

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

**Circular No. 79-123
July 31, 1979**

AMENDMENT TO REGULATION H

**Recordkeeping and Confirmation of Certain Securities
Transactions Effected by State Member Banks**

**TO ALL MEMBER BANKS IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:**

The Board of Governors of the Federal Reserve System has amended Regulation H, "Membership of State Banking Institutions in the Federal Reserve System," effective January 1, 1980, to require that State member banks that effect certain securities transactions for customers provide confirmation of and maintain records with respect to such transactions. A proposed regulation was originally published for public comment on January 31, 1978, and a revised proposal was published on November 1, 1978.

Printed on the following pages is a copy of the press release and the descriptive preamble. Enclosed is a copy of the amendment to Regulation H. Member banks and others that maintain Regulations Binders should file the amendment in their binders.

Any questions concerning Regulation H should be directed to William C. Reddick, Jr. of our Bank Supervision and Regulations Department, Ext. 6274.

Additional copies of the amendment to Regulation H will be furnished upon request to the Secretary's Office, Ext. 6267.

Sincerely yours,

Robert H. Boykin

First Vice President

Enclosure

Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank: 1-800-492-4403 (intrastate) and 1-800-527-4970 (interstate). For calls placed locally, please use 651 plus the extension referred to above.

For immediate release

July 19, 1979

The Federal bank regulators have adopted, effective January 1, 1980, new rules establishing uniform standards for bank recordkeeping, confirmation and other procedures in making securities transactions for trust departments and other bank customers.

The agencies requested public comment on one of the new rules, affecting confirmation requirements applicable to transactions in U.S. government, Federal agency and municipal securities.

The agencies' regulatory action was taken subsequent to a study by the Securities and Exchange Commission on bank securities activities and respond to certain recommendations in the SEC report. The final rules were adopted following consideration of comment received on proposals the agencies published in January 1978 and revised proposals published in November. The final rules were substantially unchanged from the November proposals.

The revised regulations of the agencies include the following uniform provisions:

Recordkeeping:

Banks are required to maintain for three years the following records concerning securities transactions:

1. Itemized daily records of purchases and sales.
2. Account records for customers.
3. A separate record of each order to purchase or sell securities. .

TITLE 12--BANKS AND BANKING

CHAPTER II--FEDERAL RESERVE SYSTEM

SUBCHAPTER A--BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Regulation H]

[DOCKET NO. R-0142]

Part 208 - Membership of State Banking Institutions
in the Federal Reserve System

Recordkeeping and Confirmation Requirements for Certain
Securities Transactions Effected by State Member Banks

AGENCY: Board of Governors of the Federal Reserve System

ACTION: Final Rule

SUMMARY: The Board of Governors of the Federal Reserve System has adopted amendments to its Regulation H (12 CFR 208) to require that State member banks that effect certain securities transactions for customers provide confirmation of and maintain records with respect to such transactions. Similar regulations are being adopted by the Comptroller of the Currency and the Federal Deposit Insurance Corporation. A proposed regulation was originally published for public comment on January 31, 1978 (43 FR 5006); a substantial number of substantive comments were received and comment was requested on a revised proposal on November 1, 1978 (43 FR 50914). Although it is intended that these amendments become effective January 1, 1980, additional comment is invited by September 24, 1979 on the confirmation requirements as they apply to transactions in U.S. government, federal agency and municipal securities (paragraph (k)(3)) and on the bank officers and employees reporting requirements as they apply to transactions in U. S. government or federal agency obligations (paragraph (k)(5)(iv)). The Board will consider such comments and the adoption of any appropriate amendments to the regulation as soon thereafter as possible.

EFFECTIVE DATE: January 1, 1980.

FOR FURTHER INFORMATION CONTACT: Robert A. Wallgren, Chief, Trust Activities Program, (202) 452-2717, or Walter R. McEwen, Attorney, (202) 452-2521, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, Washington, D. C. 20551.

