

FEDERAL RESERVE BANK  
OF NEW YORK

[ Circular No. 8273  
February 10, 1978 ]

PROPOSED AMENDMENTS TO REGULATION H

Establishment of Uniform Records and Procedures for Securities Transactions

*To All State Member Banks in the Second Federal  
Reserve District, and Others Concerned:*

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System regarding a proposal to amend its Regulation H, "Membership of State Banking Institutions in the Federal Reserve System":

The Board of Governors of the Federal Reserve System today [January 31, 1978] proposed a regulatory change that would require State member banks to establish uniform records and procedures concerning securities transactions for trust department and other bank customers.

The Board requested comment by March 31, 1978. Similar proposals by the Comptroller of the Currency and the Federal Deposit Insurance Corporation would affect most other commercial banks. The agencies' proposals were made subsequent to a study by the Securities and Exchange Commission (SEC) on bank securities activities and respond to certain recommendations in the SEC report.

The following changes in its Regulation H were included in the Board's proposal:

—Every State member bank shall be required to maintain for six years the following records concerning securities transactions:

1. Itemized daily records of purchases and sales; receipts and deliveries; receipt and disbursement of cash; the account for which each transaction was made; description of the securities and purchase and sale price.
2. A separate record of each order to purchase or sell securities, containing specified information.
3. Specified information to be furnished to each customer concerning securities transactions for the customer within five days (except in certain circumstances).

—Each State Member bank making securities transactions for customers would be required to establish written policies and procedures including the following:

1. Assignment of responsibility for supervising employees trading in securities.
2. Provision for fair and equitable allocation of securities and prices to accounts when orders for the same security are received and combined for execution at approximately the same time.
3. Provision for fair and equitable matching of buy and sell orders from different customers.
4. Requirements for bank employees handling securities transactions for customers to report their own securities transactions.

A State member bank that is in compliance with rules of the Municipal Securities Rulemaking Board with respect to transactions in municipal securities would be considered in compliance with the record-keeping and confirmation requirements proposed by the Board.

The proposed record-keeping requirements would apply to all securities transactions by State member banks for their customers, but the confirmation requirements would not apply to transactions in obligations of the U.S. Government, Federal agencies and States and municipalities.

The Board also invited comment on two further matters which it is considering:

1. Whether and to what extent regulations should require a bank to obtain the best execution of securities transactions for customers (i.e., to obtain the best terms), and
2. Whether and to what extent regulations should establish requirements for testing the competence of bank employees making securities transactions for customers.

Printed below is the text of the proposed amendments to Regulation H. Comments on the proposals should be submitted by March 31 and may be sent to our Regulations Division.

PAUL A. VOLCKER,  
*President.*

## FEDERAL RESERVE SYSTEM

[Reg. H; Docket No. R-0142]

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

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

**ACTION:** Proposed rule.

**SUMMARY:** The Board of Governors of the Federal Reserve System is proposing amendments to its Regulation H (12 CFR 208) to require that State member banks that effect certain securities transactions for customers provide confirmations of and maintain records with respect to such transactions. Commentators are also invited to consider whether and to what extent regulations should be promulgated which would (1) expressly recognize the duty of State member banks to obtain the best execution of securities transactions which they effect for customers and (2) establish competency and testing requirements for bank employees engaged in effecting securities transactions for customers. Similar proposals are expected to be published for comment by the Comptroller of the Currency and the Federal Deposit Insurance Corporation.

**DATE:** Comments must be received on or before March 31, 1978.

**ADDRESS:** Secretary, Board of Governors of the Federal Reserve System, 20th & Constitution Avenue, N. W., Washington, D. C. 20551. All material submitted should be in writing and should refer to Docket No. R-0142. Such materials will be available for public inspection during the regular hours of the Office of the Secretary at the above address.

**FOR FURTHER INFORMATION CONTACT:** Robert S. Plotkin, Assistant Director, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, Washington, D. C. 20551 (202) 452-2781.

