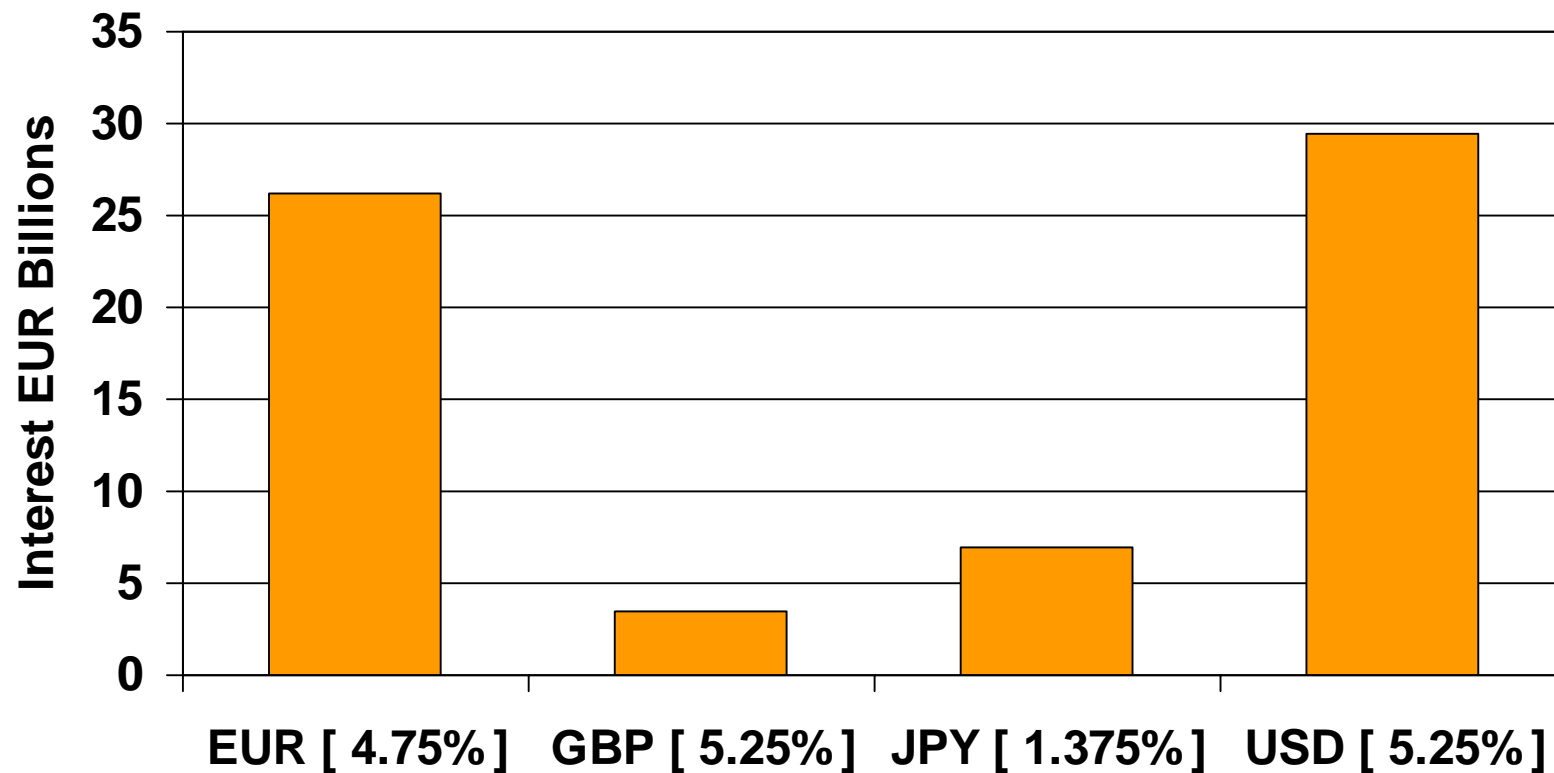


Central Bank Considerations

- **Seignorage** income (income earned from investing the face value of currency in circulation) far exceeds the cost of even the largest Central Bank cash handling operations
- As Government Bankers, Central Banks usually pay over the **net seignorage** income after Central Bank costs
- Today few Central Banks cite seignorage income generation as a key consideration, but if currency in circulation diminished would this still be the case?



