

# **FEDERAL RESERVE SYSTEM**

## **12 CFR Part 204**

**Docket No. R-1513; RIN 7100-AE 31**

### **Regulation D: Reserve Requirements for Depository Institutions**

**AGENCY:** Board of Governors of the Federal Reserve System

**ACTION:** Notice of proposed rulemaking; request for public comment.

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**SUMMARY:** The Board is requesting comment on proposed amendments to Regulation D (Reserve Requirements of Depository Institutions) regarding the payment of interest on certain balances maintained at Federal Reserve Banks by or on behalf of eligible institutions. Specifically, the Board proposes to amend Regulation D to permit interest payments on certain balances to be based on a daily rate rather than on a maintenance period average rate. The proposed amendments should help to enhance the role of such rates of interest in moving the federal funds rate into the target range established by the FOMC, particularly on occasions when changes in those rates do not coincide with the beginning of a maintenance period.

**DATE:** Comments must be received by [insert date 30 days from the date of publication in the Federal Register].

**FOR FURTHER INFORMATION CONTACT:** Sophia H. Allison, Special Counsel (202/452-3565), Legal Division, or Thomas R. Keating, Financial Analyst (202/973-7401), or Jeffrey W. Huther, Senior Economist (202/452-3139), Division

of Monetary Affairs; 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. Statutory and Regulatory 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. Regulation D, which implements section 19 of the Act, requires that a depository institution meet reserve requirements by holding cash in its vault, or if vault cash is insufficient, in the form of a balance in an account at a Federal Reserve Bank (“Reserve Bank”).<sup>1</sup> Section 19 also provides that balances maintained by or on behalf of certain institutions in an account at a Reserve Bank may receive earnings to be paid by the Reserve Bank at least once each quarter, at a rate or rates not to exceed the general level of short-term interest rates. Institutions that are eligible to receive earnings on their balances held at Reserve Banks (“eligible institutions”) include the institutions described in section 19(b)(1)(A) of the Act<sup>2</sup> and “any trust company, corporation organized

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<sup>1</sup> 12 CFR 204.5(a)(1).

<sup>2</sup> 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

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).”<sup>3</sup> Section 19 also provides that the Board may prescribe regulations concerning the payment 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.”<sup>4</sup>

Regulation D currently requires Reserve Banks to pay interest on “balances up to the top of the penalty-free band” at a rate of ¼ percent, and on “excess balances” at a rate of ¼ percent.<sup>5</sup> Regulation D defines “top of the penalty-free band” to mean “an amount equal to an institution’s reserve balance

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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).

<sup>3</sup> Federal Reserve Act § 19(b)(12)(C), 12 U.S.C. 461(b)(12)(C), see 12 CFR 204.2(y) (definition of “eligible institution”).

<sup>4</sup> Federal Reserve Act § 19(b)(12), 12 U.S.C. 461(b)(12).

<sup>5</sup> Section 204.10(b)(1)-(2) of Regulation D, 12 CFR 204.10(b)(1)-(2).

requirement plus an amount that is the greater of 10 percent of the institution's reserve balance requirement or \$50,000.”<sup>6</sup> Regulation D defines “excess balances” to mean “the average balance maintained in an account at a Federal Reserve Bank by or on behalf of an institution over a reserve maintenance period (“maintenance period”) that exceeds the top of the penalty-free band.”<sup>7</sup> As such, the balances on which interest is currently payable under Regulation D are balances that are defined as maintenance period average balances.

Currently, interest on balances up to the top of the penalty-free band and on excess balances of eligible institutions at Reserve Banks is, in each case, calculated by multiplying the average applicable interest rate over the maintenance period by the amount that the institution maintains, on average, over the maintenance period. If the rate of interest on excess balances were to change at a time other than at the beginning of a maintenance period, the interest on excess balances would be the average interest rate for excess balances over the maintenance period multiplied by the average excess balances maintained over the maintenance period. For example, if the interest rate on excess balances were to increase in the middle of a maintenance period from 25 basis points ( $\frac{1}{4}$  percent) to 50 basis points ( $\frac{1}{2}$  percent), the interest on excess balances for that maintenance

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<sup>6</sup> Section 204.2(gg) of Regulation D, 12 CFR 204.2(gg).

