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Federal Reserve Announcement of Interest on Depository Institutions

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Board of Governors of the Federal Reserve System

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Press Release



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For release at 8:15 a.m. EDT

The Federal Reserve Board on Monday announced that it will begin to pay interest on depository institutions' required and excess reserve balances. The payment of interest on excess reserve balances will give the Federal Reserve greater scope to use its lending programs to address conditions in credit markets while also maintaining the federal funds rate close to the target established by the Federal Open Market Committee.

Consistent with this increased scope, the Federal Reserve also announced today additional actions to strengthen its support of term lending markets. Specifically, the Federal Reserve is substantially increasing the size of the Term Auction Facility (TAF) auctions, beginning with today's auction of 84-day funds. These auctions allow depository institutions to borrow from the Federal Reserve for a fixed term against the same collateral that is accepted at the discount window; the rate is established in the auction, subject to a minimum set by the Federal Reserve.

In addition, the Federal Reserve and the Treasury Department are consulting with market participants on ways to provide additional support for term unsecured funding markets.

Together these actions should encourage term lending across a range of financial markets in a manner that eases pressures and promotes the ability of firms and households to obtain credit. The Federal Reserve stands ready to take additional measures as necessary to foster liquid money market conditions.

Interest on Reserves

The Financial Services Regulatory Relief Act of 2006 originally authorized the Federal Reserve to begin paying interest on balances held by or on behalf of depository institutions beginning October 1, 2011. The recently enacted Emergency Economic Stabilization Act of 2008 accelerated the effective date to October 1, 2008.

Employing the accelerated authority, the Board has approved a rule to amend its Regulation D (Reserve Requirements of Depository Institutions) to direct the Federal Reserve Banks to pay interest on required reserve balances (that is, balances held to satisfy depository institutions' reserve requirements) and on excess balances (balances held in excess of required reserve balances and clearing balances).

The interest rate paid on required reserve balances will be the average targeted federal funds rate established by the Federal Open Market Committee over each reserve maintenance period less 10 basis points. Paying interest on required reserve balances should essentially eliminate the opportunity cost of holding required reserves, promoting efficiency in the banking sector.

The rate paid on excess balances will be set initially as the lowest targeted federal funds rate for each reserve maintenance period less 75 basis points. Paying interest on excess balances should help to establish a lower bound on the federal funds rate. The formula for the interest rate on excess balances may be adjusted subsequently in light of experience and evolving market conditions. The payment of interest on excess reserves will permit the Federal Reserve to expand its balance sheet as necessary to provide the liquidity necessary 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.

The Board also approved other related revisions to Regulation D to prescribe the treatment of balances maintained by pass-through correspondents under the new rule and to eliminate transitional adjustments for reserve requirements in the event of a merger or consolidation. In addition, the Board approved associated minor changes to the method for calculating earnings credits under its clearing balance policy and the method for recovering float costs.

The revisions to Regulation D and the other changes will take effect on Thursday, October 9, 2008. The Board recognizes that depository institutions may choose to adjust their typical liquidity management practices in light of the payment of interest on required reserve balances and excess balances; the primary credit program and other Federal Reserve liquidity facilities are available to help institutions meet temporary funding requirements.

The Board's notice of its actions regarding the amendments to Regulation D and associated changes is attached. While the action is effective immediately, the Board will accept public comments until November 21, 2008, and the proposal will be published in the *Federal Register* shortly. The Board will adjust the rule as appropriate in light of comments.

Substantial Further Increases in Term Auction Facility Auctions

The sizes of both 28-day and 84-day Term Auction Facility (TAF) auctions will be boosted to \$150 billion each, effective with the 84-day auction to be conducted Monday. These increases will eventually bring the amounts outstanding under the regular TAF program to \$600 billion. In addition, the sizes of the two forward TAF auctions to be conducted in November to extend credit over year end have been increased to \$150 billion each, so that \$900 billion of TAF credit will potentially be outstanding over year end.

Exemption to Allow Limited Bank Purchases of Assets from Money Market Mutual Funds

The Board on Monday published a letter granting a request by a depository institution for an exemption from the limits on transactions with affiliates under section 23A of the Federal Reserve Act and the Board's Regulation W to allow the

institution to purchase assets from affiliated money market mutual funds under certain circumstances. The Board is open to considering similar requests from depository institutions under similar circumstances.

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