Seignorage income (based on 2006 currency in circulation and current base rates)





Central Bank Considerations

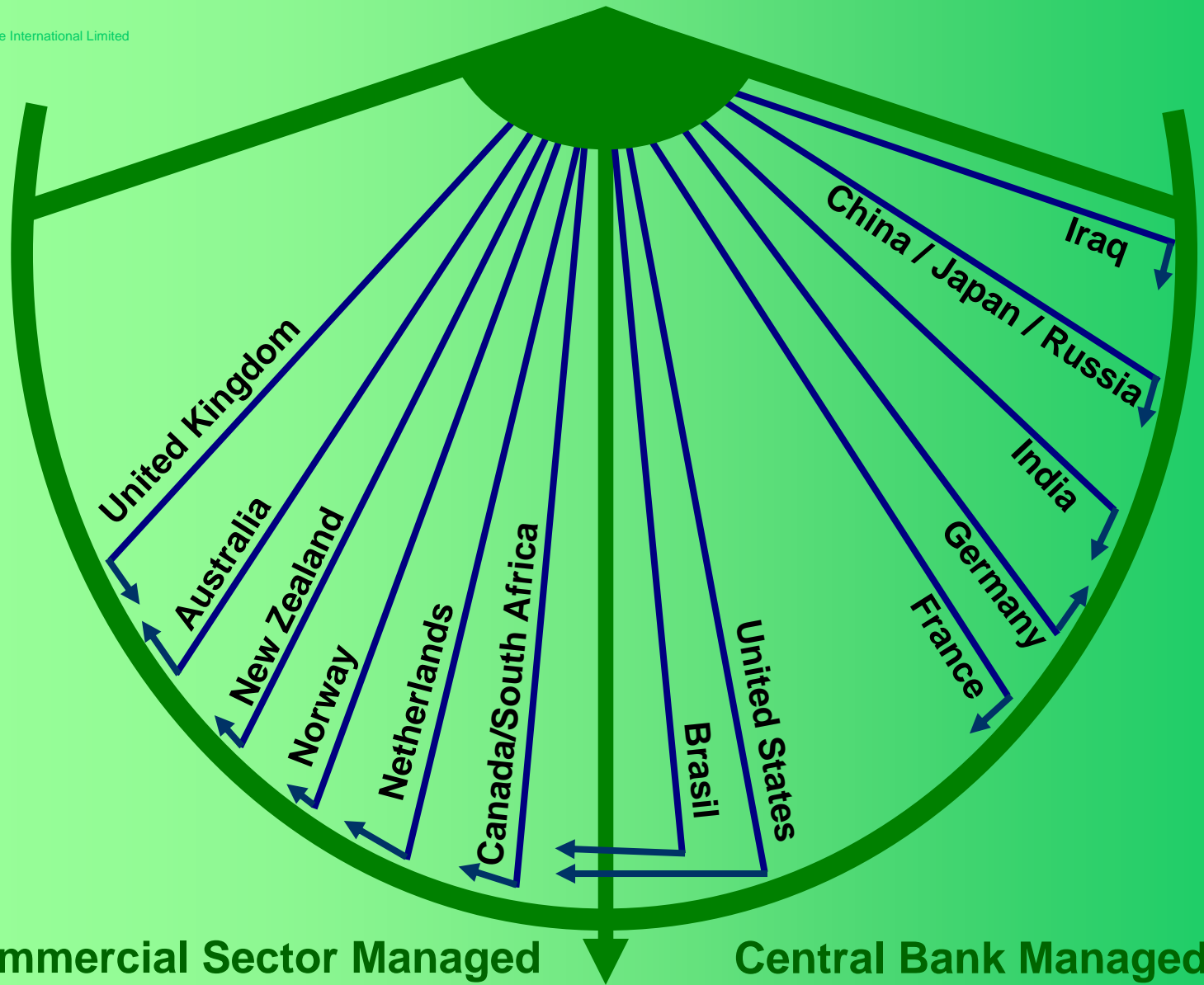
- Some Central Banks will retain (or increase) their own currency handling activities to preserve their existing infrastructure and resources, often citing reputation, risk mitigation and effective contingency arrangements as their business justification
- Other Central Banks that have delegated, or are planning to delegate, currency handling to the commercial sector are likely to introduce **tighter operation rules and regulations** and are expected to apply stronger **reporting requirements and audit controls**



