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M E M O R A N D U M

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To Our Clients and Friends

Re: Federal Reserve Proposal to Establish Excess Balance Accounts

The Federal Reserve Board is proposing to amend Regulation D (Reserve Requirements of Depository Institutions) to authorize depository institutions to establish limited purpose accounts, called “excess balance accounts” (“EBAs”), at Federal Reserve Banks. The proposal permits depository institutions to maintain excess funds in EBAs at Federal Reserve Banks under the management of a correspondent bank without having to open separate accounts at the Reserve Bank. The purpose is to enable depository institutions to earn interest on their excess reserve balances without disrupting existing correspondent relationships depository institutions may have with other institutions. Comments are due by March 2, 2009.

INTEREST ON RESERVES

The Federal Reserve pays interest on balances depository institutions maintain in their accounts at Reserve Banks at a rate equal to the Federal Funds target rate, which is currently 0.25 percent. However, the market (effective) rate for Federal Funds is 0.19 percent, which is below the target rate. Accordingly, in order to earn a higher return, depository institutions have an incentive to place excess funds in Federal Reserve accounts rather than sell them in the Federal Funds market.

However, many depository institutions do not have accounts at the Federal Reserve. Rather, they maintain account relationships with other depository institutions (correspondent banks). In order to provide depository institutions that do not have accounts with the Federal Reserve with the opportunity to benefit from higher interest rates paid by the Federal Reserve on excess reserve balances without disrupting correspondent relationships that currently exist, the Federal Reserve proposes to permit depository institutions to establish EBAs at Reserve Banks that would be managed by the institution’s correspondent bank as agent for the institution. This arrangement enables

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the correspondent bank to maintain the current relationship it has with the depository institution while facilitating the ability of the institution to obtain a higher return than otherwise possible if it had sold its excess balances in the Federal Funds market. It also enables the correspondent bank to keep the institution's balances off its financial statements, thereby avoiding any possible negative impact the balances would have on the correspondent's leverage ratio.

A copy of the Federal Reserve's proposed rule can be found on our website at http://www.schwartzandballen.com/whats_new.html.

If you have any questions, please call Gilbert Schwartz, Robert Ballen, Tom Fox or Heidi Wicker at (202) 776-0700.