

FEDERAL RESERVE SYSTEM

12 CFR Part 204

[Regulation D; Docket Nos. R-1334 and R-1350]

Reserve Requirements for Depository Institutions

AGENCY: Board of Governors of the Federal Reserve System

ACTION: Final Rule.

SUMMARY: The Board is adopting, with certain revisions, its interim final rule that amended Regulation D (Reserve Requirements of Depository Institutions) to direct Federal Reserve Banks to pay interest on certain balances held at Federal Reserve Banks by or on behalf of certain depository institutions. The Board is also amending Regulation D to authorize the establishment of limited-purpose accounts, called “excess balance accounts,” at Federal Reserve Banks for the maintenance of excess balances of eligible institutions. These excess balance accounts are intended to permit eligible institutions to earn interest on their excess balances without significantly disrupting established business relationships with their correspondents.

DATE: This final rule is effective July 2, 2009.

FOR FURTHER INFORMATION CONTACT: Sophia H. Allison, Senior Counsel (202/452-3565), or Dena L. Milligan, Attorney (202/452-3900), Legal Division, or Seth Carpenter, Deputy Associate Director (202/452-2385), or Margaret Gillis DeBoer, Section Chief (202/452-3139), Division of Monetary Affairs; for information with respect to the clearing balance policy and float calculations, contact Jonathan Mueller, Senior Financial Analyst (202/530-6291), Division of Reserve Bank Operations and Payment Systems; for users of Telecommunications Device for the Deaf (TDD) only, contact 202/263-4869; Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551.

SUPPLEMENTARY INFORMATION:

I. Interest on Balances at Federal Reserve Banks

A. Background

For monetary policy purposes, section 19 of the Federal Reserve Act (“the Act”) imposes reserve requirements on certain types of deposits and other liabilities of depository institutions. Title II of the Financial Services Regulatory Relief Act of 2006 (the “2006 Act”) (Pub. L. 109-351, 120 Stat. 1966 (Oct. 13, 2006)) amended section 19 of the Act by authorizing the Federal Reserve Banks (“Reserve Banks”) to pay earnings on balances maintained at the Reserve Banks by or on behalf of certain depository institutions. The original effective date of this authority was October 1, 2011. Section 128 of the Emergency Economic Stabilization Act of 2008 (the “2008 Act”) (Pub. L. 110-343, 122 Stat. 3765 (Oct. 3, 2008)) accelerated the effective date of this authority to October 1, 2008.

Section 19 of the Act now provides that Reserve Banks may pay earnings on balances held at the Reserve Banks by or on behalf of certain depository institutions at least once each quarter at a rate not to exceed the general level of short-term interest rates. Depository institutions that are eligible to receive earnings on their balances held at Reserve Banks include the institutions described in section 19(b)(1)(A) of the Act¹ and “any trust company, corporation organized under section 25A or having an agreement with the Board under section 25, or any branch or agency of a foreign bank (as defined in section 1(b) of the International Banking Act of 1978).”² The Act also provides that the Board may prescribe regulations concerning the payment of earnings, the distribution of earnings to the depository institutions that maintain balances or on whose behalf balances are maintained, and “the responsibilities of depository institutions, Federal Home Loan Banks, and the National Credit Union Administration Central Liquidity Facility with respect to the crediting and distribution of earnings attributable to balances maintained . . . in a Federal Reserve bank by any such entity on behalf of depository institutions.”³

Regulation D, which implements the provisions of section 19 of the Act, also provides that a depository institution must maintain its required reserves in the form of cash in its vault, or if vault cash is insufficient, in the form of a balance in an account at a Reserve Bank.⁴ A depository institution may maintain balances at a Reserve Bank in an account in its own name, or it may choose another institution as its “pass-through correspondent.”⁵ Under a “pass-through correspondent” arrangement, the pass-through correspondent holds its respondent’s required reserve balances in the correspondent’s account at a Reserve Bank. The pass-through correspondent is responsible for holding sufficient balances in its account at the Reserve Bank to satisfy its own reserve balance requirement (if any), its own contractual clearing balance (if any), and the aggregate reserve balance requirements of its respondents. The Reserve Bank’s debtor-creditor relationship is solely with the pass-through correspondent and not with any of the

¹ Section 19(b)(1)(A) defines “depository institution” as “(i) any insured bank as defined in section 3 of the Federal Deposit Insurance Act or any bank which is eligible to make application to become an insured bank under section 5 of such Act; (ii) any mutual savings bank as defined in section 3 of the Federal Deposit Insurance Act or any bank which is eligible to make application to become an insured bank under section 5 of such Act; (iii) any savings bank as defined in section 3 of the Federal Deposit Insurance Act or any bank which is eligible to make application to become an insured bank under section 5 of such Act; (iv) any insured credit union as defined in section 101 of the Federal Credit Union Act or any credit union which is an eligible to make application to become an insured credit union pursuant to section 201 of such Act; (v) any member as defined in section 2 of the Federal Home Loan Bank Act; [and] (vi) any savings association (as defined in section 3 of the Federal Deposit Insurance Act) which is an insured depository institution (as defined in such Act) or is eligible to apply to become an insured depository institution under the Federal Deposit Insurance Act.” 12 U.S.C. § 461(b)(1)(A).

² Federal Reserve Act § 19(b)(12)(C), 12 U.S.C. § 461(b)(12)(C).

³ Federal Reserve Act § 19(b)(12), 12 U.S.C. § 461(b)(12).

⁴ 12 CFR 204.5(a)(1) (formerly 12 CFR 204.3(b)(1)).

⁵ The 2006 Act amended section 19 of the Act to authorize member banks to enter into pass-through account arrangements. Prior to the 2006 Act, only nonmember banks were authorized to enter into such arrangements. As published in today’s Federal Register, the Board is also amending Regulation D to conform the regulation to the 2006 Act.

correspondent's respondents. Accordingly, Regulation D provides that the balance in a pass-through correspondent's account at a Reserve Bank represents a liability of the Reserve Bank solely to the correspondent, notwithstanding the fact that part or all of that balance may represent the funds of the correspondent's respondents.⁶ Consequently, a pass-through correspondent must show the entire balance in its Reserve Bank account on the correspondent's own balance sheet as an asset, even if the balance consists, in whole or in part, of amounts that are passed through on behalf of a respondent.⁷

B. Interim Final Rule on Payment of Interest on Balances at Federal Reserve Banks

On October 9, 2008, the Board published an interim final rule amending Regulation D to direct the Reserve Banks to pay interest on balances held at Reserve Banks to satisfy reserve requirements ("required reserve balances") and balances held in excess of required reserve balances and clearing balances ("excess balances") (73 FR 5948 (Oct. 9, 2008)). The interim final rule directed Reserve Banks to pay interest on such balances held by or on behalf of "eligible institutions." The interim final rule defined the new term "eligible institution" to mean an institution eligible to earn interest on balances held at the Federal Reserve Banks under the 2006 Act.