Changing Models in Wholesale Cash Management




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Changing Models in Wholesale Cash Management

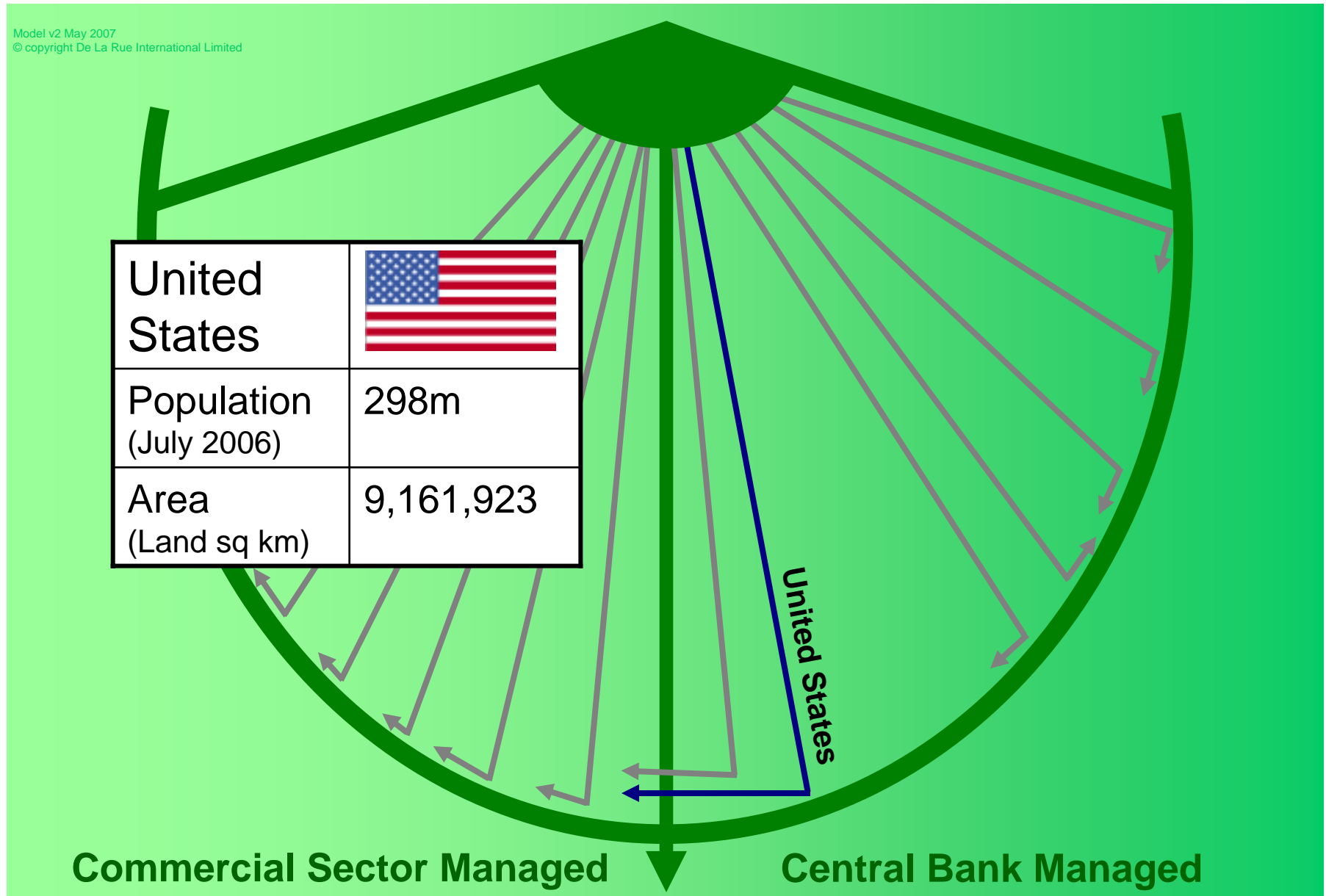