<sup>7</sup> Section 204.2(z) of Regulation D, 12 CFR 204.2(z).

period would be the average excess balances maintained over the maintenance period multiplied by the average excess balance rate, *i.e.*, 37.5 basis points. As a result, the full effect of the increase in the excess balance rate to 50 basis points may not show through to market rates until some number of days following the announcement of the new rate.

## **II. Summary of Proposal**

*In general.*

The Board proposes to amend Regulation D to permit interest payments on certain balances to be based on a daily rate rather than on a maintenance period average rate. The proposed amendments would define an “IORR<sup>8</sup> rate” and calculate interest on balances maintained up to the top of the penalty-free band as the average IORR rate over a maintenance period multiplied by the average balances maintained up to the top of the penalty-free band over the maintenance period. The proposed amendments would also define an “IOER<sup>9</sup> rate” and, for institutions that maintain balances in excess of the top of the penalty-free band on average over the maintenance period, would calculate interest as daily total balances multiplied by the daily IOER rate, reduced by an adjustment to avoid

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<sup>8</sup> *I.e.*, “interest on required reserves.” “Required reserves” is a term that historically referred to the amount that an institution must maintain on average over a maintenance period to satisfy its reserve balance requirement. Because Regulation D currently provides for a penalty-free band around an institution’s reserve balance requirement, an institution’s balances up to the top of the penalty-free band is the current equivalent of what was previously meant by “required reserves.”

<sup>9</sup> *I.e.*, “interest on excess reserves.”

double payment of interest on balances up to the top of the penalty-free band. The proposed amendments would therefore facilitate the calculation of interest paid at the IOER rate on a daily basis applied to a daily balance, while preserving the calculation of interest paid at the IORR rate as a maintenance period average rate applied to a maintenance period average balance. The proposed amendments should allow the full effect of an increase in the IOER rate to show through to the daily level of short-term market rates when an IOER rate change does not coincide with the beginning of a maintenance period.

The proposed amendments would make other changes to Regulation D to conform certain provisions to current practices as well as to improve organization and make other clarifications. Currently, section 204.10(b)(3) of Regulation D provides for payment of interest on term deposits “at any other rate or rates as determined by the Board from time to time, not to exceed the general level of short term interest rates.” The proposed amendments would reflect current practices for term deposit offerings by providing that interest on term deposits is either the amount equal to the principal amount of the term deposit multiplied by a rate specified in advance, or multiplied by the rate determined by a term deposit auction. The proposed amendments would also make

a conforming change to current section 204.10(d), governing “excess balance accounts,”<sup>10</sup> to provide for interest on such balances to be paid at the IOER rate.

The proposed amendments would make other changes to improve the organization of the section, including placing provisions generally applicable to payments of interest together into one subsection (proposed section 204.10(a)).

The proposed amendments would also add a new provision to proposed section 204.10(a) specifying that the amount of a “balance” maintained in a Reserve Bank account is determined at the close of the Reserve Bank’s business day. This provision would eliminate potential confusion over which balance (e.g., intra-day balance or end-of-day balance) would be used as the basis for the calculation of interest.

Finally, the proposed amendments would delete the provision currently in section 204.10(b) of Regulation D providing that interest rates are “as determined by the Board from time to time.” The Board proposes to announce future changes to the IORR rate or the IOER rate, or to the mechanisms for calculating the interest on term deposits, through amendments to Regulation D. The proposed amendments would add a new subsection 204.10(f) to Regulation D,

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<sup>10</sup> Regulation D defines an “excess balance account” as an account at a Reserve Bank “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.” 12 CFR 204.2(aa).

providing that generally no public comment will be sought on future changes to such rates or mechanisms, and that the effective date of such future changes will generally not be delayed.

Following the detailed description of the proposal below are numerical examples illustrating the key features of the proposed amendments in cases when the IORR and IOER rates change in the middle of the reserve maintenance period.

*Detailed description of proposal.*

*1. Proposed Calculation of Interest*

Currently, the amount of interest payable on balances maintained at a Reserve Bank by or on behalf of an eligible institution is equal to the sum of IORR and IOER. IORR is currently calculated as the arithmetic average of the daily IORR rates in effect over a maintenance period multiplied by the average level of balances up to the top of the penalty-free band maintained over that maintenance period. IOER is currently calculated as the arithmetic average of the daily IOER rate in effect over a maintenance period multiplied by the institution's average level of excess balances maintained over that maintenance period.