SUPPLEMENTARY INFORMATION:

The final rule is substantially similar to the revised proposal released on November 1, 1978. The following is a summary of the significant revisions which were made.

Commentators suggested that the definition of "investment discretion" be modified to track the language of section 3(a)(35) of the Securities Exchange Act of 1934 ("1934 Act") which defines the same term. After reconsideration, the Board has concluded that, insofar as it is pertinent, the term should be defined in Regulation H as it is defined in the 1934 Act. Accordingly, the language of subparagraph (k)(1)(iii) now tracks the language of sections 3(a)(35)(A) and (B) of the 1934 Act. If the Securities and Exchange Commission determines pursuant to regulation, as authorized by paragraph (C) of section 3(a)(35), that other exercises of influence with respect to accounts constitute "investment discretion," the Board will consider whether the definition of "investment discretion" adopted herein should be revised also. The Board notes, however, that the change in the language of the definition of "investment discretion" is not intended to alter its view that a bank would be deemed to exercise investment discretion in investment advisory account relationships where the customer, as a matter of practice, generally follows investment recommendations made by the bank.

With respect to the definition of "security", numerous amendments were suggested. In particular, it was recommended that the definition be revised to exclude short-term obligations of up to twelve-month maturities and interests in money market mutual funds. The Board has determined that the definition of "security" should not be changed from the definition stated in the revised proposal, except to exclude U. S. savings bonds from the definition. The Board recognizes that banks generally define short-term obligations as those having a maturity of twelve months or less. However, the Board believes that it would be inappropriate to alter the definition of "security" contained in the Securities Exchange Act of 1934 which provides an exclusion for certain obligations of up to nine months maturity. Since commentators failed to demonstrate that the potential cost to banks would outweigh the benefits to the investing public, the Board has determined to retain the nine months maturity exclusion. For the same reason, the Board has decided not to exclude money market mutual funds from the definition of "security" but, as indicated below, has modified the recordkeeping requirements to lessen the potential cost impact. Furthermore, the Board noted that transactions in money market fund shares derive primarily from accounts over which the banks exercise investment discretion and therefore are not required to be confirmed on an individual basis except upon customer request (paragraphs (k)(4)(ii) and (k)(4)(iii)).

With respect to the recordkeeping requirements (paragraph (k)(2)), the Board has responded to comments expressing the concern that the cost of compliance would be excessive due to the requirement of (k)(2)(ii) that an account record be maintained for each customer. The Board anticipates that this provision will impact customer accommodation transactions rather than trust activities since trust departments presently keep the records required by (k)(2)(ii). Accordingly, a provision has been added stating that paragraph (k)(2) does not require a bank to maintain the records required by

The rules provide that the required records need not be maintained in a specific manner, so long as they form an adequate basis for audit.

Confirmation:

Alternative confirmation requirements are provided depending on the type of customer relationships involved.

Where the bank uses a broker the revised rules give banks the option of sending customers their own confirmation, or a copy of the broker's confirmation within five days from the time the bank executes the transaction or receives confirmation from the broker.

In certain cases, confirmation is not required where the customer and the bank agree to a different arrangement.

In the case of accounts where the bank exercises investment discretion as an agent for a customer, the new rules require quarterly statements to the customer.

The agencies' proposals would not have applied to transactions in U.S. government securities or securities of Federal agencies or of States and municipalities. The rules as adopted require banks, when acting in an agency capacity, to identify separately their fees in transactions in these securities for customers. Dealer mark-ups need not be disclosed.

The agencies invited public comment on this requirement through September 24, 1979.

Policies and procedures:

Banks making securities transactions for customers are required to establish written policies and procedures including the following:

1. Assignment of responsibility for supervising employees involved in securities transactions.
2. Provision for fair and equitable allocation of securities and prices to accounts when orders for the same security are received for execution at approximately the same time.

3. Provisions for fair and equitable matching of buy and sell orders from different customers.
4. Requirements for bank employees involved in securities transactions for customers to report their own securities transactions quarterly.