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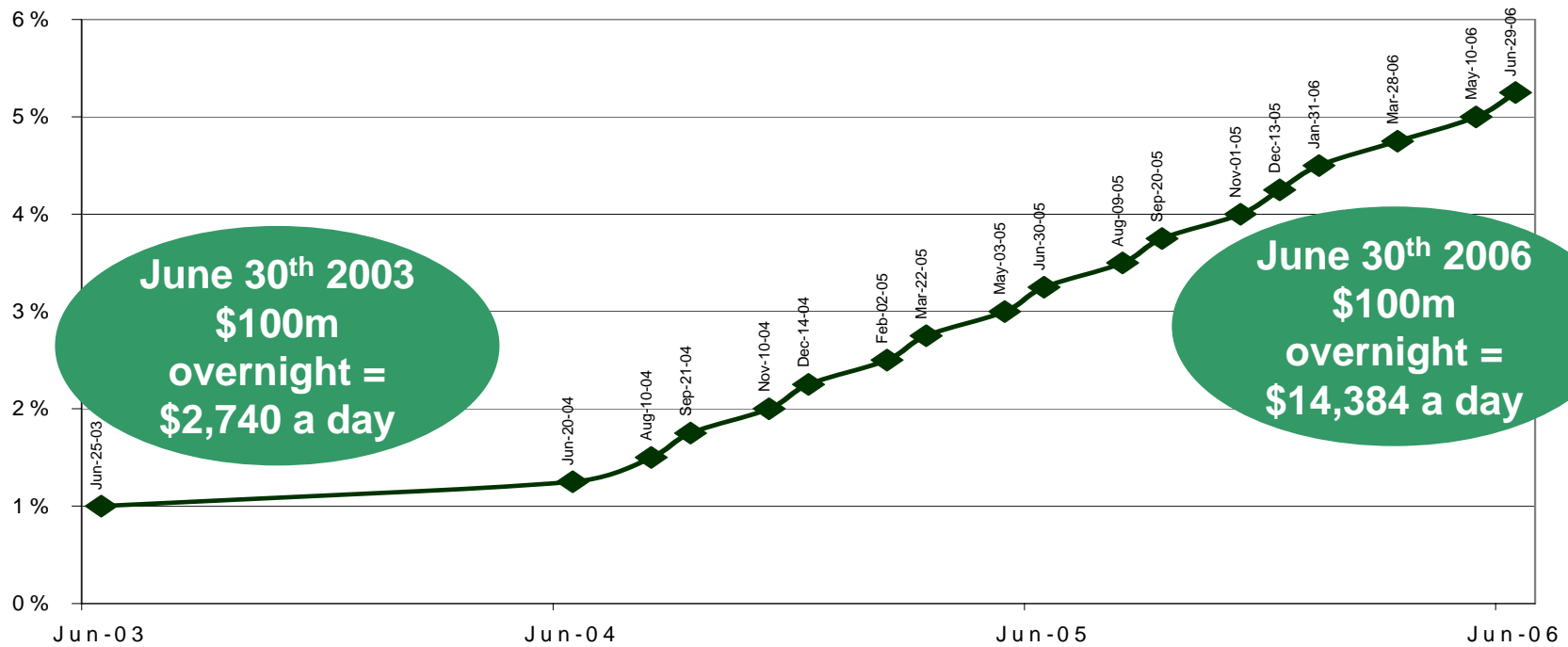
United States	
Population (July 2006)	298m
Area (Land sq km)	9,161,923