As discussed above, the current methodology for calculating IOER implies that an increase in the IOER rate may not immediately show through fully to short-term market rates in cases when an IOER rate change does not coincide

with the beginning of a maintenance period. To address this issue, for institutions that maintain balances on average over the maintenance period in excess of the top of the penalty-free band, the proposed amendments to Regulation D would implement the IOER rate by multiplying the IOER rate in effect each day of the maintenance period by the institution's *total* balances that day, less an adjustment to avoid the double payment of interest on balances maintained up to the top of the penalty-free band. The proposed amendments would make no changes to the calculation of IORR under the current provisions of Regulation D – that is, IORR would continue to be implemented by multiplying the average IORR rate over the maintenance period by the average level of balances up to the top of the penalty-free band maintained over the maintenance period.

The implementation of IOER as set forth in the proposed amendments—that is, calculating IOER based on the daily IOER rate rather than the average of the daily rates—should support the implementation of monetary policy in cases when changes in policy rates are implemented in the middle of a maintenance period. For example, under the proposed amendments, if the Board raised the IOER rate from 25 basis points to 50 basis points in the middle of a maintenance period, eligible institutions would likely base their asset-liability management decisions on the effective IOER rate of 50 basis points for the remainder of that maintenance period.

*2. Addressing a Special Case: A Floor on Interest Payments for Institutions that Maintain Balances on Average over a Maintenance Period In excess of the top of the Penalty-Free Band*

Under the proposed amendments, an institution's daily pattern of balances maintained over the maintenance period in a Reserve Bank account would determine its IOER. There is a special case, however, in which an institution that maintained positive excess balances on average over a maintenance period could end up receiving less in total interest payments than if it had held balances equal to the top of the penalty-free band on average over the maintenance period. This special case would arise only in those maintenance periods in which a rate change does not coincide with the beginning of a maintenance period and the institution maintains relatively high levels of total balances in its Reserve Bank account on days when the IORR rate and the IOER rate are lower.

To address this special case, the proposed amendments specify a minimum interest payment, or floor, applicable to total interest payments for any institution that maintains balances on average over the maintenance period in excess of the top of the penalty-free band. Specifically, the proposed amendments set the floor for institutions maintaining excess balances<sup>11</sup> at an amount that would

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<sup>11</sup> Specifically, institutions that maintain balances that are, on average over the maintenance period, in excess of the top of the penalty-free band.

be equal to the interest payment that the institution would have received if it had maintained balances up to the top of its penalty-free band on average over the maintenance period. Including the interest payment floor in the proposed amendments for these institutions means that any institution that maintained balances in excess of the top of the penalty-free band on average over the maintenance period, but maintained balances each day of the period in a manner that would cause the special case above to apply, would be assured that it would receive interest payments no lower than the interest payments it would have received if it had maintained balances up to the top of the penalty-free band on average over the maintenance period.

At present and for the foreseeable future, the proposed floor is one that likely will have little practical significance for most institutions or for federal funds market activity. Given the very large quantities of excess balances currently in the banking system, the Board believes that there are very few institutions for which this special case would be relevant. Nonetheless, the inclusion of the interest payment floor in the proposed amendments avoids penalizing an institution that maintained positive excess balances on average over a maintenance period, but nevertheless would receive less in interest under the proposed methodology than it would if it had maintained balances up to the top of the penalty-free band.