**SUPPLEMENTARY INFORMATION:** On June 30, 1977, the Securities and Exchange Commission (SEC) published its Final Report on Bank Securities Activities (the Final Report), pursuant to its mandate under Section 11A(e) of the Securities Exchange Act of 1934. The Final Report includes a recommendation to Congress that the federal banking agencies be mandated to issue and enforce specific rules and regulations governing the conduct of banks in effecting transactions in securities for the accounts of others. This recommendation would require that such rules and regulations cover all aspects of this activity, including personnel competency standards, recordkeeping requirements and confirmation requirements. This proposal is responsive, in part, to the recommendations of the SEC Final Report.

An essential element of bank fiduciary activities is the purchase and sale of securities for accounts under management in a trust department, and also for bank customers generally. Because of the growth of these activities, improved supervision is necessary to ensure that banks perform these activities in accordance with the highest standards, in order to protect the public interest. Accordingly, the Board proposes to require State member banks to establish and maintain uniform procedures to facilitate effective supervision by banks and their supervisory personnel and to assist in protecting the interests of these bank customers.

This proposal would require specific written procedures in connection with effecting securities transactions for customers and the maintenance of certain records with respect to such transactions. As proposed, the recordkeeping requirements would apply to all securities transactions by the bank for customers, but the confirmation requirements would not apply to transactions in U.S. Government obligations, federal agency obligations, and obligations of States and municipalities. State member banks that are municipal securities dealers are already required to comply with comparable rules of the Municipal Securities Rule-making Board with respect to transactions in municipal securities.

Generally, confirmation of securities transactions would be required to be furnished to customers within 5 business days. In the case of accounts for which the bank exercises investment discretion, collective investment funds and periodic plans administered by the bank, monthly, quarterly or annual statements of transactions and certain other information would be required. Further, bank personnel engaged in effecting securities transactions would be required to advise the bank of their personal transactions in securities, wherever effected.

The Board is considering the necessity for regulation in two additional areas addressed in the SEC Final Report. The Final Report observed that under traditional agency principles banks, like brokers, have a duty to obtain the best terms for their customers. No specific regulation applicable to State member banks articulates this duty in a manner similar to that imposed upon broker/dealers and there is uncertainty as to the degree to which this principle of "best execution" is applicable to banks. The Board would appreciate receiving the views of interested parties as to (a) the need for such a regulation, and (b) the appropriate scope and content of an implementing regulation.

The SEC Final Report also recommended that bank employees engaged in effecting transactions in securities for others be subject to competency and testing requirements regarding securities laws and operations of securities markets, as are brokerage personnel similarly engaged, and that banks be required to adopt specific supervisory procedures with respect to these activities. The Board believes that its statutory authority to prescribe competency and testing requirements of the magnitude contemplated by the SEC Report is questionable. However, assuming such authority exists, the Board invites comment with respect to (a) the scope and content of competency and testing standards, (b) the scope and content of such regulation, with particular regard to types of personnel who should be subject to competency and testing standards.

1. Pursuant to sections 9 and 11 of the Federal Reserve Act (12 U.S.C. § 321, § 248(a) and (i)) and section 8(b)(1) *et. seq.* of the Federal Deposit Insurance Act (12 U.S.C. § 1818(b)) the Board proposes to amend Regulation H (12 CFR 208) by adding a paragraph (k) to section 208.8 as set forth below:

#### SECTION 208.8 — BANKING PRACTICES

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

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

(i) "customer" shall mean any person including any 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 transaction;

(ii) "time of transaction" means the time of execution of the customer's order, to the extent feasible;

(iii) "periodic plan" 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), 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;

(iv) "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, or guardian, 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;

(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 as defined in Section 3(I) of the Federal Deposit Insurance Act, 12 U.S.C. § 1813(I), (B) a loan participation, (C) a letter of credit or other form of bank indebtedness incurred in the ordinary course of business, (D) currency, or (E) any note, draft, bill of exchange, or bankers acceptance which has a maturity at the time of issuance of not exceeding 9 months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited;

(vi) 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.

