

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8455]
November 13, 1978

PROPOSED AMENDMENTS TO REGULATION H

Establishment of Uniform Standards for Bank Recordkeeping and
Procedures in Making 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 on their own behalf and on behalf of the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation:

The Federal bank regulators today [November 1, 1978] proposed regulatory revisions establishing uniform standards for bank recordkeeping, confirmation and other procedures in making securities transactions for trust department and other bank customers:

The agencies, named above, requested comment by December 18, 1978. Their proposals represented a revision, in the light of comment received, of proposals published early this year.

The agencies' original proposals were made subsequent to a study by the Securities and Exchange Commission on bank securities activities and respond to certain recommendations in the SEC report.

The revised proposals of the agencies¹ include the following uniform provisions:

Recordkeeping:

Banks would be 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.

Confirmation:

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

Where the bank utilizes a broker the revised proposals would 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 would not be 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 revised proposals require quarterly statements to the customer.

Confirmation requirements would not apply to transactions in U.S. government securities or securities of Federal agencies or of States and municipalities.

Policies and procedures:

Banks making securities transactions for customers would be 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.

¹ The Comptroller's proposals would establish a new Part 12 of the Comptroller's regulations affecting national banks. The Federal Reserve's proposals would amend its Regulation H, affecting State chartered member banks. The proposals of the FDIC would amend its proposed regulation, Part 344, affecting State chartered nonmember banks.

(OVER)

3. Provision 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 would be considered in compliance with the recordkeeping and confirmation requirements proposed by 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 revised proposal would:

- Exempt the securities activities of foreign branches of banks from requirements of the regulation;
- Exempt banks that normally make only small numbers of securities transactions for customers from certain recordkeeping requirements. The Comptroller and the FDIC would exempt banks making an average of 50 or less transactions a year over the three prior calendar years. The Federal Reserve would exempt those with less than 200 such transactions a year.

The agencies determined not to take further action in regard to regulatory requirements concerning best execution and competency and testing standards for bank employees engaged in effecting securities transactions. The agencies believe that traditional trust and agency provisions make clear the obligations of banks to use reasonable care to obtain the best terms for customers. Bank examinations provide a means for regulators to assess the competence of employees making securities transactions.

Printed below is the text of the Board's proposed amendments to its Regulation H. Comments on the proposal should be submitted by December 18 and may be sent to our Bank Regulations and Consumer Affairs Department.

PAUL A. VOLCKER,
President.

FEDERAL RESERVE SYSTEM

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

Membership 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: Republication of proposed rule.

SUMMARY: On January 31, 1978, the Board of Governors of the Federal Reserve System published for comment proposed amendments of 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 (43 FR 5006). Commentators were also invited to consider whether and to what extent regulations should be promulgated concerning: (1) Best execution of securities transactions and (2) competency and testing requirements for bank employees. The comment period was extended (43 FR 12720) and ended May 1, 1978. Similar proposals were also published for comment by the Comptroller of the Currency and the Federal Deposit Insurance Corporation.

A substantial number of critical, but useful, comments were received by the Board expressing significant concerns regarding the feasibility of the proposed amendments. As a result, the

Board determined to revise the proposed amendments to its regulation H in light of the comments received and to republish the amendments for additional comment. Information setting forth estimated costs of implementation of the proposed amendment is also being requested. The Board has determined to take no further action at this time regarding the promulgation of regulations concerning best execution of securities transactions, and competency and testing requirements of bank employees.

DATE: Comments must be received on or before December 18, 1978.

ADDRESS: Secretary of the Board of Governors of the Federal Reserve System, 20th & Constitution Avenue NW., Washington, D.C. 20551. All material submitted should be in writing and should refer to docket No. R-0142. Such material 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, 202-452-2782, or Robert A. Wallgren, Chief, Trust Activities Program, 202-452-2717, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION: The original proposal to amend regulation H has been substantially revised as a result of the numerous comments which were received. The most significant revision of the amendment as originally proposed pertains to the confirmation requirements. However, substantial revisions to the recordkeeping portion of the proposed amendments have also been made. The following is a summary of the significant revisions which are proposed.

