

FEDERAL RESERVE BANK OF NEW YORK

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KENNETH LAMAR
SENIOR VICE PRESIDENT

October 6, 2008

To: Chief Financial Officer Federal Reserve Account Position Manager

Re: Implementation of Interest on Reserves and Changes to Earnings Credits

The Emergency Economic Stabilization Act of 2008 accelerated, to October 1, 2008, the effective date for the Federal Reserve's authority to pay interest on account balances that depository institutions hold at the Federal Reserve Banks. The provisions to pay interest on such balances are contained in the Financial Services Regulatory Relief Act of 2006, with an original implementation date of October 1, 2011.

The Federal Reserve Board announced today that the Reserve Banks will pay interest on balances held to satisfy reserve requirements ("required reserve balances") and on balances held in excess of required reserve balances and clearing balances ("excess balances"), commencing with the maintenance period beginning Thursday, October 9, 2008. The rate on required reserve balances will be set initially at 10 basis points below the average target federal funds rate during the maintenance period. The rate on excess balances will be set initially at 75 basis points below the lowest target federal funds rate during the maintenance period. The formula for the interest rate on excess balances may be adjusted subsequently in light of experience and evolving market conditions.

The Board's action should help promote efficiency and stability in the banking sector. Paying interest on required reserve balances should essentially eliminate the opportunity cost of holding required reserves. Paying interest on excess balances should help to establish a lower bound on the federal funds rate. The payment of interest on excess balances will permit the Federal Reserve to provide the necessary liquidity to support financial stability, while implementing the monetary policy that is appropriate in light of the Federal Reserve's objectives of maximum employment and price stability.

Two other actions are also effective on October 9, 2008. The Board has eliminated transitional adjustments to reserve requirements following a merger or consolidation. Paying interest on required reserve balances is a more effective method to address the resulting increase in the surviving institution's reserve requirement than complex adjustment provisions. Adjustments associated with mergers completed prior to October 9, 2008, will be left in place,

but no new adjustments will be issued on or after that date. The Board also changed the calculation of earnings credits. Earnings credits will now be calculated based on 100 percent of an institution's eligible clearing balances. Previously, earnings credits were based on a fraction of the clearing balance maintained because of certain adjustments related to reserve requirements. These adjustments are no longer necessary with interest on required reserve balances.

More information about these actions is available. The Board's press release and notice can be found on the Board's website, www.federalreserve.gov. Frequently asked questions and illustrative examples for depository institutions of how interest on required reserve balances and excess balances will be calculated are available at www.reportingandreserves.org. Comments on the Board's rule are due November 21, 2008, following the procedures described in the Board's notice in the *Federal Register*.

Additional details regarding changes to the monthly Statement of Service Charges as well as updated www.federalreserve.gov including the *Reserve Maintenance Manual*, Service Charge Information manual, and clearing balance calculator will be published shortly. To receive timely alerts regarding these announcements, subscribe to Email Alert Notifications at www.frbservices.org/communications/e_alerts.html. Include "Accounting" in your subscriptions to receive alerts related to implementation of this policy.

If you have any additional questions, please contact Eartha Collins, Reports Specialist at (212) 720-5993 or Brian Osterhus, Staff Director at (212) 720-8023. This Bank's reserve administration contacts are also available at www.reportingandreserves.org/contact.

Sincerely,

-- Signed by Kenneth P. Lamar --

Kenneth P. Lamar
Senior Vice President
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