

## **I. Background**

### **1. Under what authority do the Federal Reserve Banks pay interest on balances maintained at Reserve Banks?**

The Financial Services Regulatory Relief Act of 2006 authorized the Federal Reserve Banks to pay interest on balances held by or on behalf of depository institutions at Reserve Banks, subject to regulations of the Board of Governors, effective October 1, 2011. The effective date of this authority was advanced to October 1, 2008 by the Emergency Economic Stabilization Act of 2008. The text of both Acts is available on the [Library of Congress' THOMAS Legislative Information website](#).

### **2. Will the Federal Reserve use the authority provided in the Financial Services Regulatory Relief Act of 2006 to reduce required reserve ratios below their previously permitted ranges or to eliminate reserve requirements?**

The Board of Governors has not made any determination about changing required reserve ratios or eliminating reserve requirements.

### **3. What kinds of balances do depository institutions hold at Reserve Banks?**

Institutions hold required reserve balances, clearing balances, and excess balances. Required reserve balances are balances that an institution holds in an account directly at a Federal Reserve Bank or indirectly through a pass-through correspondent to satisfy its reserve requirement. Clearing balances are balances that an institution agrees to hold, in addition to a required reserve balance, in its account at a Federal Reserve Bank under a contractual clearing balance agreement. Excess balances are balances that an institution holds in its account that exceed the sum of the institution's required reserve balance and clearing balance.

### **4. What kinds of balances will receive interest?**

The Federal Reserve Banks will pay interest on required reserve balances and on excess balances. Clearing balances already earn implicit interest in the form of earnings credits.

### **5. Why does the Federal Reserve want to pay interest on required reserve balances?**

The inability to pay interest on balances held to satisfy reserve requirements essentially imposes a tax on depository institutions equal to the interest that might otherwise have been earned by investing those balances in an interest-bearing asset. Paying interest on required reserve balances effectively eliminates this tax.

### **6. Why does the Federal Reserve want to pay interest on excess balances?**

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Paying interest on excess balances should help to establish a lower bound on the federal funds rate by lessening the incentive for institutions to trade balances in the market at rates much below the rate paid on excess balances. Paying interest on excess balances will permit the Federal Reserve to provide sufficient liquidity to support financial stability while implementing the monetary policy that is appropriate in light of the System's macroeconomic objectives of maximum employment and price stability. For more information about the implementation of monetary policy with the payment of interest on required reserve balances and on excess balances, please see the [Federal Reserve Bank of New York's website](#).

### **7. Will the Federal Reserve pay interest on vault cash?**

No. The Federal Reserve is not authorized to pay interest on vault cash.

### **8. Which institutions are eligible to receive interest on their balances?**

Depository institutions, U.S. branches and agencies of foreign banks, Edge Act and agreement corporations, and trust companies are eligible to receive interest (eligible institutions). Pass-through correspondents that are not themselves eligible institutions are eligible to receive interest on required reserve balances held on behalf of their respondents.

### **9. Are pass-through correspondents required to pass the interest they receive back to their respondents?**

Pass-through correspondents that are themselves eligible to receive interest **may** pass the interest they receive on balances that represent their respondents' required reserve balances and excess balances, but they are not required to do so. By contrast, pass-through correspondents that are not themselves eligible to receive interest **must** pass back to their respondents the interest they receive on balances that represent their respondents' required reserve balances.

Passing back such interest to a respondent will not be considered a payment of interest on a demand deposit in violation of Regulation Q ("Prohibition Against Payment of Interest on Demand Deposits," 12 CFR Part 217).

### **10. Does the legislation permit depository institutions to pay interest on customers' demand deposits?**

No. Depository institutions are still prohibited from paying interest on demand deposits.