A bank that is in compliance with rules of the Municipal Securities Rulemaking Board with respect to transactions in municipal securities is deemed to be in compliance with the recordkeeping and confirmation requirements of the agencies.

In addition to the exemption for these activities of banks subject to the regulations of the Municipal Securities Rulemaking Board, a new section of the agencies' revised regulations would:

- Exempt the securities activities of foreign branches of banks from requirements of the regulation;
- Exempt banks that normally make 200 or fewer securities transactions a year for customers from certain recordkeeping requirements.

The texts of the agencies' rules are available upon request.

#

the paragraph in any given manner, provided that the information required to be shown is clearly and accurately reflected and provides an adequate basis for the audit of such information. In addition, subparagraph (k)(2)(iii)(a) has been amended to provide that a single order ticket may be used for multiple account transactions (e.g. a purchase of securities of a money market fund for several accounts at the same time).

Paragraph (k)(3), dealing with the form of notification, has been revised significantly. The Securities and Exchange Commission has questioned the provision in the revised proposal that would have excluded transactions in U. S. government, federal agency and municipal obligations from the confirmation requirements. During the period that the Board was considering the revised proposal, the SEC amended its confirmation rule for brokers and dealers setting forth requirements applicable to both dealer and agency transactions in equity and debt securities, other than U. S. Savings Bonds and municipal securities (Securities Exchange Act Release No. 34-15219). The SEC also solicited additional comment as to whether disclosure should be required on confirmations of markups and markdowns on "riskless principal" transactions in non-municipal debt securities and municipal securities (Securities Exchange Act Release No. 34-15220). The Commission also solicited comment as to whether a "market-maker" exception similar to that provided for dealers in equity securities should also be provided for dealers in municipal securities and non-municipal debt securities. In view of the significant controversy concerning the SEC's proposed disclosure requirements for "riskless principal" transactions, the Board's revised proposal excluded, in toto, transactions in U.S. government, agency and municipal securities from the proposed confirmation requirements. Upon further examination, the Board believes that it would not impose an undue hardship and would be consistent with investor protection to apply the confirmation rules to transactions in U. S. government securities (other than U. S. Savings Bonds), federal agency obligations and municipal securities (where the bank is not already required to comply with rules of the Municipal Securities Rulemaking Board), but that the rules should not operate at the present time to require banks to disclose mark-ups, mark-downs and other remuneration where the bank executes transactions in U. S. government, federal agency or municipal obligations in a dealer capacity. The Board noted that further study of the issue appears necessary, particularly on the question as to the type of market maker exception that should be provided if a "riskless principal" requirement along the lines proposed by the SEC is to be adopted for bank dealers. Additional comment on the confirmation requirements as they apply to transactions in U.S. government, federal agency and municipal securities is requested by September 24, 1979.

In addition, paragraph (k)(3)(ii)(d) has been revised to eliminate the requirement that time of execution be shown on the form of notification and to substitute a requirement that the form of notification contain a statement that the time of execution will be furnished within a reasonable time upon written request of the customer.

As to the requirements concerning time of notification (paragraph (k)(4)), the Board reviewed numerous comments suggesting that State member banks be permitted to mail confirmations within five business days from the settlement date rather than, as contemplated by the revised proposal, the date of the transaction or the date that the bank receives the broker-dealer confirmation. The Board concluded that no change was warranted because the provision as stated in the revised proposal provided the greatest likelihood that confirmations would be received by the customer at or before the completion of the transaction while simultaneously maintaining flexibility in situations in which confirmations from the broker-dealer are not received by the bank prior to the settlement date.

Finally, the Board has followed the suggestions of numerous commentators in two areas. First, the confirmation requirements for a periodic plan have been amended and paragraph (k)(4)(v) now provides that the bank mail or otherwise furnish to the customer as promptly as possible after each transaction a written statement showing the funds and securities in the custody or possession of the bank, all service charges and commissions paid by the customer in connection with the transaction, and all other debits and credits of the customer's account involved in the transaction. Paragraph (k)(4)(v) also provides that upon request of the customer, the bank will furnish the information required in paragraph (k)(3).