Commercial Sector Managed

Central Bank Managed



'Fed Fund' Rates – the cost of holding currency



Federal Reserve Cash Recirculation Policy Changes



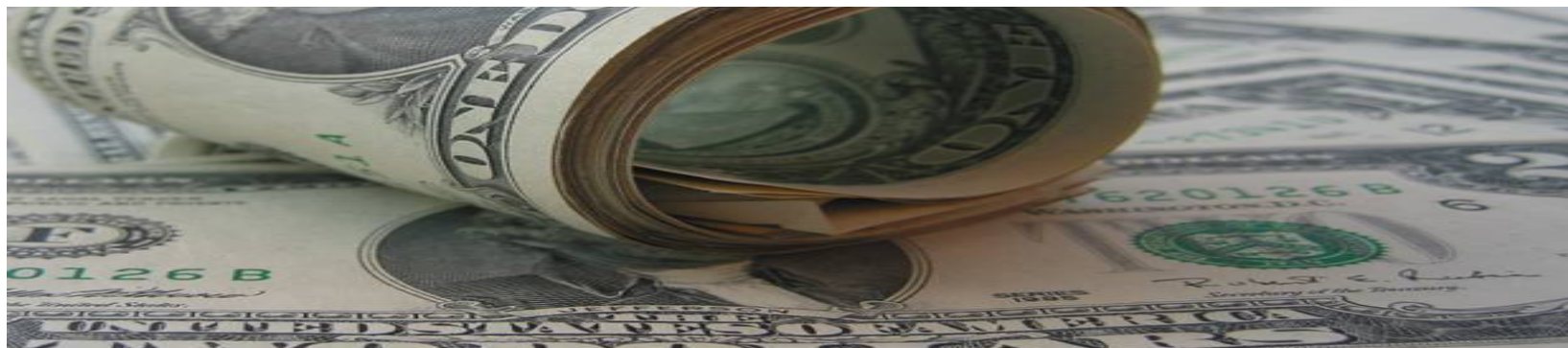
- **CROSS SHIPPING**

From July 1st 2007 cross shipping penalties of \$5 per bundle of 1,000 FIT \$10 or \$20 notes paid in to and withdrawn from FRB in the same week - subject to a de minimus allowance of 875 bundles per quarter

- **CUSTODIAL INVENTORY PROGRAM**

Subject to meeting minimum recirculation levels, security and audit standards, and agreeing to hold 1 days worth of \$10 and \$20 withdrawal demand on their books a bank may hold a further 4 days worth of withdrawals off balance sheet

- **FITNESS STANDARDS**





United States Fitness Standards

- FRB defines fit currency as “a note that is suitable for continued circulation and is sufficiently clean to allow its genuineness and denomination to be readily ascertained”
- FRB has published a fitness quality policy to define the level at which each denomination is ‘fit for commerce’
- Published parameters define soiling, ink wear, and substrate defects such as holes, tears, missing or folded corners, and tape