The interim final rule provided that Reserve Banks would pay interest on required reserve balances at a rate equal to the average targeted federal funds rate over the reserve maintenance period less 10 basis points and that Reserve Banks would pay interest on excess balances at a rate equal to the lowest targeted federal funds rate during the maintenance period less 75 basis points. Since publishing the interim final rule, the Board has adjusted the method for determining the rate of interest on excess balances three times (73 FR 65506 (Nov. 4, 2008), 73 FR 67713 (Nov. 17, 2008), 73 FR 78616 (Dec. 23, 2008)) and the method for determining the rate of interest on required reserves balances twice (73 FR 67713 (Nov. 17, 2008), 73 FR 78616 (Dec. 23, 2008)). Currently, the rate of interest on both required reserve balances and excess balances is ¼ percent.⁸ Additionally, in its December amendments, the Board amended the regulation to specify that it may from time to time determine any other rate for payment of interest on required reserve balances and excess balances.

The interim final rule deemed any excess balance held by a pass-through correspondent in the correspondent's account, when the correspondent was not itself an eligible institution, to be held on behalf of the pass-through correspondent's respondents. Further, the interim final rule permitted, but did not require, pass-through correspondents to pass back to their respondents the interest paid on balances held on behalf of respondents. The interim final rule also provided that when a pass-through correspondent passes back interest to its respondents, such a payment is not a payment of interest on a demand deposit for purposes of Regulation Q (12 CFR part 217). The interim final rule also defined the new terms used therein.

⁶ 12 CFR 204.5(d)(3) (formerly 12 CFR 204.3(i)(2)).

⁷ Similarly, a correspondent that is not acting in a pass-through capacity must also show its entire account balance at the Reserve Bank as an asset on its own balance sheet. Regulation D, however, does not specifically address correspondents other than pass-through correspondents.

⁸ 12 CFR § 204.10(b).

C. Request for Public Comment and Summary of Comments

The Board requested comment on all aspects of the interim final rule. In response, the Board received 19 comments, consisting of comments from eight depository institutions, four financial institution trade associations, two research organizations, and five individuals. Two commenters fully supported the interim final rule, but made suggestions regarding other aspects of Regulation D. Six commenters expressed concerns about the potential adverse impact of the interim final rule on correspondent-respondent relationships. Other commenters expressed monetary policy concerns related to paying interest on balances.

D. General Comments and Analysis

Two commenters supported paying interest on balances held at the Reserve Banks by or on behalf of eligible institutions as a monetary policy tool. One commenter noted that payment of interest on balances at Reserve Banks provides depository institutions with “a reasonable option [for] needed liquidity.” In contrast, six commenters stated that paying interest on excess balances encouraged banks to remove funds from the federal funds market, and thus, reduced inter-bank lending and liquidity. One commenter suggested that, in order to avoid negative effects on liquidity, the Federal Reserve should pay interest on required reserve balances, but not on excess balances. One commenter stated that paying interest on excess balances could encourage financial institutions to neglect other markets where those institutions could obtain higher returns. The Board also received one comment on market conditions in general, but not specifically related to paying interest on balances held at the Reserve Banks.

The Board has carefully considered the comments about the effects of paying interest on balances at Reserve Banks. In the past, the absence of interest payments on required reserve balances acted as a tax on depository institutions’ issuance of deposits subject to reserve requirements. To the extent that depository institutions could not satisfy reserve requirements with vault cash, they were required to hold more balances than they otherwise would in a non-interest bearing account at a Reserve Bank. Further, the absence of interest payments on excess balances meant that, when reserve supply significantly exceeds demand, the federal funds rate could fall to as low as zero.

The Board continues to believe that the ability to pay interest on balances held at Reserve Banks promotes efficiency and stability of the banking sector. Paying interest on required reserve balances also eliminates much of the implicit reserve tax and lessens the incentives for depository institutions to engage in reserve-avoidance behavior, which absorbs real resources and diminishes the efficiency of the banking system. By paying interest on excess balances, the Federal Reserve can expand its balance sheet as necessary to provide sufficient liquidity to support financial stability while implementing monetary policy that is appropriate in light of macroeconomic objectives of maximum employment and price stability.

In order to help foster trading in the federal funds market, the Board has made adjustments to the rates at which the Reserve Banks pay interest on required reserve balances and excess balances, and will continue to evaluate, and make any necessary adjustments to, the appropriate rate in light of evolving market conditions. Accordingly, the Board has determined that the Reserve Banks will continue to pay interest on required reserve and excess balances held at Reserve Banks by or on behalf of eligible institutions.

One commenter expressed concern that under the interim final rule, excess balances held by a correspondent on behalf of respondents “would become demand deposits on the correspondent’s balance sheet,” and thus the correspondent would be required to hold

reserves against those balances. Prior to the implementation of the interim final rule, a correspondent was required to hold reserves against any respondent excess funds held as a deposit subject to immediate withdrawal by the respondent. The implementation of paying interest on balances at Reserve Banks has not changed the accounting and reporting treatment of such balances for purposes of reserve requirements.

The remaining comments concerned reserve requirements generally, limits on transfers from savings deposit accounts, and member-bank pass-through arrangements. Two comments addressed Regulation D's limitation on certain convenient transfers from savings deposits: one comment suggested broadening the definition of "in person" transfer, while the other comment suggested removing the numeric limitations on certain convenient transfers from savings deposits. One commenter recommended eliminating reserve requirements, while another commenter recommended increasing reserve requirements ratios.

The Board is not exercising its authority at this time to eliminate reserve requirements or to change any required reserve ratios at this time, even though the 2008 Act made both authorities effective in 2008. The Board may consider such changes in the future in the context of a broader review of the role of reserve requirements in the conduct of monetary policy. Finally, as explained in the companion Regulation D rulemaking announced today, the Board is eliminating the prohibition on member bank pass-through accounts and is amending the numeric limitations on convenient transfers from savings deposits to remove the sublimit that applied to checks and drafts.⁹

E. Section-By-Section Analysis

1. § 204.2(v) Definition of Clearing Balance

The interim final rule defined the new term "clearing balance" as "the amount that an eligible institution holds to satisfy a contractual clearing balance with a Federal Reserve Bank, in addition to any required reserve balance." The Board received no comments on this provision of the interim final rule. As part of the final rule, the Board is adopting a definition of "clearing balance" that more accurately reflects calculations of account balances and interest payments. The final rule defines "clearing balance" as "the average balance held in an account at a Federal Reserve Bank by an institution over a reserve maintenance period to satisfy its contractual clearing balance with a Reserve Bank." Thus, the amount of funds an institution actually maintains for clearing purposes may be different from its "contractual clearing balance," which is the amount that the institution has agreed to maintain, on average, over the reserve maintenance period. Further, the phrase "in addition to any required reserve balance" is unnecessary in light of the new definition of "contractual clearing balance," which specifies that such amount is in addition to the institution's reserve balance requirement.¹⁰

As stated in the interim final rule, only certain institutions are eligible to receive earnings on their balances at Reserve Banks ("eligible institutions"). Accordingly, the interim final rule's definition of "clearing balance" was restricted to "eligible institutions." Institutions that are not "eligible institutions," however, may hold balances for clearing purposes in the

⁹ See final amendments to Regulation D elsewhere in today's Federal Register.