With respect to the proposed recordkeeping requirements, the Board has taken into consideration the many comments which have been received expressing the concern that these requirements, as proposed, would be burdensome and costly due to: (1) The length of time for which the required records would be kept; and (2) the variety of records which would be required to be maintained. In order to reduce the volume of records which a State member bank would be required to maintain, the Board has proposed to decrease the number of years required for retention. Although the original proposal was silent with respect to the number of years for which copies of confirmations must be maintained, it is now proposed that the number of years for which all required records, including copies of confirmations, must be maintained be reduced from 6 years to 3 years.

In further response to these concerns, and in consideration of those comments expressing the view that the recordkeeping requirements should be less onerous for smaller banks, the Board has proposed to exempt from certain of the recordkeeping requirements those banks which effect an average of fewer than 200 securities transactions per year. Thus, such banks that effect a nominal number of securities transactions would be required, pursuant to these proposed regulations, to maintain significantly fewer records.

In addition to these revisions to the recordkeeping requirements, several other significant changes have been proposed with respect to recordkeeping. The revised proposal would delete the requirement for maintaining a chronological record of all receipts and deliveries of securities and of receipts and disbursements of cash. However, this information would still be required to be maintained in account records of customers. The regulations as revised would also change the requirement for including on the order ticket the time the order was executed to the time the order was placed with the broker/dealer, where a broker/dealer has been utilized. Where a broker/dealer is not used, the time of execution would still be required. A further proposed revision would permit banks to maintain records of only those broker/dealers for whom the bank has exercised discretion in selecting the broker/dealer to effect a particular securities transaction for its customers, rather than to require that a record be kept of all broker/dealers used by the bank to effect such transactions. In addition, and in connection with this revision, a newly proposed provision would also require that a record be kept of the amount of commissions paid or allocated to each such broker during the calendar year.

With respect to the proposed confirmation requirements there have been two major revisions. The first pertains to the length of time within which a member bank must provide a customer with a confirmation of a securities transaction which has been effected for that customer. As revised, the proposal would require that where a broker/dealer is utilized, the confirmation would be furnished within 5 business days from the date the bank receives the broker/dealer confirmation, rather than 5 business days from the date of the transaction. However, where there is no broker/dealer utilized, the confirmation would be furnished to the customer within 5 business days from the date of the transaction. The second major revision to the confirmation requirements substantially diminishes the number of confirmations which member banks would be required to furnish. The revised proposal reflects the concern, as expressed by many of the commentators, that the customer should have the right to request not to receive the confirmation. Thus, in those cases where the bank does not exercise in-

vestment discretion, the bank and the customer can agree to alternative arrangements. In those cases where the bank exercises investment discretion, in other than an agency capacity, no confirmation would be required except upon request. The confirmation requirements have been similarly liberalized for other types of accounts. It should also be noted that as an alternative to furnishing a separate bank confirmation containing certain specified information, the revised proposal provides that the bank may furnish the customer with a copy of the broker/dealer confirmation supplemented by certain additional information.

In addition to the changes which have been made with respect to the recordkeeping and confirmation requirements, a new section has been added to the regulation which contains the exceptions from requirements of this proposal. Two of the exceptions contained in this section are newly proposed by this revised proposal. These new exceptions represent a further significant revision to the original proposal. The exception for banks having an average of fewer than 200 securities transactions per year has previously been discussed. It should be noted that although such banks would be exempt from certain of the recordkeeping requirements, these banks would nevertheless be subject to the confirmation requirements and other provisions of the regulation, wherever applicable. In addition, activities of foreign branches of State member banks would be exempt from the requirements of this regulation.

In connection with its original proposal, the Board also requested comment regarding the need for regulations requiring best execution of securities transactions and imposing competency and testing requirements for bank employees engaged in effecting securities transactions. Based on comments received, the Board has decided to take no further action in this area at this time.

As to the best execution requirement, the Board believes that traditional trust and agency principles already make clear the obligation of banks to use reasonable care in effecting securities transactions to obtain the best terms possible for customers.

