

# Rules and Regulations

Federal Register

Vol. 62, No. 43

Wednesday, March 5, 1997

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## FEDERAL RESERVE SYSTEM

### 12 CFR Part 208

[Regulation H; Docket No. R-0909]

#### Membership of State Banking Institutions in the Federal Reserve System; Recordkeeping and Confirmation of 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 is adopting final amendments to Regulation H pertaining to the recordkeeping and confirmation of certain securities transactions. The amendments accommodate developments in recordkeeping, confirmation and settlement requirements for broker-dealers by adding certain yield-related confirmation disclosure requirements for transactions involving debt and asset-backed securities effected by State member banks for customers, and providing for three-day settlement of those transactions. The amendments also clarify that State member banks that effect *de minimis* government securities brokerage transactions and are exempt from registration under Department of the Treasury regulations, also are exempt from Regulation H. Finally, the amendments address the minimum recordkeeping requirements for State member banks exempt from the regulation, require State member banks to establish trading policies and procedures that separate the sales function from the back office function, liberalize the written notification requirements for periodic plans, and include several new definitions and language edits.

**DATES:** Effective April 1, 1997.

#### FOR FURTHER INFORMATION CONTACT:

Angela Desmond, Senior Counsel, or Susan Meyers, Senior Securities Regulation Analyst, (202) 452-2781. For users of Telecommunications Device for the Deaf (TDD), please contact Dorothea Thompson, (202/452-3544), Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

**SUPPLEMENTARY INFORMATION:** The amendments to § 208.24 are part of an interagency effort to update the respective regulations of the Board, the OCC and the FDIC (agencies) that were adopted in 1979<sup>1</sup> as part of a coordinated effort to provide guidance to banks effecting securities transactions for customers in trust departments and in other areas of the bank. The regulations are based on SEC recordkeeping and confirmation rules.<sup>2</sup>

Recognizing that a number of market and regulatory changes have occurred since the regulation was adopted, the Board, in consultation with the other agencies, published draft amendments for comment on December 26, 1995.<sup>3</sup> The draft amendments were designed to update the recordkeeping and confirmation requirements of Regulation H to conform with SEC rules, with pertinent Department of the Treasury regulations adopted under the Government Securities Act of 1986, 15 U.S.C. 78o-5, and with principles of safe and sound banking practices. The draft amendments also were consistent with the amendments published by the other agencies.<sup>4</sup>

After reviewing the comments, the Board has determined to adopt final amendments to Regulation H as described in the section-by-section summary below. The amendments are limited to § 208.24 (formerly § 208.8(k)) of Regulation H and are part of an ongoing comprehensive review of the

regulation. Adoption of the amendments will provide continued consistency among the regulations of the agencies and parity with securities industry practices in these important areas.

As is the practice with respect to other notification practices of banks, the confirmation and notification requirements of § 208.24 can be satisfied by facsimile and, when the parties agree and the necessary safeguards are in place, via electronic means. Such safeguards should ensure correct delivery, the maintenance of confidentiality and security of the transmission, appropriate notice that the transmission is being sent, and evidence of delivery. In addition, a customer consenting to electronic delivery should still be able to request and obtain a written version of the information.

#### Summary of Comments and Section-by-Section Summary of Final Amendments

The Board received twelve comment letters; seven were from Federal Reserve Banks, one from a trade association, three from banks, and one from a law firm. Eleven commenters expressed general support for the proposed amendments, and one bank expressed general concern with the complexity and burden of complying with the regulation. Six commenters stated that the proposed amendments would not have a significant cost or burden impact on banks.

Several commenters offered constructive suggestions that were incorporated into the final amendments. In addition, certain organizational changes have been made to assure as much consistency as possible between the respective regulations of the agencies. A section-by-section summary of the final amendments noting changes from the amendments proposed for comment follows.

#### Section 208.24(a) Exceptions and Safe and Sound Operations

The exceptions previously found in current § 208.8(k)(6) and the new section related to safe and sound operations for banks exempt from § 208.24 have been combined into one subsection and moved to the front of the regulation, to § 208.24(a). This makes it easier for State member banks to determine whether they qualify for an exemption from the regulation, and if so, what recordkeeping procedures are expected.

<sup>1</sup> 44 FR 43258 (July 24, 1979). The OCC and the FDIC adopted similar rules on the same date, 12 CFR Part 12, 44 FR 43252 (July 24, 1979) and 12 CFR Part 344, 44 FR 43261 (July 24, 1979), respectively.

<sup>2</sup> SEC rule 10b-10, 17 CFR 240.10b-10; rule 17a-3, 17 CFR 240.17a-3; and rule 17a-4, 17 CFR 240.17a-4, all adopted under the Securities Exchange Act.

<sup>3</sup> 60 FR 66759.

<sup>4</sup> The OCC published amendments for comment on December 22, 1995, 60 FR 66517, and adopted final amendments on December 2, 1996, 61 FR 63958. The FDIC published an advanced notice of rulemaking on its regulation on May 24, 1996, 61 FR 26135 and published amendments for comment on December 24, 1996, 61 FR 67729.

The Board is adopting the proposed language in § 208.24(a)(1)(B), which clarifies that State member banks that effect up to 500 government securities brokerage transactions and are exempt from registration under Department of the Treasury regulation 401.3(a)(2)(i), 17 CFR 401.3(a)(2), also are exempt from § 208.24. This exemption is not available if a bank has filed notice or is required to file notice indicating that it acts as a government securities broker or dealer.