The second area of change affects the Securities Trading Policies and Procedures section. Paragraph (k)(5)(d), establishing reporting requirements for bank officers and employees, has been amended to focus more clearly upon those individuals involved in the making of investment decisions. In addition, the Board has determined that the reporting requirements should apply to U. S. government or agency obligations in order to provide a desirable audit control for banks. After considering numerous comments which stated that the reporting provisions of the revised proposal constituted an invasion of personal privacy, the Board believes that the purpose of the provision (to prevent "scalping" or other improper use of inside information and to provide a desirable audit control for banks) will be served by (1) excluding reporting of transactions in mutual fund shares, (2) excluding reporting of transactions which in the aggregate involve \$10,000 or less during a calendar quarter, and (3) where reportable transactions have occurred, requiring only that the date and name of the security purchased or sold be reported (but not the actual number of shares or dollar amount of securities purchased or sold). Where reports indicate the possibility of misuse of inside information, the Board expects State member banks to obtain such additional information as may be necessary to satisfy themselves that the employee has not misused non-public information in his possession for his own personal enrichment.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MEMBERSHIP OF STATE BANKING INSTITUTIONS

IN THE FEDERAL RESERVE SYSTEM

AMENDMENT TO REGULATION H†

Effective January 1, 1980, Section 208.8 is amended by adding a new paragraph (k) as follows:

SECTION 208.8 — BANKING PRACTICES

* * * * *

(k) **Recordkeeping and confirmation of certain securities transactions effected by State member banks.**

(1) **Definitions:** For purposes of this paragraph (k):

(i) "customer" shall mean any person or account, including any agency, trust, estate, guardianship, committee or other fiduciary account, for which a State member bank effects or participates in effecting the purchase or sale of securities, but shall not include a broker, dealer, dealer bank or issuer of the securities which are the subject of the transactions;

(ii) "collective investment fund" means funds held by a State member bank as fiduciary and, consistent with local law, invested collectively (A) in a common trust fund maintained by such bank exclusively for the collective investment and reinvestment of monies contributed thereto by the bank in its capacity as trustee, executor, administrator, guardian, or custodian under the Uniform Gifts to Minors Act, or (B) in a fund consisting solely of assets of retirement, pension, profit sharing, stock bonus or similar trusts which are exempt from Federal income taxation under the Internal Revenue Code;

(iii) a bank shall be deemed to exercise "investment discretion" with respect to an account if, directly or indirectly, the bank (A) is authorized to determine what securities or other property shall be purchased or sold by or for the account, or (B) makes decisions as to what securities or other property shall be purchased or sold by or for the account even though some other person may have responsibility for such investment decisions.

(iv) "periodic plan" (including dividend reinvestment plans, automatic investment plans and employee stock purchase plans) means any written authorization for a State member bank acting as agent to purchase or sell for a customer a specific security or securities, in specific amounts (calculated in security units or dollars)

or to the extent of dividends and funds available, at specific time intervals and setting forth the commission or charges to be paid by the customer in connection therewith or the manner of calculating them;

(v) "security" means any interest or instrument commonly known as a "security", whether in the nature of debt or equity, including any stock, bond, note, debenture, evidence of indebtedness or any participation in or right to subscribe to or purchase any of the foregoing. The term "security" does not include (A) a deposit or share account in a federally or state insured depository institution, (B) a loan participation, (C) a letter of credit or other form of bank indebtedness incurred in the ordinary course of business, (D) currency, (E) any note, draft, bill of exchange, or bankers acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited, (F) units of a collective investment fund, (G) interests in a variable amount (master) note of a borrower of prime credit, or (H) U.S. Savings Bonds.