### *3. Proposed Formulas for the Calculation of Interest and Examples*

The proposed methodology calculates IOER by multiplying the IOER rate in effect each day of the maintenance period by the institution's total balances that day, less an adjustment to avoid the double payment of interest on balances maintained up to the top of the penalty-free band. Under the proposed methodology, the formulas used in determining interest payments distinguish between two basic cases—one in which institutions maintain, on average over the maintenance period, balances in excess of the top of the penalty-free band, and a second in which the institution maintains, on average over the maintenance period, balances that are equal to or lower than the top of the penalty-free band. In the first case, the proposed methodology would result in calculating the interest on balances in an account at a Reserve Bank as follows:

Equation (1)

$$\begin{aligned}
 \text{Interest Payment} = & 14 \times \overbrace{\frac{\text{Avg. IOER rate}}{360} \times \text{BMRBR}}^{\text{IOER}} \\
 & + \max\left[0, \overbrace{\sum_{t=1}^{14} \frac{(\text{IOER rate}_t \times \text{Total Balances}_t)}{360}}^{\text{IOER}} - \left(14 \times \frac{\text{Avg. IOER rate}}{360} \times \text{BMRBR}\right)\right]
 \end{aligned}$$

Where:

*14 = the number of days in a reserve maintenance period*

*360 = the number of days in the year used to annualize interest*

*Avg. IOER rate = arithmetic average of the daily IOER rates in effect over a maintenance period*

*BMRBR = average balances maintained to satisfy a reserve balance requirement (up to the top of the penalty-free band) over a maintenance period*

*Avg. IOER rate = arithmetic average of the daily IOER rates in effect over a maintenance period*

*Total Balances = daily total balance held*

In the second case, the proposed methodology would result in calculating the interest as follows:

Equation (2)

$$\text{Interest Payment} = 14 \times \frac{\overbrace{\text{Avg. IOER rate}}^{\text{IOER}}}{360} \times \text{BMRBR}$$

The following are examples of the application of the key features of the proposed amendments to a case where the IORR and IOER rates change in the middle of a maintenance period. Each of the examples assumes:

- The top of the penalty-free band is \$100,000;
- Balances maintained are the same for each day of the calendar week of the two-week maintenance period. Thus, the average daily balance for each week is equal to the daily amount of balances maintained;
- The IORR and IOER annual rates are set at 0.36 percent in week one and at 0.72 percent in week two; and
- Interest is calculated based on a 360-day year.

As a baseline, Example 1 applies the current methodology for calculating IORR and IOER interest payments for an eligible institution that

maintains an average daily balance of \$150,000 throughout the maintenance period:

### **Example 1: Current Calculation of IORR and IOER**

| Week         | Balance | IORR Rate | IOER Rate |
|--------------|---------|-----------|-----------|
| 1            | 150,000 | 0.0036    | 0.0036    |
| 2            | 150,000 | 0.0072    | 0.0072    |
| IORR Payment |         | 21.00     |           |
| IOER Payment |         | 10.50     |           |

In Example 1, the institution maintains a balance of \$150,000 each day of the maintenance period. IORR is calculated as the average IORR rate (annualized using a 360-day year ) over the maintenance period (0.54 percent) multiplied by average balances up to the top of the penalty free band over the maintenance period (\$100,000) times the number of days in the maintenance period (14), resulting in an IORR payment of \$21.00. IOER is similarly calculated as the average IOER rate (annualized using a 360-day year) over the maintenance period (0.54 percent) multiplied by average excess balances over the maintenance period (\$50,000) times the number of days in the maintenance period (14), resulting in an IOER payment of \$10.50. The institution thus receives \$31.50 in total interest payments for the two week maintenance period.

## **Example 2: Proposed Amendments: Week 1 Balances = Week 2 Balances**

| <b>Week 1</b>       | <b>Balance</b> | <b>IORR Rate</b> | <b>IOER Rate</b> |
|---------------------|----------------|------------------|------------------|
| <b>1</b>            | <b>150,000</b> | <b>0.0036</b>    | <b>0.0036</b>    |
| <b>2</b>            | <b>150,000</b> | <b>0.0072</b>    | <b>0.0072</b>    |
| <b>IORR Payment</b> |                | <b>21.00</b>     |                  |
| <b>IOER Payment</b> |                | <b>10.50</b>     |                  |