¹⁰ See final amendments to Regulation D elsewhere in today's Federal Register that define "contractual clearing balance" as "an amount that an institution agrees or is required to maintain in its account at a Federal Reserve Bank in addition to balances the institution may hold to satisfy its reserve balance requirement."

institution's Reserve Bank account. Therefore, the Board is adopting a definition of "clearing balance" that is not limited to institutions that are eligible to receive earnings on balances at Reserve Banks. For ease of reference, the final rule places all the definitions in a single section of Regulation D (§ 204.2), and thus, the rule redesignates § 204.10(d)(1) as § 204.2(v).

2. § 204.2(y) Definition of Eligible Institution

Section 19(b)(12) of the Act permits Reserve Banks to pay interest on balances held by or behalf of "depository institutions." Because section 19(b)(12)(C)'s definition of "depository institution" is broader than the definition of that term in section 19(b)(1)(A) of the Act and in Regulation D, the interim final rule used the new term "eligible institution" to refer to those "depository institutions" listed in section 19(b)(12)(C) that are eligible to receive interest on their balances. The Board received no comment on this definition and is retaining the current provision but moving it to the definitions section of the regulation, redesignated as § 204.2(y).

3. § 204.2(z) Definition of Excess Balance

The interim final rule defined "excess balance" as "the average balance held in an account at a Federal Reserve Bank by or on behalf of an eligible institution over a reserve maintenance period that exceeds the sum of the required reserve balance and any clearing balance." The Board received no comments on this definition and is retaining the current provision but moving it to the definitions section of the regulation, redesignated as § 204.2(z), with one technical amendment. Like the definition of "clearing balance," discussed *supra*, the interim final rule's definition of "excess balance" was limited to eligible institutions. Because institutions other than eligible institutions may maintain excess balances at Reserve Banks, the Board is adopting a definition of "excess balances" in the final rule that is not limited to "eligible institutions."

4. § 204.2(bb) Definition of Required Reserve Balance

The interim final rule defined "required reserve balance" as "the average balance held in an account at a Federal Reserve Bank by or on behalf of an eligible institution over a reserve maintenance period to satisfy the reserve requirements of this part." The Board received no comments on this definition and is retaining the current provision but moving it to the definitions section of the regulation, with one technical amendment, redesignated as § 204.2(bb). Because the term "required reserve balance" is used in Regulation D in contexts other than paying earnings on balances at Reserve Banks, the definition of the term in the final rule is not limited to "eligible institutions."

5. § 204.2(cc) Definition of Targeted Federal Funds Rate

The interim final rule defined "targeted federal funds rate" as "the federal funds rate established from time to time by the Federal Open Market Committee." The Board received no comments on this definition and is retaining the current provision but moving it to the definitions section of the regulation, redesignated as § 204.2(cc).

6. § 204.10(a) Payment of Interest on Balances

The Board amended Regulation D to direct the Reserve Banks to pay interest on required reserve balances and excess balances maintained at Reserve Banks by or on behalf of an eligible institution. The Reserve Banks make interest payments within the existing framework for reserve computation and maintenance, which includes reserve averaging, carryover

provisions, and reserve deficiency charges. For both excess balances and required reserve balances, Reserve Banks pay interest on average balances maintained over the reserve maintenance period. This approach is consistent with the current reserves framework under which compliance with reserve requirements is measured over either a seven-day or a fourteen-day reserve maintenance period, depending on the size of the institution. Interest is credited to eligible institutions after the close of the maintenance period (usually 15 days thereafter) in order to apply reserve carryover provisions.

One commenter stated that paying interest on required reserve balances rendered useless the current “as-of adjustment” process for correction of errors from previous reserve maintenance periods. An as-of adjustment is a memorandum item used by the Federal Reserve to correct the effect of errors made in processing of checks or other transactions on an institution’s reserve position. These technical adjustments are used when determining a depository institution’s required reserve balance and clearing balance for the payment of interest and therefore remain useful.¹¹ Accordingly, the Board is adopting the current language in § 204.10(a) as part of its final rule.

7. § 204.10(b) Rate

The Board received no comments on the initial rate of interest on required reserve balances. The Board received two comments on the formula for the rate on excess balances. One commenter stated that the initial rate paid on excess balances (the lowest targeted federal funds rate during the reserve maintenance period less 75 basis points) and the rate after the first adjustment to the formula for calculating the interest rate on excess balances (the lowest targeted federal funds rate during the reserve maintenance period less 35 basis points) were too high in a “dysfunctional market.” The Board received one comment that reducing the 75-basis point difference between the rate of interest on excess balances and the targeted federal funds rate over the reserve maintenance period exacerbated the “untimely implementation” of the payment of interest on balances at Reserve Banks, but that commenter did not propose an alternative rate. One commenter suggested that the Board set the rate of interest on excess balances at the effective federal funds rate, rather than the targeted federal funds rate, so as to avoid artificially drawing funds to the Reserve Banks.

The Board has continued to evaluate the rate of interest on required reserve and excess balances and is not at this time changing the rates from the current amount of ¼ percent. Flexibility to make adjustments to the rates of interest in response to evolving market conditions continues to be necessary. Accordingly, the Board is retaining the current language of § 204.10(b)(3), which provides that the Board may revise from time to time the rates for payment of interest on balances at Reserve Banks.

8. § 204.10(c) Pass-through balances

a. Background

As noted above, the 2006 Act authorized Reserve Banks to pay earnings on balances maintained at a Reserve Bank by or on behalf of certain depository institutions. The 2006 Act also authorized the Board to prescribe regulations concerning “the responsibilities of depository institutions, Federal Home Loan Banks, and the National Credit Union

¹¹ More detailed information about the “as-of adjustment” process is available in the Reserve Maintenance Manual, available at <http://www.frbservices.org/files/regulations/pdf/rmm.pdf>.