### **11. Why did the Board of Governors eliminate transitional adjustments for reserve requirements following a merger or consolidation?**

These adjustments were originally intended to phase-in the burden of higher reserve requirements associated with a merger or consolidation. The reserve requirement for the surviving institution is higher because the merged institution receives only one low reserve tranche and one exemption amount, while, prior to the merger, each institution had a low reserve tranche and an exemption amount.

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Paying interest on required reserve balances is a much more effective method for addressing the higher reserve tax associated with mergers or consolidations because the interest earned essentially eliminates the tax.

### **12. How does the Board's ruling affect depository institutions that currently have transitional adjustments due to a prior merger or consolidation?**

Adjustments associated with mergers completed prior to October 9, 2008 will be left in place. No new adjustments will be issued on or after that date.

### **13. Did the Board of Governors seek comment on the rules governing the payment of interest?**

Yes. The Board of Governors sought comment on the rules governing the payment of interest, particularly on the treatment of interest paid on required reserve balances and on excess balances held by pass-through correspondents. Comments were due November 21, 2008, following the procedures in the Board's notice in the [Federal Register](#).

### **14. Are the comments on the interim final rule available to the public?**

Yes. Comments on the interim final rule, identified by Docket No. R-1334, have been posted to the [Board of Governors' website](#).

### **15. Whom do I contact if I have further questions?**

Contact the reserve administration staff at your Reserve Bank. For a list of contacts please visit the [Federal Reserve System Reporting and Reserves website](#).

## **II. Interest Payment Calculations**

### **1. What is the interest rate for required reserve balances?**

On December 16, 2008, the Board of Governors amended its rules governing the payment of interest on reserves so that the interest rate on required reserve balances will be set equal to 25 basis points effective with the reserve maintenance periods beginning December 18, 2008.

### **2. What is the interest rate for excess balances?**

On December 16, 2008, the Board of Governors amended its rules governing the payment of interest on reserves so that the interest rate on excess balances will be set equal to 25 basis points effective with the reserve maintenance periods beginning December 18, 2008.

### **3. Where will interest rates on required reserve balances and on excess balances be posted?**

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Current and historical interest rates on required reserve balances and on excess balances will be posted on the [Board of Governors' website](#) under Monetary Policy and Policy Tools.

**4. When will interest rates on required reserve balances and on excess balances for a reserve maintenance period be updated on the Board of Governor's website?**

The Board of Governors will post updated interest rates on required reserve balances and on excess balances for a given reserve maintenance period on the [Board of Governors' website](#) on the last day of that reserve maintenance period.

**5. How are required reserve balances and excess balances for interest payment calculations determined?**

The Federal Reserve has developed a set of examples that illustrate how to determine required reserve balances and excess balances for interest payment calculations. These examples are available on the [Federal Reserve System Reporting and Reserves website](#) using the examples link.

**6. When did the Federal Reserve begin to pay interest on required reserve balances and on excess balances?**

The Federal Reserve began to pay interest on required reserve balances and excess balances for the reserve maintenance periods beginning on Thursday, October 9, 2008.

**7. When will interest payments be credited to an institution's account?**

Interest will be credited to an institution's Federal Reserve account fifteen days after the close of a reserve maintenance period to allow for the application of reserve carryover.

**8. What effect will the clearing balance allowance and carry-over have on the calculation of interest?**

Balances up to the top of the clearing balance band are included in clearing balances and therefore are excluded from excess balances.

The carry-over provision will affect the allocation of an institution's average balance maintained among its required reserve balance, clearing balance, and excess balance for the purposes of interest calculations. Contact the reserve administration staff at your Reserve Bank if you have any questions.

**9. How will revisions to amounts reported on the Report of Transaction Accounts, Other Deposits, and Vault Cash (FR2900) affect previously paid interest?**

Revisions to amounts reported on an institution's FR 2900 report that change an institution's reservable liabilities can change an institution's required reserve balance. In this case, the reallocation of the average balance maintained in a

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reserve maintenance period among the institution's required reserve balance, clearing balance, and excess balance may result in a recalculation of previously paid interest. The difference between the original and revised interest payments will be credited to or debited from, depending on the revision, an institution's account.

