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1-1-1900

### Staff Proposal to Implement Interest on Reserves

Federal Reserve System: Board of Governors

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## Staff Proposal to Implement Interest on Reserves

- 1) Implement for reserve maintenance periods that begin on October 9, 2008.
- 2) Pay interest on balances held to meet reserve requirements (“required reserve balances”) at the average target federal funds rate during the reserve maintenance period less 10 basis points.
  - a. Rate paid essentially eliminates the reserve tax
  - b. Rate reflects risk-free nature of deposit at the central bank
- 3) Pay interest on balances held in excess of required reserve balances and clearing balances at the *lowest* target federal funds rate during the reserve maintenance period less 75 basis points.
  - a. Rate is designed to help establish a floor for the funds rate
  - b. Spread below target should foster trading in market.
  - c. Rate will be a tool help implement the appropriate stance of monetary policy while simultaneously providing liquidity to promote financial stability.
- 4) Permit, but do not require, pass-through correspondent banks to pass back to their respondents the interest that is attributable to the respondents’ balances held in correspondent’s account. This approach does not interfere with existing multi-faceted service and account arrangements between correspondents and respondents.
- 5) For ineligible institutions that are pass-through correspondents, define any excess balance in that correspondent’s account as being held on behalf of the correspondent’s respondents and require correspondent to attest to that fact.
  - a. Ineligible institutions include accountholders that are not depository institutions, such as accountholders for whom the Reserve Banks act as fiscal agents, including the Federal Home Loan Banks and the Federal Farm Credit Banks.
  - b. Prohibit any payment of interest on balances held by an ineligible institution that is not a pass-through correspondent.
- 6) Eliminate transitional adjustments to reserve requirements in the event of a consolidation or a merger. The burden that this provision was designed to minimize is effectively removed by the payment of interest on required reserve balances.
- 7) Make three other small technical small changes to the calculation of earnings credits and methodology for recovering float costs that eliminate adjustments related to reserve requirements.
- 8) Staff plans to continue its studies of possible monetary policy implementation strategies and potential restructuring of the clearing balance policy.
  - a. The framework for reserve computation and maintenance is still too complex.
  - b. Staff will monitor the behavior of clearing balances and assess implications for on measuring costs for and imputing income to Federal Reserve priced services.