Administration Central Liquidity Facility with respect to crediting and distribution of earnings attributable to balance maintained . . . in a Federal Reserve bank by any such entity on behalf of depository institutions.”¹² Thus, the 2006 Act contemplated that certain institutions (such as Federal Home Loan Banks) could hold balances on behalf of depository institutions that were eligible to earn interest on those balances, even if the correspondent institutions were not themselves eligible to receive earnings on their own balances.

b. Correspondents that are Eligible Institutions

Under the interim final rule, Reserve Banks paid interest on required reserve balances maintained on behalf of an eligible institution. Where a pass-through correspondent is an eligible institution, the required reserve balances in the correspondent’s account may include those balances held by the correspondent to meet its own reserve requirement (if any), as well as those balances held to meet its respondents’ reserve requirements. The interim final rule also permitted, but did not require, a pass-through correspondent to pass back to its respondent interest paid on behalf of that respondent’s required reserve balances.

The Board requested comment on whether it should permit or require a correspondent to pass back interest to its respondents. In response, the Board received four comments. Two commenters supported permissive passing back of interest in order to preserve the parties’ flexibility in negotiating contractual relationships. One commenter supported requiring passing back of interest, stating that permitting correspondents to retain the interest would be unfair. This commenter also suggested delaying the effective date of a pass-back requirement to two years after adoption of a final rule in order to provide correspondents with an opportunity “to modify accounting systems and business models.” Finally, one commenter stated that paying interest on pass-through balances as a lump-sum was a poor service because doing so places responsibility on the correspondent to calculate the amount of interest to be passed back to each respondent.

Under the final rule, correspondents that are eligible institutions will continue to be permitted, but not required, to pass back to their respondents interest earned on balances held on behalf of the respondents. As these correspondents are eligible to earn interest on their own account balances, permitting them to make arrangements with their respondents with respect to passing back of interest is consistent with the statutory provisions. In addition, permissive, but not required, passing back of interest avoids interfering with existing correspondent-respondent arrangements. Correspondents structure their relationships with respondents in a variety of ways, depending on factors such as services provided or balances held. Respondents may adjust the level of balances held with a correspondent in response to changes in the rates received on those balances, as well as in response to other factors. Respondents that are not satisfied with their existing correspondent arrangements may take steps to renegotiate the terms of the relationship or enter into a relationship with a different correspondent.

Additionally, permitting, but not requiring, the passing back of interest to respondents is consistent with the treatment of reserve deficiency charges in Regulation D.¹³ Reserve Banks assess deficiency charges to the account of the pass-through correspondent for any deficiency in its account balances, even if the deficiency is attributable to the correspondent’s respondent. Then, the pass-through correspondent determines whether to assess

¹² Federal Reserve Act § 19(b)(12)(B)(iii), 12 U.S.C. § 461(b)(12)(B)(iii).

¹³ See 12 CFR § 204.5(d)(4)(i) (formerly 12 CFR § 204.3(i)(3)(ii)).

a deficiency charge on its respondent, or whether to make adjustments to other aspects of the correspondent-respondent relationship in response to the deficiency. Accordingly, the Board has determined to continue permitting, but not requiring, correspondents that are eligible institutions to pass back to respondents earnings on both required reserve balances and excess balances held on behalf of the respondents.

c. Correspondents that are Not Eligible Institutions

Under the interim final rule, Reserve Banks paid interest on required reserve balances maintained on behalf of an eligible institution, even if the pass-through correspondent was not an eligible institution. Where a pass-through correspondent is not an eligible institution, the required reserve balances held in the correspondent's account are solely those balances held to meet its respondent's reserve requirements.

The interim final rule also provided that Reserve Banks pay interest on excess balances maintained on behalf of an eligible institution, even if the pass-through correspondent is not an eligible institution but has excess balances in its account. Because Reserve Banks cannot determine whether all or part of the excess balances in a pass-through correspondent's account are held on behalf of respondents without imposing additional reporting or accounting requirements, the interim final rule deemed all of the excess balances held in an account of a correspondent that is not an eligible institution to be held on behalf of the correspondent's respondents.

The Board requested comment on alternative methods for determining whether all or part of the excess balances in a correspondent's account at a Reserve Bank are held on behalf of the respondent where the correspondent is not an eligible institution. The Board received one comment in support of deeming all excess balances held in an account of a pass-through correspondent that is not an eligible institution to be held on behalf of the correspondent's respondents. This commenter stated that deeming the excess balances to be held on behalf of the respondents would avoid imposing "unnecessarily burdensome" reporting requirements on correspondents and provide flexibility in structuring correspondent-respondent relationships. One commenter, however, indicated that additional reporting requirements would not be burdensome because correspondents already maintain records of excess balances held on behalf of respondents.

Since the implementation of paying interest on balances at Reserve Banks, some correspondents that are not eligible institutions are holding extremely high excess balances relative to the total assets of their respondents, indicating that these balances may not be held on behalf of those respondents. In order to carry out the intent of the 2006 Act with respect to institutions that are and are not eligible to receive interest on balances held at Reserve Banks, the final rule will no longer deem any excess balance in the account of a correspondent institution that is not an eligible institution to be held on behalf of respondents. Thus, any excess balance in the account of a correspondent that is not an eligible institution will be attributable to the correspondent, and no earnings will be paid on the excess balance in that account. The respondents of a correspondent that is not an eligible institution may elect to participate in an excess balance account (discussed *infra*) in order to receive earnings on excess balances.

Required reserve balances held on behalf of respondents by correspondents that are not eligible institutions, however, will continue to receive interest, which will be posted to the correspondent's master account. As discussed *supra*, where a pass-through correspondent is not an eligible institution, the required reserve balances held in the correspondent's account will

be solely those held to meet its respondent's reserve requirements. Further, because any excess balance held in the account of a correspondent that is not an eligible institution will not receive interest, any earnings received on balances in such an account will be attributable solely to the required reserve balances of the correspondent's respondents. Unlike the interim final rule, the final rule will require correspondents that are not eligible institutions to pass back to their respondents all interest credited to the correspondent's accounts. The correspondent is responsible for calculating the amount of interest apportioned to each of its respondents.

d. Exemption from Regulation Q

Under the interim final rule, passing back interest to respondents is not a payment of interest on a demand deposit for purposes of Regulation Q (12 CFR Part 217). One commenter stated that by paying interest on "transaction accounts," the Board has "created an unfair playing field" by not allowing other correspondent banks to do the same for the same types of accounts held with them. Another commenter expressed concern that requiring a correspondent to hold excess balances on its balance sheet negated the FDIC's insurance coverage of the respondent's demand deposit account by transforming the respondent's account from a non-interest-bearing transaction account to an interest-bearing transaction account.

The Board recognizes that, although Reserve Banks may pay interest on balances that are subject to immediate withdrawal, many private sector banks are prohibited by law from doing so.¹⁴ The Board has long sought statutory amendments to eliminate the prohibition against interest on demand deposits. The 2006 Act, however, expressly authorizes the Board to prescribe regulations to allow pass-through correspondents to pass back interest to respondents. Congress, therefore, contemplated that pass-through correspondents could pass back part or all of the interest received in a correspondent's Reserve Bank account to its respondents, even though the payment of interest on demand deposit accounts is otherwise prohibited. Accordingly, the Board has specified in the final rule that when a pass-through correspondent passes back to its respondent any interest paid on balances held on behalf of the respondent, such a payment is not a payment of interest on a demand deposit for purposes of Regulation Q.¹⁵ The Board received no other comments on this provision and is retaining the current language in the final rule, with the exception of one technical amendment for clarity.