Unfit note due to Ink Wear

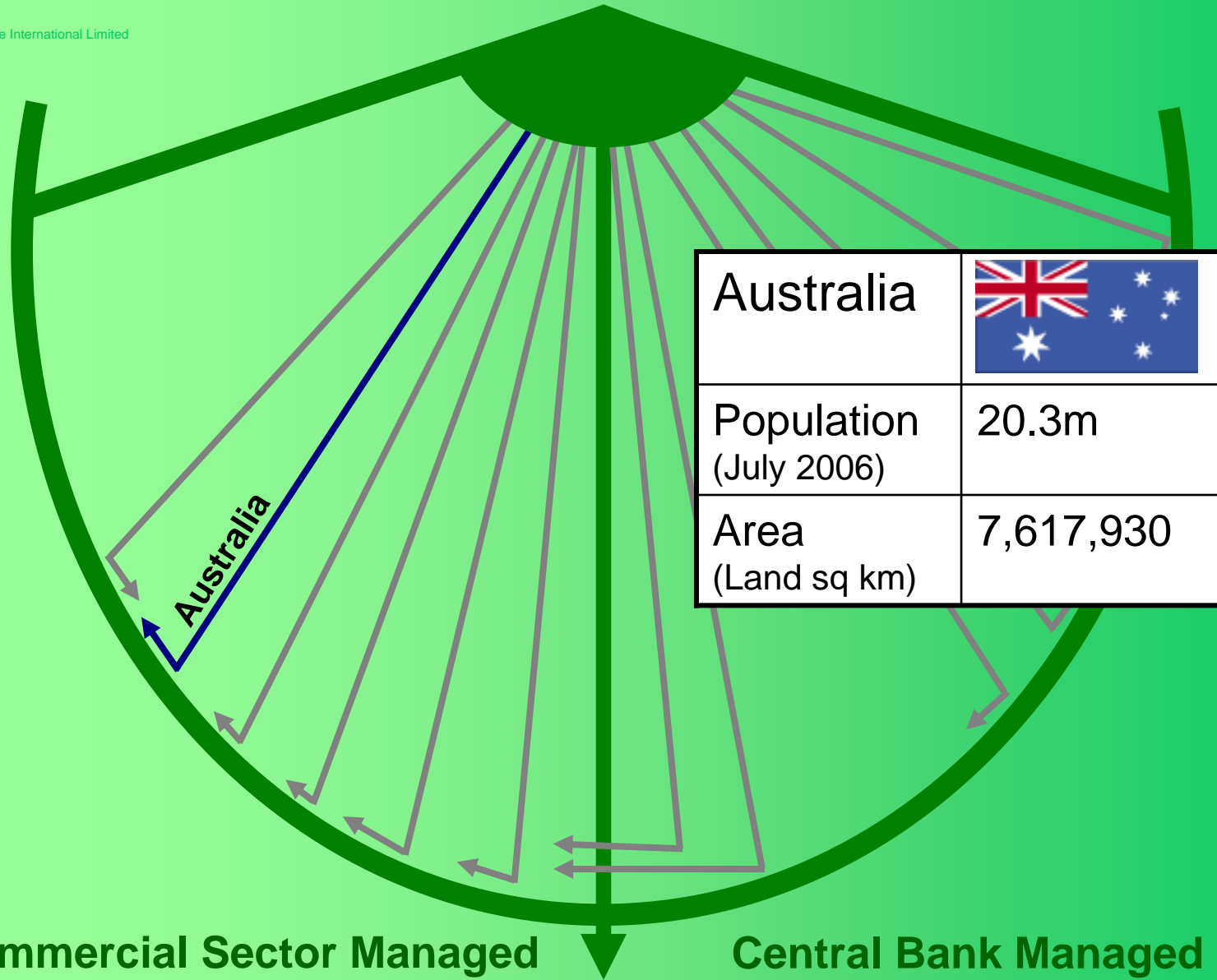


Unfit note due to Soil level

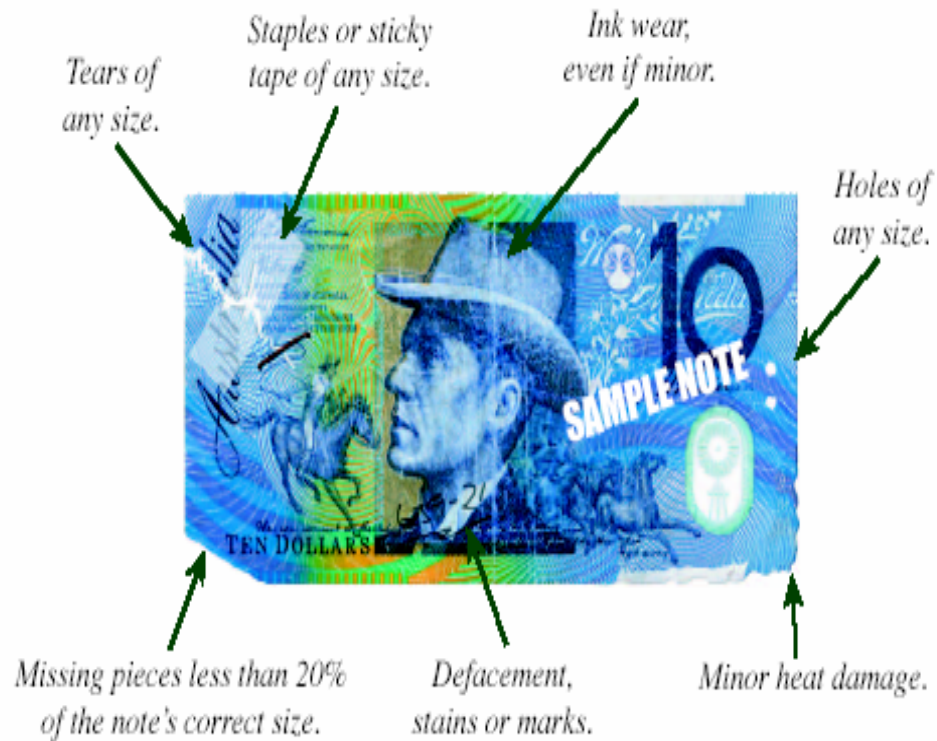
Changing Models in Wholesale Cash Management