(2) Every State member bank effecting securities transactions for customers shall maintain the following records with respect to such transactions for 6 years:

(i) "blotters" or other records of original entry, containing an itemized daily record of all purchases and sales of securities, all receipts and deliveries of securities (including certificate, bond or note number), all receipts and disbursements of cash with respect to transactions in securities and all other debits and credits pertaining to transactions in securities. The records of original entry shall also show the account for which each 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 person from whom purchased or received or to whom sold or delivered;

(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. Account records of bank employees shall be so designated as to be readily identifiable from those records relating to

other customers of the bank but need not be segregated.

(iii) a separate record (for example, an order ticket) of each order to purchase or sell securities (whether executed or cancelled) which shall include:

(a) the account 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 bank employee responsible for effecting the transaction;

(d) the time the order was executed or cancelled;

(e) the price at which the order was executed;

(f) the broker/dealer utilized and the market in which the transaction occurred.

(iv) a record of all broker/dealers used by the bank to effect securities transactions.

(3) Every State member bank effecting securities transactions for a customer shall furnish to such customer as to all such transactions, written notification disclosing:

(i) the name, address and telephone number of the bank;

(ii) the name of the customer;

(iii) the capacity in which the bank effected the transaction;

(iv) the name of the person from whom the security was purchased, to whom it was sold, or the fact that such information will be furnished within a reasonable time upon written request of such customer;

(v) the source and amount of any remuneration received or to be received by the bank from the customer or any other source in connection with the transaction, unless remuneration is determined pursuant to a written agreement otherwise than on a transactional basis;

(vi) the amount of any remuneration received or to be received, directly or indirectly, by any broker from such customer in connection with the transaction; and

(vii) the date and time of the transaction (or the fact that the time of the transaction 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; provided, however, that the requirements of this subparagraph (3) shall not be applicable to transactions in (i) securities issued or guaranteed as to principal or interest by the United States; (ii) federal agency obligations; or (iii) municipal securities as defined in section 3(a)(29) of the Securities Exchange Act of 1934.

(4) A State member bank which effects securities transactions for a customer shall furnish to such customer the written notification described in subparagraph (3) within 5 business days from the date of the transaction, unless the transaction is effected with respect to:

(i) accounts, except collective investment funds, for which the bank exercises investment discretion, in which instance the bank, within 5 business days after the end of each month in which a transaction occurred, shall furnish a written statement disclosing with respect to each transaction effected during the month the information required in subparagraph (3). This statement shall also include information concerning any dividend or distribution credited to or reinvested for such customer. The bank shall furnish the written statement to the person having power to terminate the account or, if there is no such person, to the ascertained beneficiaries of those accounts or their legal representatives.

(ii) a collective investment fund, in which instance the bank shall at least annually furnish the customer 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.

(iii) a periodic plan, in which instance the bank shall furnish the customer within 5 business days after the end of each quarterly period in which a transaction occurred, a written statement disclosing with respect to each transaction effected during the period the information described in subparagraph (3). This statement shall include information concerning any dividend or distribution credited to, or reinvested for each customer. In addition, the bank shall furnish the information described in subparagraph (3) upon written request from the customer within 5 business days of receipt as to transactions during the present quarter, and within 15 business days of receipt as to transactions during previous quarters.

(5) 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 trade in securities;

(ii) for the fair and equitable allocation of securities and prices to accounts when orders for the same security are received and combined for execution at approximately the same time;

(iii) for the crossing of buy and sell orders on a fair and equitable basis to the parties to the transaction;

(iv) that bank officers or employees whose duties include account management or effecting securities transactions for customers, or who supervise such activities, must promptly report to the bank all securities transactions made by them or in their behalf, either at the bank or elsewhere, in which they have a beneficial interest. These reports must be retained by the bank for 6 years.

(6) A State member bank that is in compliance with rules of the Municipal Securities Rulemaking Board with respect to transactions in municipal securities shall be considered to be in compliance with the requirements of this paragraph (k).