II. Excess Balance Accounts

A. Background

1. Correspondent-Respondent Relationship

Since the implementation of the payment of interest on excess balances of eligible institutions, eligible institutions that are respondents of a pass-through correspondent may receive earnings on excess balances in two ways. First, the respondents of a pass-through correspondent may direct the correspondent to sell the respondent's excess funds in the federal funds market. Second, under the interim final rule adopted in October, the respondents may

¹⁴ For example, section 19(i) of the Act provides: "[no] member bank shall, directly or indirectly, by any device whatsoever, pay any interest on any deposit which is payable on demand" See Regulation Q (Prohibition Against Payment of Interest on Demand Deposits), which implements section 19(i) (12 CFR 217).

¹⁵ See 12 CFR § 329.2 (Payment of interest) and 12 CFR § 329.3 (Exception to prohibition on payment of interest) for implications to FDIC regulations regarding payment of interest.

direct the correspondent to hold the respondent's excess funds as excess balances in the correspondent's account at a Reserve Bank. These two approaches have different implications for the correspondent's balance sheet and its leverage ratio for capital adequacy purposes. If a correspondent holds its respondents' excess balances in the correspondent's account at a Reserve Bank, the correspondent's account balance at the Reserve Bank increases. Accordingly, the correspondent has more assets on its balance sheet, resulting in a lower leverage ratio for capital adequacy purposes. In contrast, if the correspondent sells the funds in the federal funds market on the respondent's behalf, the balances are transferred to the entity purchasing them. This transaction is effected by a debit to the correspondent's account at a Reserve Bank and a credit to the purchaser's account at a Reserve Bank. All other things being equal, the correspondent's Reserve Bank account balance is lower. The correspondent has fewer assets on its balance sheet, and therefore, has a higher regulatory leverage ratio.

When the federal funds rate is below the rate the Reserve Banks pay on excess balances, respondents have an incentive to shift the investment of their excess funds away from sales of federal funds through their correspondents, and toward holding those funds as excess balances in accounts at the Reserve Banks. Although correspondents may hold those funds as excess balances at a Reserve Bank on behalf of the respondent, doing so could result, in some cases, in a significant reduction in a correspondent's regulatory leverage ratio for capital adequacy purposes. Alternatively, a respondent could open its own account at a Reserve Bank; doing so, however, could potentially disrupt part or all of the respondent's established relationship with its correspondent.

2. Comments Received on Paying Interest on Excess Balances Held by Correspondents on Behalf of Respondents

In response to its interim final rule that implemented payment of interest on balances at Reserve Banks, the Board received comments concerning the effects of paying interest on excess balances on correspondent-respondent relationships. Five commenters stated that paying interest on excess balances, in conjunction with unusual market conditions, was causing respondents to shift funds away from correspondents to the Reserve Banks; thus, disrupting correspondent-respondent relationships. Three commenters stated that respondents' increasing demands to have correspondents hold funds as excess balances (as opposed to selling the funds in the federal funds market) was not only decreasing the availability of federal funds, but was also requiring correspondents to maintain more capital to raise their leverage ratio for capital adequacy purposes. One commenter expressed concern that, without changes to the interim final rule, the long-term viability of correspondent-respondent relationships would be jeopardized.

The Board received five comments proposing solutions to mitigate the adverse effects on correspondent-respondent relationships of paying interest on excess balances. Four commenters proposed that the Board authorize new accounts for the purpose of holding excess balances that did not require correspondents to hold the respondents' excess balances on their balance sheets. One commenter suggested that the Reserve Banks purchase excess funds directly from correspondents at the rate of interest on excess balances.

B. Excess Balance Account Proposed Rule

In response to these concerns, the Board requested comment in January 2009 on a proposal to amend Regulation D to authorize the creation of excess balance accounts ("EBAs")

(74 FR 5628 (Jan. 30, 2009)). The proposal would authorize the establishment of EBAs for maintaining the excess balances of participating eligible institutions (“EBA Participants”). The EBA Participants would designate another institution to act as their agent (“EBA Agent”) for purposes of general account management, including transferring excess balances in and out of the EBA and apportioning the interest paid on excess balances. The Board proposed that the EBA Agent could not commingle its funds in the EBA. The excess balances in the EBA would represent a liability of the Reserve Bank solely to the EBA Participants. Neither the EBA Participants nor the EBA Agent could maintain required reserve or clearing balances in the EBA or use the EBA for general payment or other activities. The Board stated in the proposal that it would re-evaluate the continuing need for EBAs when more normal market functioning resumes.

C. General Comments and Analysis

In response to its request for comment on the EBA proposal, the Board received 61 comments, representing comments from 44 depository institutions, two financial holding companies, one Federal Home Loan Bank, five financial institution trade associations, and three individuals. Sixteen commenters supported the proposal in its entirety. Two of these commenters sought clarification on technical aspects of the proposed rule on EBAs. Several commenters supported EBAs in general, but suggested that EBA Participants be able to designate more than one institution to act as EBA Agent. One commenter found no significant value in the EBA proposed rule, citing high administrative costs and few benefits. One commenter raised concerns about the impact of EBAs on existing business models if balances are moved into Reserve Bank accounts. Two commenters encouraged the Board to evaluate the continuing need for EBAs when more normal market functioning resumes; one of these commenters suggested the Board seek public comment as part of its re-evaluation.

The Board has carefully considered the comments and has determined to authorize the establishment of EBAs, largely as described in the proposal. The Board believes that authorizing EBAs should reduce the potential for significant disruptions to long-standing correspondent-respondent relationships in the current market environment. Because the excess balances of EBA Participants in EBAs would be Reserve Banks’ direct liabilities to EBA Participants, correspondents would not show those balances on their balance sheets. Therefore, the adverse leverage ratio impact of correspondents of holding respondent excess balances in the correspondent’s account would be mitigated. Further, participation in an EBA, either as a participant or agent, is voluntary. Thus, if an institution does not believe that an EBA will provide additional value, the institution does not have to participate in an EBA or act as an EBA Agent. As stated in the proposal, the Board will re-evaluate the continuing need for EBAs when more normal market functioning resumes.

D. Section-by-Section Analysis

1. § 204.2(aa) Definition of Excess Balance Account

The Board proposed to define “excess balance account” as “an account at a Reserve Bank pursuant to § 204.10(e) of this part that is established by one or more eligible institutions and in which only excess balances of the participating eligible institutions may at any time be maintained.” The proposed rule explicitly excludes excess balance accounts from the definition of “pass-through accounts.”