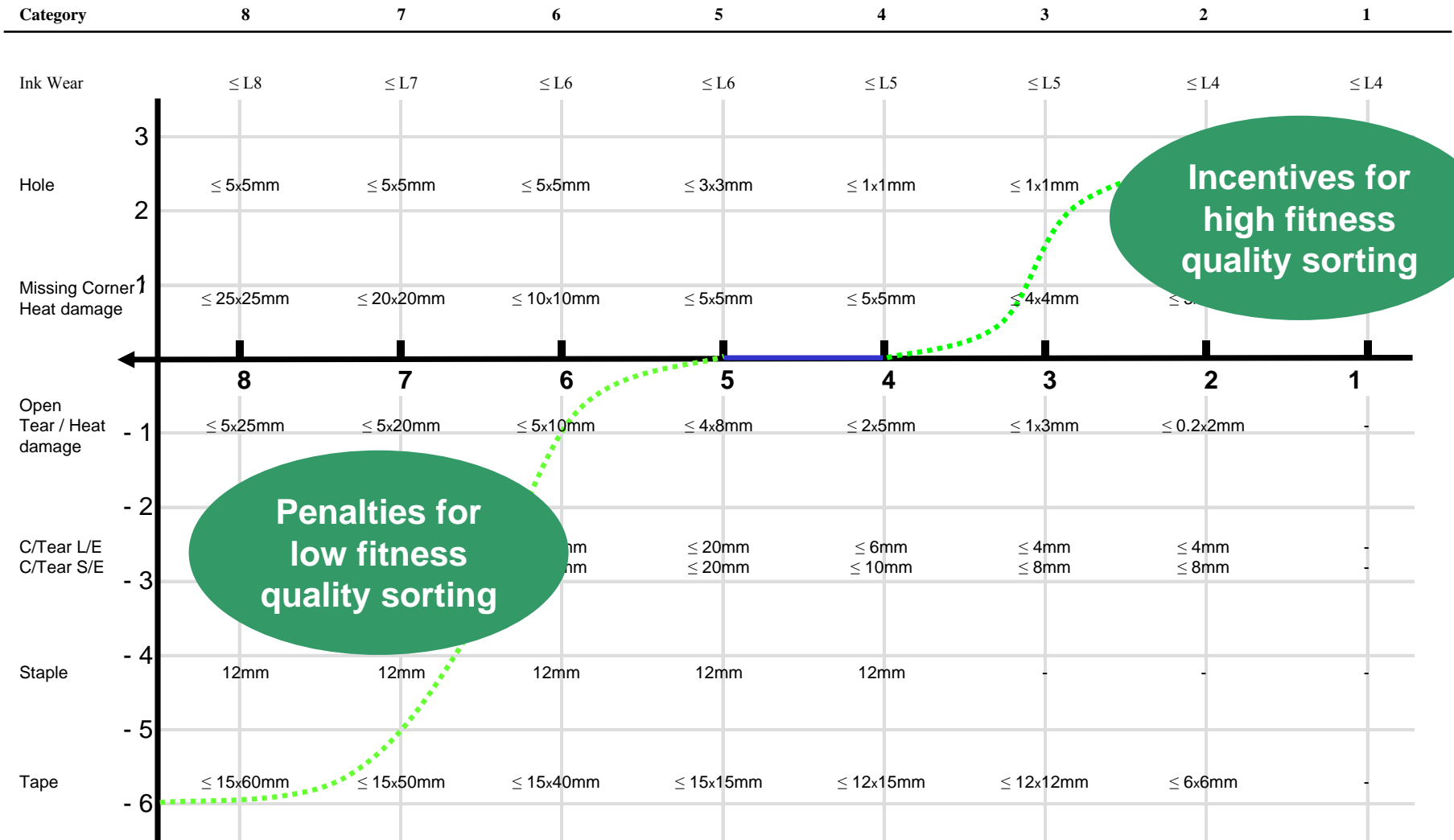
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Australia – Challenges in Banknote Fitness Quality



Australia - Banknote Fitness Standards



Incentives for high fitness quality sorting

Penalties for low fitness quality sorting

Source: Reserve Bank of Australia

Australia - "Double S" Payment Curve