(2) **Recordkeeping:** Every State member bank effecting securities transactions for customers shall maintain the following records with respect to such transactions for at least three years:

(i) chronological records of original entry containing an itemized daily record of all purchases and sales of securities. The records of original entry shall show the account or customer for which such transaction was effected, the description of the securities, the unit and aggregate purchase or sale price (if any), the trade date and the name or other designation of the broker/dealer or other person from whom purchased or to whom sold;

(ii) account records for each customer which shall reflect all purchases and sales of securities, all receipts and deliveries of securities, and all receipts and disbursements of cash with respect to transactions in securities for such account and all other debits and credits pertaining to transactions in securities.

(iii) a separate memorandum (order ticket) of each order to purchase or sell securities

(whether executed or cancelled), which shall include:

- (a) the account(s) for which the transaction was effected;
- (b) whether the transaction was a market order, limit order, or subject to special instructions;
- (c) the time the order was received by the trader or other bank employee responsible for effecting the transaction;
- (d) the time the order was placed with the broker/dealer, or if there was no broker/dealer, the time the order was executed or cancelled;
- (e) the price at which the order was executed; and
- (f) the broker/dealer utilized;

(iv) a record of all broker/dealers selected by the bank to effect securities transactions and the amount of commissions paid or allocated to each such broker during the calendar year. Nothing contained in this subparagraph shall require a bank to maintain the records required by this rule in any given manner, provided that the information required to be shown is clearly and accurately reflected and provides an adequate basis for the audit of such information.

(3) **Form of Notification:** Every State member bank effecting a securities transaction for a customer shall maintain for at least three years and, except as provided in subparagraph (4), shall mail or otherwise furnish to such customer either of the following types of notification:

- (i) (a) a copy of the confirmation of a broker/dealer relating to the securities transaction; and (b) if the bank is to receive remuneration from the customer or any other source in connection with the transaction, and the remuneration is not determined pursuant to a prior written agreement between the bank and the customer, a statement of the source and the amount of any remuneration to be received; or
- (ii) a written notification disclosing
 - (a) the name of the bank;
 - (b) the name of the customer;
 - (c) whether the bank is acting as agent for such customer, as agent for both such customer and some other person, as principal for its own account, or in any other capacity;
 - (d) the date of execution and a statement that the time of execution will be furnished within a reasonable time upon written request of such customer, and the identity, price and number of shares or units (or principal amount in the case of debt securities) of

such security purchased or sold by such a customer;

- (e) the amount of any remuneration received or to be received, directly or indirectly, by any broker/dealer from such customer in connection with the transaction;
- (f) the amount of any remuneration received or to be received by the bank from the customer and the source and amount of any other remuneration to be received by the bank in connection with the transaction, unless remuneration is determined pursuant to a written agreement between the bank and the customer, provided, however, in the case of U.S. Government securities, federal agency obligations and municipal obligations, this subparagraph (f) shall apply only with respect to remuneration received by the bank in an agency transaction; and
- (g) the name of the broker/dealer utilized; or, where there is no broker/dealer, the name of the person from whom the security was purchased or to whom it was sold, or the fact that such information will be furnished within a reasonable time upon written request.

(4) **Time of Notification:** The time for mailing or otherwise furnishing the written notification described in subparagraph (3) shall be 5 business days from the date of the transaction, or if a broker/dealer is utilized, within 5 business days from the receipt by the bank of the broker/dealer's confirmation, but the bank may elect to use the following alternative procedures if the transaction is effected for:

- (i) accounts (except periodic plans) where the bank does not exercise investment discretion and the bank and the customer agree in writing to a different arrangement; provided, however, that such agreement makes clear the customer's right to receive the written notification within the above prescribed time period at no additional cost to the customer;
- (ii) accounts (except collective investment funds) where the bank exercises investment discretion in other than an agency capacity, in which instance the bank shall, upon request of the person having the power to terminate the account or, if there is no such person, upon the request of any person holding a vested beneficial interest in such account, mail or otherwise furnish to such person the written notification within a reasonable time. The bank may charge such person a reasonable fee for providing this information.
- (iii) accounts, where the bank exercises investment discretion in an agency capacity, in which instance (a) the bank shall mail or otherwise furnish to each customer not less frequently

than every three months an itemized statement which shall specify the funds and securities in the custody or possession of the bank at the end of such period and all debits, credits and transactions in the customer's accounts during such period, and (b) if requested by the customer, the bank shall mail or otherwise furnish to each such customer within a reasonable time the written notification described in subparagraph (3).