The Board received three comments seeking clarification as to whether each EBA Participant needed to open an EBA or whether the EBA Participants could designate an EBA

Agent to open an EBA on behalf of the EBA Participants. To establish an EBA, eligible institutions that desire to become EBA Participants must designate one other institution to act as the EBA Agent for that EBA. EBA Participants will be required to execute EBA agreements with the Reserve Bank where the EBA Agent maintains its own master account (“Administrative Reserve Bank”). Similarly, the EBA Agent will be required to execute an EBA agreement with its Administrative Reserve Bank. In order to facilitate establishing EBAs and to reduce administrative burdens, EBA Participants will deliver their executed EBA agreement to their EBA Agent. The EBA Agent then will deliver the executed EBA agreements of all the EBA Participants for which it acts as EBA Agent to its Administrative Reserve Bank. The Board is adding language to the definition of “excess balance account” to clarify that eligible institutions establish an EBA through the EBA Agent. The Board is also making a technical amendment to the definition to reflect renumbering of sections elsewhere in Regulation D. The Board is also redesignating the definition as § 204.2(aa) (from § 204.10(d)(6) in the proposed rule) in connection with moving the definition into the general definition section of Regulation D.

2. § 204.10(d)(1) Establishing an EBA

The proposed rule (at § 204.10(e)(1)) provided that a Reserve Bank may establish an excess balance account for eligible institutions. The proposed rule also provided that the excess balances in the EBA are the property of the eligible institutions that participate in the EBA and represent a liability of the Reserve Bank solely to the participating institution. The Board received no comments on this portion of the proposal.

The Board is deleting the phrase that states the excess balances are the property of the eligible institutions. This phrase is not necessary and its deletion does not change the substance of the provision, which continues to state that excess balances represent a liability of the Reserve Bank solely to the participating institutions. The Board is otherwise adopting the provision as proposed.

3. § 204.10(d)(2) EBA Agent

a. General Account Management

The proposed rule on EBAs provided that the EBA Participants would authorize another institution, the EBA Agent, to act as agent to perform general account management, including transferring excess balances of EBA Participants into and out of the EBA. One commenter expressed concerns about the feasibility for the EBA Agent of passing back interest. Specifically, the commenter sought clarification as to whether an EBA Agent could distribute the earnings to the EBA Participants at a different rate than the Reserve Banks paid out the earnings, as using the same formula as the Reserve Banks would require significant programming efforts. One commenter requested that the Board delay the effective date of the rule 120 days after publication to provide sufficient time to adjust operating systems to accommodate the new EBA Agent services.

The EBA program contemplates that Reserve Banks will calculate interest on the aggregate balance in the EBA, rather than calculate the amount of interest attributable to each EBA Participant’s balances in the EBA. The EBA Participants will be responsible for instructing the EBA Agent with respect to the disposition of the interest. For example, an EBA Participant and an EBA Agent may by agreement provide that all interest attributable to an EBA Participant should be paid to the EBA Participant, or may by agreement provide that the EBA Agent may retain part or all of the interest paid as part of the EBA Agent’s compensation for

providing EBA Agent services or other services for the EBA Participant. Thus, the EBA Agent is not required by regulation to utilize the same formula for the disposition of earnings to EBA Participants as the Reserve Banks use for calculating interest on the EBA's aggregate balance. Moreover, the Board anticipates that the Reserve Banks will establish terms and conditions such that each EBA Agent will manage only one EBA.¹⁶ Because acting as an EBA Agent is voluntary, the Board does not believe it necessary to delay the effective date of the rule. The Board is making one additional technical amendment to the final rule to replace the proposed phrase "agent of the eligible institutions" with the phrase "agent of the participating institutions." This amendment is intended to provide consistent usage of terms throughout the final rule and does not represent a substantive change to the provision.

b. Participation in One EBA

The proposed rule provided that the EBA Participants would authorize another institution to act as its EBA Agent with respect to an EBA. The proposed rule, however, did not specify whether an EBA Participant could participate in more than one EBA. One commenter recommended removing the requirement that an EBA Participant designate only one institution as its EBA Agent, while not specifically suggesting that an EBA Participant be able to designate more than one institution as EBA Agent or to participate in more than one EBA. This commenter stated that requiring an EBA Participant to designate only one EBA Agent was unnecessary as most respondents "do not participate in multiple correspondent agency programs." Some commenters, however, suggested that the final rule should permit EBA Participants to participate in more than one EBA.¹⁷ These commenters stated that respondents currently use more than one correspondent institution for selling funds in the federal funds market, among other services, in order to diversify credit risk, obtain better rates, and for liquidity contingency planning purposes.

While the Board recognizes that certain respondents may wish to maintain relationships with more than one correspondent for various purposes, the Board believes that permitting each eligible institution to participate in only one EBA is appropriate. Specifically, multiple EBAs are not necessary in order to diversify credit risk, as with federal funds sales, because there is no credit risk associated with maintaining a balance in an account at a Reserve Bank. Similarly, the need to use multiple agents to manage liquidity risk does not exist in the context of EBAs, because excess balances in an EBA are highly liquid. Moreover, any potential disruption to existing correspondent-respondent relationships is lessened by the fact that each EBA Participant can choose each day whether to sell funds in the federal funds market (through any number of correspondent institutions), to place the funds at a Federal Reserve Bank through their (single) EBA Agent, or to select a combination of the two. Accordingly, EBA Participants may maintain relationships with more than one correspondent notwithstanding the fact that an EBA Participant participates in only one EBA at a Reserve Bank.

Restricting eligible institutions to participating in only one EBA is consistent with Regulation D's treatment of correspondent-respondent relationships in pass-through arrangements, where each respondent uses a single correspondent to pass through the

¹⁶ An EBA Agent that wishes to segregate different types of respondents from one another can set up subaccounts for the EBA.

¹⁷ Because the proposed rule on EBAs limits EBA Participants to designating one institution as EBA Agent for the EBA, an EBA Participant that wished to designate multiple institutions as EBA Agent would need to participate in multiple EBAs to do so.

respondent's required reserve balances.¹⁸ This single-correspondent structure also reflects the current Federal Reserve policy that permits each chartered depository institution to maintain a single master account at one Reserve Bank. Such a structure provides streamlined control and a single coordination point for the Reserve Banks to manage the debtor-creditor relationship with each depository institution. This structure also helps minimize the risk of loss to the Federal Reserve in the event the account holder becomes insolvent. Authorizing the establishment of EBAs loosens such control and coordination to the extent that it potentially permits EBA Participants to have accounts at two Reserve Banks: one account in the district where the EBA Participant itself is located, and an EBA in the district where the EBA Agent is located. Given that offering EBAs is motivated largely by unusual financial market conditions in which the effective federal funds rate has been below the rate on excess balances, and given that EBAs are being offered on a temporary basis, staff believes that permitting EBA Participants to potentially have an EBA and a master account at different Reserve Banks is appropriate to ensure that respondents are able to hold excess balances within their existing correspondent-respondent relationships. A more significant expansion, however, involving multiple account relationships by permitting eligible institutions to participate in more than one EBA, introduces further complexity into the oversight and coordination for the Reserve Banks for managing the debtor-creditor relationship without a substantial justification for doing so.