### **10. How will as-of adjustments affect the calculation of interest?**

As-of adjustments affect the level of average balances maintained by an institution and are included in the calculation of interest payments and earnings credits.

### **11. How will interest be calculated for a Federal Reserve account that closes in the middle of a reserve maintenance period due to a merger?**

The survivor of a merger will receive any interest payments earned by the nonsurvivor.

### **12. Where will interest payments on required reserve balances and on excess balances appear on my Final Position Report?**

Interest payments on required reserve balances and on excess balances will be listed on each institution's Final Position Report, which is generated 14 days after the maintenance period ends and is received through FedMail (via fax or e-mail). On the report, the interest information will be displayed in a boxed area on the bottom of the report. The box will indicate the type of balance for which interest is being paid ("RES REQ" for interest on average required reserve balances and/or "EXCESS BALS" for interest on average excess balances) and the interest rate, base amount, and interest payment amount for each type of balance.

Information on interest payments will also be provided through ReserveCalc. Within ReserveCalc, you will need to access the Position view for the maintenance period for which interest is being paid. Once in this view, click on the "Point in Time" drop down menu and select the date which is 14 days after the maintenance period ends. Information on interest payments can be found below the Net Position information and will include the expected or actual payment date, the type of balance for which interest is being paid (required reserve balances and/or excess balances), and the interest rate and the payment amount for each balance type.

Finally, an Advice of Interest Payment will be generated 15 days after the maintenance period ends for each institution receiving an interest payment. Advices will be sent through FedMail (via fax or e-mail). The Advice will contain the interest payment date, the maintenance period for which interest is being paid, the base amount, interest rate and interest payment amount for each balance type being paid (required reserve balance or excess balance), and the total interest payment.

Note that if interest payment amounts are revised, due to changes in your institution's required reserve balances, the Final Position Report, ReserveCalc

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Position view, and Advice of Interest Payment will be provided and will reflect the revised interest payment amounts.

If you have any additional questions, please contact the reserve administration staff in your District (see <http://www.reportingandreserves.org/contact2.html> for District-specific contact information)

### **III. Clearing Balances and Earnings Credits**

#### **1. What are the implications for the contractual clearing balances program?**

Clearing balances will continue to receive earnings credits. Beginning with the reserve maintenance period that started October 9, 2008, earnings credits are paid on 100 percent of eligible clearing balances. There will not be any change in the way that earnings credits are used to offset Federal Reserve service charges.

#### **2. What is the new calculation for earnings credits?**

Earnings credits are calculated using the institution's clearing balance, which includes amounts held up to the top of the clearing balance band, and the earnings credits rate for a reserve maintenance period. The clearing balance is no longer adjusted for the Federal Reserve Bank's imputed reserve requirement or the institution's marginal reserve requirement. For more detailed information on the new calculation for earnings credits, please see the [Federal Reserve Financial Services website](#).

#### **3. Why did the Board of Governor's decide to eliminate the imputed reserve requirement adjustment and the marginal reserve requirement adjustment from the calculation of earnings credits?**

Prior to the payment of interest on required reserve balances, the earnings credits calculation used to include two adjustments that were meant to ensure that respondents viewed balances at the Federal Reserve Banks and balances at a private-sector correspondent as equivalent. One adjustment imputed a reserve requirement to the Federal Reserve Bank to treat it like a private-sector correspondent. The other adjustment accounted for the fact that a respondent could lower the amount of its reserve requirement by the amount of demand deposits due from its private-sector correspondent but not from its Federal Reserve Bank. When interest is paid on required reserve balances, such adjustments are no longer needed because the private-sector correspondent will receive interest on amounts held at the Federal Reserve Bank to satisfy reserve requirements. For a more detailed discussion of the rationale behind eliminating these adjustments, please see the discussion in the [Federal Register notice](#).