(iv) a collective investment fund, in which instance the bank shall at least annually furnish a copy of a financial report of the fund, or provide notice that a copy of such report is available and will be furnished upon request, to each person to whom a regular periodic accounting would ordinarily be rendered with respect to each participating account. This report shall be based upon an audit made by independent public accountants or internal auditors responsible only to the board of directors of the bank.

(v) a periodic plan, in which instance the bank shall mail or otherwise furnish to the customer as promptly as possible after each transaction a written statement showing the funds and securities in the custody or possession of the bank, all service charges and commissions paid by the customer in connection with the transaction, and all other debits and credits of the customer's account involved in the transaction; provided that upon the written request of the customer the bank shall furnish the information described in subparagraph (3), except that any such information relating to remuneration paid in connection with the transaction need not be provided to the customer when paid by a source other than the customer. The bank may charge a reasonable fee for providing the information described in subparagraph (3).

(5) Securities Trading Policies and Procedures:

Every State member bank effecting securities transactions for customers shall establish written policies and procedures providing:

(i) assignment of responsibility for supervision of all officers or employees who (a) transmit orders to or place orders with brokers/dealers, or (b) execute transactions in securities for customers;

(ii) for the fair and equitable allocation of securities and prices to accounts when orders for the same security are received at approximately the same time and are placed for execution either individually or in combination;

(iii) where applicable and where permissible under local law, for the crossing of buy and sell orders on a fair and equitable basis to the parties to the transaction; and

(iv) that bank officers and employees who make investment recommendations or decisions for the accounts of customers, who participate in the determination of such recommendations or decisions, or who, in connection with their duties, obtain information concerning which securities are being purchased or sold or recommended for such action, must report to the bank, within ten days after the end of the calendar quarter, all transactions in securities made by them or on their behalf, either at the bank or elsewhere in which they have a beneficial interest. The report shall identify the securities purchased or sold and indicate the dates of the transactions and whether the transactions were purchases or sales. Excluded from this requirement are transactions for the benefit of the officer or employee over which the officer or employee has no direct or indirect influence or control, transactions in mutual fund shares, and all transactions involving in the aggregate \$10,000 or less during the calendar quarter.

(6) **Exceptions:** The following exceptions to subparagraph (k) shall apply:

(i) the requirements of section (k)(2)(ii) through (k)(2)(iv) shall not apply to banks having an average of less than 200 securities transactions per year for customers over the prior three calendar year period;

(ii) activities of a State member bank that are subject to regulations promulgated by the Municipal Securities Rulemaking Board shall not be subject to the requirements of this paragraph (k); and

(iii) activities of foreign branches of a State member bank shall not be subject to the requirements of this paragraph (k).

†For this Regulation to be complete as amended effective January 1, 1980, retain:

- 1) Printed Regulation pamphlet as amended effective March 18, 1969;
- 2) Amendments to Sections 208.10(b) and (c) effective December 21, 1973;
- 3) Amendment adding a new Section 208.8 and renumbering succeeding sections effective March 2, 1974;
- 4) Amendment to Section 208.8 effective September 16, 1974;
- 5) Amendment to Section 208.8 effective October 17, 1975;
- 6) Amendment to Section 208.8 effective October 3, 1977;
- 7) Amendment to Section 208.8 effective October 31, 1977;
- 8) Amendment to Section 208.8 effective April 20, 1978; and
- 9) This slip sheet.