The Board believes that permitting eligible institutions to participate in one EBA, but not more, at this time benefits both correspondent and respondent by allowing respondents to place excess balances at a Reserve Bank in a way that does not increase the leverage ratio for the correspondent, therefore mitigating disruption to correspondent-respondent relationships. This approach also does not significantly increase the complexity for the Reserve Banks in managing these accounts and the associated debtor-credit relationships. In addition, the significance of the demand for participation in multiple EBAs is not clear from the comments received, because only a few commenters expressed an interest in multiple EBAs. Accordingly, the Board expects that, absent a compelling reason to do otherwise at this time, the Reserve Banks will set terms and conditions with respect to EBAs that will limit each eligible institution to participation in one EBA.

c. EBA Agent Must Maintain Separate Master Account

The proposed rule also provided that the EBA Agent "must maintain its own separate account at a Reserve Bank" and that the EBA Agent may not commingle its own funds in the EBA. The proposal indicated that the EBA would be established at the Reserve Bank where the EBA Agent maintains its own master account, although the proposed regulatory text did not reflect this. Accordingly, the final rule adds language to the regulatory text to specify that the EBA must be held at the Reserve Bank where the EBA Agent maintains its master account.

d. Record-keeping

The supplementary information to the proposed rule stated that the EBA Agent would be responsible for maintaining records adequate to demonstrate the level of excess balances in the EBA of each EBA Participant. The Board received five comments regarding record-keeping requirements for the EBA Agent. One commenter suggested the Board clarify the record-keeping requirements of an EBA Agent with respect to the EBA. Three commenters stated that EBA Agents should be responsible for maintaining adequate records that could

¹⁸ 12 CFR 204.5(d)(1) (formerly 12 CFR 204.3(i)(1)).

demonstrate the level of excess balances in the EBA of each EBA Participant. Additionally, one commenter indicated that maintaining such records would not be difficult for EBA Agents because correspondents maintain daily, detailed records of respondents' "agency" funds. Because the informational needs of each Reserve Bank with respect to each EBA may vary, the Board has not included such specifications in the final rule. Rather, the Board believes that setting forth the EBA Agent's record-keeping responsibilities is more appropriately done through account agreements with the Reserve Banks or through account terms and conditions.

4. § 204.10(d)(3) Balances Maintained in EBA

The proposed rule provided that, at any given time, only excess balances of an eligible institution may be maintained in an EBA. The proposed rule also provided that balances maintained in an EBA would not satisfy any institution's reserve balance requirement or contractual clearing balance. The Board received two comments on this provision, both seeking clarification on how EBA Participants should classify balances held in an EBA.

Balances held in an EBA by an EBA Participant represent a liability of the Reserve Bank to the EBA Participants and not to the EBA Agent. Therefore, for reporting and accounting purposes, an EBA Participant should treat balances held in an EBA as balances held at a Reserve Bank and should report such balances as "balances due from a Federal Reserve Bank" for purposes of FR 2900 deposit reporting.¹⁹ The Board received no other comments on this provision and is adopting the proposed provision, with minor editorial revisions, redesignated as § 204.10(d)(3).

5. § 204.10(d)(4) Restrictions on Use of EBA

The proposed rule provided that neither EBA Participants nor the EBA Agent may use the EBA for general payments or other activities. The Board received one comment on this provision, seeking clarification on restrictions as to when the EBA Agent would be required or allowed to move excess balances into the account.

The final rule imposes no regulatory restrictions on when an EBA Agent may or must transfer funds into and out of an EBA. The EBA Agent, however, must manage the EBA such that the account does not incur either intra-day or overnight overdrafts. The Board is adopting this provision as proposed, redesignated as § 204.10(d)(4).

6. § 204.10(d)(5) Payment of Interest on Balances in EBA

The Board proposed that interest would be paid on excess balances in accordance with section 204.10(b)(2). The Board received no comments on this provision. In light of the amendments to Regulation D since the proposed rule on EBAs setting forth the Board's authority to provide that interest on excess balances be paid at a different rate than the rate set forth in section 204.10(b)(2), the final rule will reflect that authority set forth in current section 204.10(b)(3).

7. § 204.10(d)(6) Additional Terms and Conditions

The proposed rule on EBAs was silent about the authority of Reserve Banks to establish additional terms and conditions with respect to the operation of an EBA. The Board, however, is adding new § 204.10(d)(6) to the final rule to clarify that the Reserve Banks have the authority to set additional terms and conditions with respect to the operation of EBAs, to the

¹⁹ See Instructions for Form FR 2900 (Sep. 2003) at p. 39, no. 1 (http://www.federalreserve.gov/reportforms/forms/FR_2900cb20071001_i.pdf),

extent that such terms and conditions are consistent with provisions in Regulation D. Such terms and conditions include, but are not limited to, terms of service, fees for services, conditions under which an institution may act as agent for an EBA, restrictions on the EBA Agent's account management, penalties for noncompliance with the terms of Regulation D's provisions on EBAs or with the additional terms and conditions established by the Reserve Banks, and termination of EBAs. The provision provides examples of the operational aspects for which the Reserve Banks may set forth additional terms and conditions, but indicates that those categories of additional terms and conditions are illustrative.

III. Clearing Balance Policy Adjustments

At the time it adopted the interim final rule, the Board made adjustments to its clearing balance policy so as to discontinue practices related to reserve requirements that were no longer necessary in light of the amendments to Regulation D. First, the Board eliminated the "imputed reserve requirement adjustment" to earnings credits because reserves on respondents' balances would earn interest at the rate on required reserve balances. Second, the Board eliminated the "marginal reserve requirement adjustment" because respondents would be indifferent between holding balances at a Reserve Bank (and earning the rate on required reserves balances) and maintaining the balance at a private-sector correspondent (taking a due from deduction, and investing those funds). Finally, the Board eliminated the imputed reserve requirement adjustment and the adjustment for cash items in the process of collection that are applied when measuring float costs to be recovered by Reserve Bank priced services. The Board received no comments on its adjustments to the clearing balance policy and is retaining that policy as previously adopted.

IV. Transitional Adjustments in Mergers

The interim final rule eliminated the provisions in Regulation D associated with merger-related adjustments to reserve requirements, applicable to mergers completed on or after October 9, 2008. The provisions were set forth in § 204.4. The Board received no comments on this issue and is not reinstating the provisions.