In Example 2, the institution again maintains a balance of \$150,000 each day of the maintenance period, but interest payments are calculated according to equation (1) under the proposed amendments. The calculation of IORR is the same as in Example 1: the average IORR rate over the maintenance period (0.54 percent) multiplied by average balances up to the top of the penalty free band over the maintenance period (\$100,000) times the number of days in the maintenance period (14), resulting in an IORR payment of \$21.00. However, the calculation of IOER is based on the application of proposed section 204.10(b)(1)(B)(i)-(ii), where the amount of IOER is equal to the IOER rate in effect each day multiplied by the total balances maintained on that day for each day of the maintenance period, reduced by the amount specified in subparagraph (b)(1)(B)(ii) of this section. The amount of the reduction prescribed by proposed 204.10(b)(1)(B)(ii) is equal to the average IOER rate over the maintenance period multiplied by the average balance up to the top of the penalty-free band maintained over the maintenance period. The proposed amendments described in Example 2 yield a total IOER payment of

\$10.50. Thus, the total interest payments in this case are exactly the same as in Example 1. For any institution that maintains excess balances, this is a general result: if balances are constant across all days of the maintenance period, the proposed methodology generates exactly the same interest payments as the calculation under current provisions of Regulation D.

**Example 3: Proposed Amendments: Week 2 Balances Exceed Week 1 Balances**

| Week 1       | Balance | IORR Rate | IOER Rate |
|--------------|---------|-----------|-----------|
| 1            | 100,000 | 0.0036    | 0.0036    |
| 2            | 200,000 | 0.0072    | 0.0072    |
| IORR Payment |         | 21.00     |           |
| IOER Payment |         | 14.00     |           |

In Example 3, the eligible institution’s maintenance of excess balances during the course of the maintenance period is tilted toward Week 2, when the higher IOER rate is in effect. The calculation for IORR under the proposed amendments is unchanged from Example 1 (current methodology), resulting in an IORR payment of \$21.00. The calculation for IOER under the proposed amendments, however, results in an IOER payment of \$14.00 calculated as follows:

$$\begin{aligned}
 \text{IOER} = & (\$100,000 * 0.0036) * 7/360 + (\$200,000 * 0.0072) * 7/360 - (100,000 * \\
 & 0.0054) * 14/360 \\
 & [ (\text{Daily Balance Week 1} * \text{IOER Week 1}) + \\
 & (\text{Daily Balance Week 2} * \text{IOER Week 2}) - \\
 & ( \text{Avg. Required Reserve Balance} * \text{Average IOER rate} ) ]
 \end{aligned}$$

IOER is higher under the proposed amendments as shown in Example 3 (\$14.00) than under the current provisions of Regulation D as shown in Example 1 (\$10.50). This illustrates a key feature of the proposed amendments: when an IOER rate change occurs in the middle of a maintenance period, eligible institutions immediately begin receiving interest on balances in excess of the penalty-free band at the new IOER rate. In Example 3, the eligible institution begins earning the higher IOER rate of 0.72 percent as soon as the higher IOER rate becomes effective in the middle of the maintenance period. In contrast, as shown in Example 1, the effective IOER rate on balances in excess of the penalty-free band under the current provisions of Regulation D is 0.54 percent—the average of the IOER rates in weeks 1 and 2. In Example 1, the full effect of the increase in IOER to 72 basis points would not be reflected in interest payments until the beginning of a new maintenance period.

**Example 4: Role of the Floor on Interest Payments in Proposed Methodology**

| Week 1                             | Balance | IOER Rate | IOER Rate |
|------------------------------------|---------|-----------|-----------|
| 1                                  | 130,000 | 0.0036    | 0.0036    |
| 2                                  | 80,000  | 0.0072    | 0.0072    |
| IOER Payment                       |         | 21.00     |           |
| IOER Payment                       |         | 0.00      |           |
| Memo: IOER Payment (without Floor) |         | -0.69     |           |

In Examples 2 and 3, the provision in the proposed amendments for a floor on interest payments did not come into play. In Example 4, the institution’s average

total balances over the period are \$105,000 (implying only \$5,000 in excess), and the institution ends up holding higher balances during the first week of the maintenance period when the IOER rate is lower. As shown in the Example 4 table above, the institution maintains \$130,000 in the first week of the maintenance period and \$80,000 in the second week of the maintenance period. Calculating IOER under the proposed amendments would result in a “pre-floor” interest payment on excess balances of  $-\$0.69$ . The negative “interest payment” results from the end of period adjustment factor in proposed section 204.10(b)(1)(B)(ii). That adjustment factor is equal to the average IOER rate over the maintenance period multiplied by the average balance up to the top of the penalty-free band maintained over the maintenance period. Since the institution held the majority of its balances that would receive the daily IOER rate when the daily IOER rate was below the average IOER rate, the adjustment factor in proposed section 204.10(b)(1)(B)(ii) was greater than the interest attributable to balances over the top of the penalty-free band in proposed section 204.10(b)(1)(B)(i). With the inclusion in the proposed amendments of the interest payment floor, however, the interest payment on excess balances is revised upwards to 0 and the eligible institution’s total interest payment is \$21.00—the same as the interest payments the institution would have earned had it held balances on average exactly equal to the top of the penalty-free band (\$100,000) over the maintenance period.