Because of the numerous and highly subjective considerations involved in meeting this obligation, the Board believes that the term "best execution" cannot be reasonably defined by regulation and that any attempt to do so would limit the flexibility of banks in complying with such principles and would unfairly impose upon all banks a detailed standard of performance that may not be appropriate to, or adequately reflect, their individual circumstances or the needs of their customers. It is further observed that the regulations presently applicable to broker/dealers, through which most securities transactions of banks are effected, contain little more than a simple restatement of the traditional agency principle.

Regarding competency and testing requirements, the Board believes that, even if sufficient statutory authority were deemed to exist to promulgate regulations in this area, it would be inappropriate to establish a costly and elaborate scheme for testing the competence of individuals associated with only one small aspect of total banking activity. The Board recognizes the need for specific training of bank personnel engaged in effecting securities transactions in operation of the securities market and of the requirements of the securities laws. As the SEC final report itself recognizes, however, the level of training and knowledge that is required will vary depending on the volume and size of the transactions effected. The bank examination process has traditionally been effectively used to detect and remedy personnel weaknesses and the Board believes that continued reliance on the examination process, augmented by increased examiner training in the requirements of the Federal securities laws, will be more effective in assuring an appropriate level of competence than prescribing a generalized uniform test that may or may not be relevant to a particular situation.

To aid in consideration of this proposal by the Board, interested persons are invited to submit relevant data, views, comments or arguments. The Board is specifically requesting information concerning the projected costs of implementing the proposed amendments. Information should be separately furnished as to projected startup costs and continuing costs and, to the extent feasible, these estimates should be allocated between the recordkeeping and confirmation requirements. Unit transaction costs should be furnished if possible, indicating, if known, variances in such costs, depending on volume of transactions.

1. Pursuant to sections 9 and 11 of the Federal Reserve Act (12 U.S.C. 321, 248(a) and (b)) 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 § 208.8 as set forth below:

§ 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) "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 (cal-

culated 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;

(iii) "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;

(iv) "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 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, or (G) interests in a variable amount (master) note of a borrower of prime credit;

(v) 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 purchased or sold by or for the specific account even though some other person may have responsibility for such investment decisions.

(2) *Recordkeeping.* Every State member bank effecting securities transactions for customers shall maintain the following records with respect to such transactions for at least 3 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 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 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 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.

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

(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 and time of execution (or the fact 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 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 between the bank and the customer; 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.

Provided, however, That the requirements of this paragraph (k)(3) shall not be applicable to transactions in (1) securities issued or guaranteed as to principal or interest by the United States; (2) Federal agency obligations; or (3) municipal securities as defined in section 3(a)(29) of the Securities Exchange Act of 1934.

(4) *Time of notification.* The time for mailing or otherwise furnishing the written notification described in paragraph (k)(3) of this section 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, unless 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 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 once every 3 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 account 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 paragraph (k)(3) of this section.

(iv) 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 respon-

sible only to the board of directors of the bank.

(v) A periodic plan, in which instance the bank shall: A mail or otherwise furnish to the customer after the end of each quarterly period in which a transaction was completed, a written statement showing 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 account during such period; or (B) the bank shall mail or otherwise furnish on a per transaction basis within a reasonable time following each transaction the information described in paragraph (k)(3) of this section, except that any such information relating to remuneration paid in connection with transactions in securities 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 this information. In the event the bank elects (1) above, it shall, upon written request from the customer, supply the information described in (2) above.

(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 broker/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, 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 or employees whose duties include account management or effecting securities transactions for customers, or who are directly engaged in the management, direction or supervision of such officers or employees, must report to the bank, all securities transactions made by them or on their behalf, either at the bank or elsewhere, in which they have

a beneficial interest, except (A) transactions effected in any account over which the bank officer or employee has no direct or indirect influence or control, and (B) transactions in U.S. Government or agency obligations. These reports shall be filed with the bank within 10 days after the end of each quarterly period in which any such security transaction was effected and shall be retained by the bank for 3 years.

(6) *Exceptions.* The following exceptions to this paragraph (k) shall apply:

(i) The requirements of paragraphs (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 3-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).