V. Solicitation of Comments Regarding Use of "Plain Language"

Section 722 of the Gramm-Leach-Bliley Act of 1999 (12 U.S.C. 1408) requires the Board to use "plain language" in all final rules. The Board has sought to present this final rule in a simple and straightforward manner. The Board received no comments on whether the interim final rule and proposed rule were clearly stated and effectively organized or on how the Board might make the text easier to understand.

VI. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires an agency that is issuing a final rule to prepare and make available a regulatory flexibility analysis that describes the impact of the final rule on small entities. 5 U.S.C. 603(a). The RFA provides that an agency is not required to prepare and publish a regulatory flexibility analysis if the agency certifies that the final rule will not have a significant economic impact on a substantial number of small entities. 5 U.S.C. 605(b).

Pursuant to section 605(b), the Board certifies that this final rule will not have a significant economic impact on a substantial number of small entities. The rule implements a

program for paying interest on certain balances held by eligible institutions at the Federal Reserve Banks and will benefit small institutions that receive such interest. Additionally, the rule permits, but does not require, institutions to establish EBAs at Reserve Banks. The impact on institutions choosing to establish EBAs at Reserve Banks would be positive, not adverse, because EBA Participants would be able to earn the rate payable on excess balances in a debtor-creditor relationship directly with a Reserve Bank without disrupting established correspondent-respondent relationships. Likewise, the impact would be positive, not adverse, on institutions that choose to establish EBAs but that are not currently in correspondent-respondent relationships, as such institutions would be expected to establish EBAs only to the extent that EBA Agents and EBA Participants found it mutually beneficial to do so. There are no new reporting, recordkeeping, or other compliance requirements associated with this rule.

VII. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR 1320 Appendix A.1), the Board reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget. No collections of information pursuant to the Paperwork Reduction Act are contained in the final rule.

List of Subjects in 12 CFR Part 204

Banks, banking, Reporting and recordkeeping requirements.

Authority and Issuance

For the reasons set forth in the preamble, the Board is amending 12 CFR part 204 as follows:

PART 204—RESERVE REQUIREMENTS OF DEPOSITORY INSTITUTIONS (REGULATION D)

1. The authority citation for part 204 continues to read as follows:

Authority: 12 U.S.C. 248(a), 248(c), 371a, 461, 601, 611, and 3105.

2. Amend section 204.10(d)(1), and redesignate sections 204.10(d)(1), (d)(2), (d)(3), (d)(4), and (d)(5) as sections 204.2(v), (y), (z), (aa), and (bb), respectively, and add section 204.2(cc) to read as follows:

§ 204.2 Definitions

* * * * *

(v) Clearing balance means the average balance held in an account at a Federal Reserve Bank by an institution over a reserve maintenance period to satisfy its contractual clearing balance with a Reserve Bank.

* * * * *

(y) Eligible institution means—

- (i) Any depository institution as described in § 204.1(c) of this part;
- (ii) Any trust company;

(iii) Any corporation organized under section 25A of the Federal Reserve Act (12 U.S.C. 611 *et seq.*) or having an agreement with the Board under section 25 of the Federal Reserve Act (12 U.S.C. 601 *et seq.*); and

(iv) Any branch or agency of a foreign bank (as defined in section 1(b) of the International Banking Act of 1978, 12 U.S.C. 3101(b)).

(z) Excess balance means the average balance held in an account at a Federal Reserve Bank by or on behalf of an institution over a reserve maintenance period that exceeds the sum of the required reserve balance and any clearing balance.

(aa) Excess balance account means an account at a Reserve Bank pursuant to § 204.10(d) of this part that is established by one or more eligible institutions through an agent and in which only excess balances of the participating eligible institutions may at any time be maintained. An excess balance account is not a “pass-through account” for purposes of this part.

(bb) Required reserve balance means the average balance held in an account at a Federal Reserve Bank by or on behalf of an institution over a reserve maintenance period to satisfy the reserve requirements of this part.

(cc) Targeted federal funds rate means the federal funds rate established from time to time by the Federal Open Market Committee.

3. Republish sections 204.10(a) and 204.10(b), revise section 204.10(c), and add section 204.10(d) to read as follows:

§ 204.10 Payment of interest on balances.

(a) *Payment of interest.* The Federal Reserve Banks shall pay interest on balances maintained at Federal Reserve Banks by or on behalf of an eligible institution as provided in this section and under such other terms and conditions as the Board may prescribe.

(b) *Rate.* Except as provided in paragraph (c) of this section, Federal Reserve Banks shall pay interest at the following rates—

(1) For required reserve balances, at ¼ percent;

(2) For excess balances, at ¼ percent; or

(3) For required reserve balances or excess balances, at any other rate or rates as determined by the Board from time to time.

(c) *Pass-through balances.* A pass-through correspondent that is an eligible institution may pass back to its respondent interest paid on balances held on behalf of that respondent. In the case of balances held by a pass-through correspondent that is not an eligible institution, a Reserve Bank shall pay interest only on the required reserve balances held on behalf of one or more respondents, and the correspondent shall pass back to its respondents interest paid on balances in the correspondent’s account. Any passing back of interest by a correspondent to a respondent under this subsection is not a payment of interest on a demand deposit for purposes of Part 217 of this chapter (Regulation Q).

(d) *Excess balance accounts.*

(1) A Reserve Bank may establish an excess balance account for eligible institutions under the provisions of this subsection (d). Notwithstanding any other provisions of this part, the excess balances of eligible institutions in an excess balance account represent a liability of the Reserve Bank solely to those participating eligible institutions.

(2) The participating eligible institutions in an excess balance account shall authorize another institution to act as agent of the participating institutions for purposes of general account management, including but not limited to transferring the excess balances of participating

institutions in and out of the excess balance account. An excess balance account must be established at the Reserve Bank where the agent maintains its master account, unless otherwise determined by the Board. The agent may not commingle its own funds in the excess balance account.

(3) No required reserve balances or clearing balances may be maintained at any time in an excess balance account, and balances maintained in an excess balance account will not satisfy any institution's reserve balance requirement or contractual clearing balance.

(4) An excess balance account must be used exclusively for the purpose of maintaining the excess balances of participants and may not be used for general payments or other activities.

(5) Interest shall be paid on excess balances of eligible institutions maintained in an excess balance account in accordance with § 204.10(b)(2) or § 204.10(b)(3).

(6) A Reserve Bank may establish additional terms and conditions consistent with this part with respect to the operation of an excess balance account, including, but not limited to, terms of and fees for services, conditions under which an institution may act as agent for an account, restrictions on the agent with respect to account management, penalties for noncompliance with this section or any terms and conditions, and account termination.

By order of the Board of Governors of the Federal Reserve System, May 19, 2009.

Robert deV. Frierson (signed)
Robert deV. Frierson,
Deputy Secretary of the Board.