### **Example 5: Balances Equal to or Lower than Top of Penalty-Free Band**

| <b>Week 1</b>       | <b>Balance</b> | <b>IOER Rate</b> | <b>IOER Rate</b> |
|---------------------|----------------|------------------|------------------|
| <b>1</b>            | <b>90,000</b>  | <b>0.0036</b>    | <b>0.0036</b>    |
| <b>2</b>            | <b>106,000</b> | <b>0.0072</b>    | <b>0.0072</b>    |
| <b>IOER Payment</b> |                | <b>20.58</b>     |                  |
| <b>IOER Payment</b> |                | <b>0.00</b>      |                  |

The first four examples involve eligible institutions that maintained balances, on average over the maintenance period, in excess of the top of their penalty-free bands. Example 5 involves an eligible institution that maintained balances on average over the maintenance period equal to \$98,000, slightly lower than the top of the penalty-free band. Under the proposed amendments, the interest calculation method for institutions that hold average balances over the maintenance period equal to or lower than the top of the penalty-free band would not change from the current practice. For these institutions, interest would be calculated by taking the average IOER rate over the maintenance period (0.54 percent) multiplied by average balances up to the top of the penalty free band over the maintenance period (\$98,000) times the number of days in the maintenance period (14), resulting in an IOER payment of \$20.58. The institution does not hold balances above the top of the penalty-free band and thus would not receive an IOER payment nor would it benefit from holding larger balances on days when the higher IOER rate was in effect.

### **III. Section by Section Analysis**

#### *Section 204.10(a) General.*

The Board proposes to amend section 204.10(a) to incorporate certain provisions of current section 204.10(b) and to add a new provision describing the amount of a “balance” in an account at a Reserve Bank for purposes of the section.

Proposed 204.10(a)(1) incorporates part of current section 204.10(b)(3) into current section 204.10(a) and provides that, except as provided in 204.10(c), interest on balances maintained at Reserve Banks by or on behalf of an eligible institution is established by the Board in accordance with this section, at a rate or rates not to exceed the general level of short-term interest rates.

Proposed section 204.10(a)(2) adds a new provision to Regulation D specifying that the amount of a “balance” in an account at a Reserve Bank for purposes of section 204.10 is determined at the close of the Reserve Bank’s business day.

Proposed section 204.10(a)(3) moves the definition of “short-term interest rates” from current section 204.10(b)(3) into proposed section 204.10(a)(3).

Proposed section 204.10(a)(4) moves the provision in current 204.10(a) regarding other terms and conditions for interest payments as the Board may prescribe into proposed section 204.10(a)(4).

*Section 204.10(b) Payment of interest.*

Proposed section 204.10(b) relates to payments of interest on balances at Reserve Banks: excess balances, balances up to the top of the penalty-free band, and term deposits.

Proposed section 204.10(b)(1) and section 204.10(b)(2) set forth the amount of interest to be paid on balances of institutions that, on average over the maintenance period, maintain balances in excess of the top of the penalty-free band. These two subsections provide for interest at the IOER rate, interest at the IOER rate, the adjustment to interest at the IOER rate, and the minimum interest amount.

Proposed section 204.10(b)(3) provides that interest for institutions that, on average over the maintenance period, maintain balances that are equal to or lower than the top of the penalty-free band is the average IOER rate over the maintenance period multiplied by the average balances maintained over the maintenance period.

Proposed section 204.10(b)(4) provides for interest on term deposits. New subsection 204.10(b)(4)(A) provides for interest on term deposits “at a rate specified in advance by the Board, in light of existing short-term market rates, to maintain the federal funds rate at a level consistent with monetary policy

objectives.” Subsection 204.10(b)(4)(B) provides for interest on term deposits “at a rate determined by the auction through which such term deposits are offered.”

Proposed section 204.10(b)(5) specifies the IORR rate used in proposed section 204.10(b)(1) and section 204.10(b)(3), and the IOER rate used in proposed section 204.10(b)(1)(B)(i)-(ii).

*Section 204.10(c) Pass-through balances.*

Proposed section 204.10(c) sets forth the language of current section 204.10(c), with one change. In the second sentence of proposed section 204.10(c), the word “shall” is changed to “may” to conform the paragraph with the provisions of section 204.10(b).

*Section 204.10(d) Excess balance accounts.*

Proposed section 204.10(d)(5) revises current section 204.10(d)(5) by specifying that interest on excess balance accounts is the amount equal to the IOER rate in effect each day multiplied by the total balances maintained on that day for each day of the maintenance period.

*Section 204.10(f) Procedure for determination of rates.*

Proposed section 204.10(f) sets forth a provision not previously appearing in Regulation D governing the procedure for determination of rates. Specifically, proposed section 204.19(f) provides that the Board anticipates that it generally will not seek advance notice, public comment, or delayed effective dates with respect to

changes in the rates of interest set forth in section 204.10. Proposed section 204.10(f) also specifies the reasons that the Board generally expects to apply in such cases.

#### **IV. Form of Comment Letters**

Comment letters should refer to Docket No. R-1513 and, when possible, should use a standard typeface with a font size of 10 or 12; this will enable the Board to convert text submitted in paper form to machine-readable form through electronic scanning, and will facilitate automated retrieval of comments for review. Comments may be mailed electronically to [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov).

#### **V. Solicitation of Comments Regarding Use of “Plain Language”**

Section 722 of the Gramm-Leach-Bliley Act of 1999 requires the Board to use “plain language” in all proposed and final rules published after January 1, 2000. The Board invites comments on whether the proposed rule is clearly stated and effectively organized, and how the Board might make the proposed text easier to understand.

#### **VI. Initial Regulatory Flexibility Analysis**

In accordance with Section 3(a) of the Regulatory Flexibility Act (RFA) (5 U.S.C. 601, et seq.), the Board has reviewed the proposed amendments to Regulation D. A final regulatory flexibility analysis will be conducted after consideration of comments received during the public comment period.

1. *Statement of the objectives of the proposal.* The Board is proposing to amend Regulation D in order to facilitate the conduct of monetary policy. Section 19 of the Act was enacted to impose reserve requirements on certain deposits and other liabilities of depository institutions for monetary policy purposes. The Board proposes to amend Regulation D to facilitate the transmission of monetary policy through the rates of interest paid on balances of eligible institutions at Reserve Banks. Specifically, the Board proposes to amend Regulation D to permit interest payments on certain balances to be based on a daily rate rather than on a maintenance period average rate. The proposed amendments should help to enhance the role of such rates of interest in moving the federal funds rate into the target range established by the FOMC.

2. *Small entities affected by the proposal.* The proposal would affect all eligible institutions that maintain balances to satisfy reserve balance requirements or excess balances at a Reserve Bank. The Board estimates that there are currently approximately 8,725 eligible institutions that maintain such balances. The Board estimates that approximately 6,950 of these institutions could be considered small entities with assets of \$550 million or less.

3. *Other federal rules.* The Board believes that no federal rules duplicate, overlap, or conflict with the proposed amendments.

4. *Significant alternatives to the proposed amendments.* The proposed amendments do not impose any burden on depository institutions of any size. The proposed amendments relate to payment of earnings on balances of eligible institutions and do not provide for any new or additional reporting or other obligations.

## **VI. Paperwork Reduction Act**

In accordance with the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3506; 5 CFR part 1320 Appendix A.1), the Board reviewed the proposed rule under the authority delegated to the Board by the Office of Management and Budget (OMB). The proposed rule contains no requirements subject to the PRA.

### **List of Subjects in 12 CFR Parts 204**

Banks, Banking, Reporting and recordkeeping requirements.

### **Authority and Issuance**

For the reasons set forth in the preamble, the Board proposes to amend 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. Section 204.10 is amended to read as follows:

**§ 204.10—Payment of Interest on Balances.**

(a) *General.*

- (1) Except as provided in paragraph (c) of this section, interest on balances maintained at Federal Reserve Banks by or on behalf of an eligible institution shall be established by the Board in accordance with this section, at a rate or rates not to exceed the general level of short-term interest rates.
- (2) For purposes of this section, the amount of a “balance” in an account maintained by or on behalf of an eligible institution at a Federal Reserve Bank is determined at the close of the Federal Reserve Bank’s business day.
- (3) For purposes of this section, “short-term interest rates” are rates on obligations with maturities of no more than one year, such as the primary credit rate and rates on term federal funds, term repurchase agreements, commercial paper, term Eurodollar deposits, and other similar instruments.
- (4) The payment of interest on balances under this section shall be subject to such other terms and conditions as the Board may prescribe.

(b) *Payment of interest.* Interest on balances maintained at Federal Reserve Banks by or on behalf of an eligible institution is established as set forth below. The rates for IORR and IOER are set forth in subparagraph (b)(5).

(1) For institutions that maintain balances that are, on average over the maintenance period, in excess of the top of the penalty-free band, interest is:

(A) the amount equal to the average IORR rate over the maintenance period multiplied by the average balance up to the top of the penalty-free band maintained over the maintenance period; plus

(B) (i) the amount equal to the IOER rate in effect each day multiplied by the total balances maintained on that day for each day of the maintenance period; minus

(ii) the amount equal to the average IOER rate over the maintenance period multiplied by the average balance up to the top of the penalty-free band maintained over the maintenance period.

(2) The interest amount under paragraph (b)(1) shall not be less than an amount equal to the amount specified in subparagraph (b)(1)(A).

- (3) For institutions that maintain balances that are, on average over the maintenance period, equal to or lower than the top of the penalty-free band, interest is the amount equal to the average IORR rate over the maintenance period multiplied by the average balance maintained over the maintenance period.
- (4) For term deposits, interest is:
- (A) the amount equal to the principal amount of the term deposit multiplied by a rate specified in advance by the Board, in light of existing short-term market rates, to maintain the federal funds rate at a level consistent with monetary policy objectives;
  - or
  - (B) the amount equal to the principal amount of the term deposit multiplied by a rate determined by the auction through which such term deposits are offered.
- (5) The rates for IORR and IOER are:

|             | <b>Rate</b> | <b>Effective</b> |
|-------------|-------------|------------------|
| <b>IORR</b> | ¼ percent   | --               |
| <b>IOER</b> | ¼ percent   | --               |

(c) *Pass-through balances.* A pass-through correspondent that is an eligible institution may pass back to its respondent interest paid on balances maintained to satisfy a reserve balance requirement of that respondent. In the case of balances maintained by a pass-through correspondent that is not an eligible institution, a Reserve Bank may pay interest only on the balances maintained to satisfy a reserve balance requirement of one or more respondents up to the top of the penalty-free band, and the correspondent shall pass back to its respondents interest paid on balances in the correspondent's account.

(d) *Excess balance accounts.*

\* \* \*

(5) Interest on balances of eligible institutions maintained in an excess balance account is the amount equal to the IOER rate in effect each day multiplied by the total balances maintained on that day for each day of the maintenance period.

\* \* \*

(e) \* \* \*

(f) *Procedure for determination of rates.* The Board anticipates that notice and public participation with respect to changes in the rate or rates of interest to be paid under this section will generally be impracticable, unnecessary, contrary to the public interest, or otherwise not required in the public interest, and that there will

generally be reason and good cause in the public interest why the effective date should not be deferred for 30 days. The reason or reasons in such cases are generally expected to include that such notice, public participation, or deferment of effective date would prevent the action from becoming effective as promptly as necessary in the public interest, would permit speculators or others to reap unfair profits or to interfere with the Board's actions taken with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country, would provoke other consequences contrary to the public interest, would not aid the persons affected, or would otherwise serve no useful purpose.

\* \* \* \* \*

**By order of the Board of Governors of the Federal Reserve System, April 13, 2015.**

Michael Lewandowski (signed)  
Michael Lewandowski,  
Associate Secretary of the Board.