The Board also is adopting, with the support of the commenters, a provision on safe and sound operations for banks exempt from § 208.24. The provision codifies the longstanding interpretation of Board staff that principles of safety and soundness require such a bank to maintain effective systems of records and controls regarding customer securities transactions that reflect accurate information and are sufficient to provide an adequate basis for an audit of the information.

#### *Section 208.24(b) Definitions*

The amendments add definitions of: asset-backed security, completion of the transaction, crossing of buy and sell orders, debt security, government security, and municipal security. In general, the new definitions are based on definitions contained in the Securities Exchange Act, or in the SEC's confirmation rule 10b-10, 17 CFR 240.10b-10, and are necessary for applying the confirmation disclosure and the three-day settlement requirements. The definition of "security" has been amended to conform generally to the definition in section 3(a)(10) of the Securities Exchange Act, 15 U.S.C. 78c(a)(10), although the Board has retained the current exclusions from the definition in the final rule.

The definition of "periodic plan" has been modified to include cash management sweep services or other prearranged automated transfers of funds from a deposit account to purchase a security in response to commenters seeking clarification how the transaction notification requirements for periodic plans apply to automatic sweep or transfer arrangements. Finally, the term "dealer bank" in the definition of "customer" has been replaced by the term "municipal securities broker or dealer" to clarify that a bank acting as a municipal securities broker is not a customer for purposes of § 208.24.

#### *Section 208.24(c) Recordkeeping*

The Board is adopting language in § 208.24(c) that clarifies that § 208.24

applies to government securities transactions effected for customers by State member banks and to municipal securities transactions effected by State member banks that are not registered as municipal securities dealers. All recordkeeping requirements are now located in § 208.24(c), and explanatory language that was at the end of the old recordkeeping section has been moved to the beginning of the rule to simplify the section.

#### *Section 208.24(d) Content and Time of Notification*

Section 208.24(d) has been renamed to clarify its subject matter. Substantively, the amendments delete the old five business day requirement for confirmation delivery and provide that confirmations be given or sent to customers "at or by completion of the transaction," defined as the payment and delivery of the securities in § 208.24(b).

The proposed amendments would have deleted the extension of time for State member banks that choose to send confirmations from the executing broker to a customer rather than creating their own confirmations. In response to a commenter who stated that it may be difficult to meet the three-day delivery requirement in this situation, § 208.24(d) now provides that if a State member bank uses a broker-dealer's confirmation, it must give or send the confirmation to its customer within one business day of the bank's receipt of the confirmation.

As proposed, the final amendments require confirmations to: (i) Contain a legend when the security is callable prior to maturity indicating that an early redemption could affect the yield stated on the confirmation and offering additional information on request (§ 208.24(d)(2)(viii)); (ii) disclose the yield and/or resulting dollar price of transactions involving debt securities and asset-backed securities (§ 208.24(d)(2) (ix) and (x)); and, (iii) indicate when a debt security, other than a government security, is unrated by a nationally recognized statistical rating organization (§ 208.24(d)(2)(xii)). These disclosures conform bank confirmations with those of broker-dealers under SEC rule 10b-10 and with longstanding practice in the municipal securities industry.

The Board had requested comment whether it would be preferable to incorporate SEC rules 10b-10, 17a-3 and 17a-4 by reference for State member banks to refer to, rather than specify items of confirmation disclosure in the regulation. All of the comments received on this issue preferred the

current approach, i.e., to specify the disclosures required to be contained on confirmations in the regulation.

Section 208.24(d)(2)(vi) requires banks to disclose on confirmations the amount of any remuneration received by the bank on the transaction. In response to commenters who pointed out that SEC rule 10b-10(a)(2)(i)(D) provides more flexibility to brokers in this area, the final amendments provide that a State member bank may elect to disclose whether it has or will receive remuneration from a party other than the customer and offer to furnish the information within a reasonable time on request.

#### *Section 208.24(e) Notification by Agreement; Alternative Forms and Times*

Section 208.24(e) has been renamed to indicate that it deals with alternative arrangements for the delivery of notifications of securities transactions to customers. Substantive changes have been made to § 208.24(e)(5), pertaining to notifications of transactions in periodic plans, to conform more completely with securities industry requirements. Formerly, the regulation required that a notification be provided to a customer "as soon as possible after each transaction." The Board is amending this requirement to require notification "not less than every three months" for all periodic plans other than cash management sweep accounts. As requested by two commenters, the final amendments provide that a notification of a transaction involving a cash management sweep service should be given or sent to a customer "for each month in which a securities transaction takes place but not less than every three months if there are no securities transactions."<sup>5</sup> These amendments will provide more flexibility to State member banks in scheduling notifications in periodic plans and conform with SEC rule 10b-10(b)(2).

#### *Section 208.24(f) Settlement of Securities Transactions*

The amendments to § 208.24(f) update the regulation to require State member banks to settle transactions effected for customers within the "standard settlement cycle for broker-dealers in the United States" unless the parties agree to a different settlement date at the time of the transaction. The standard settlement cycle currently is three business days (T+3) after the trade date.

<sup>5</sup> Notwithstanding the provisions of this paragraph, banks that retain custody of government securities that are the subject of a hold-in-custody purchase agreement are subject to the requirements of 17 CFR 403.5(d).

The requirement applies to transactions in securities that would fall under SEC rule 15c6-1, 17 CFR 240.15c6-1, for broker-dealers, and brings banks into line with the rest of the securities industry in this area.

The commenters were nearly split with respect to the rule's use of the term "standard settlement cycle for broker-dealers in the United States" rather than specifying T+3 for sending customer confirmations. Four commenters favor the approach taken in the rule, while three commenters would specify T+3. The Board has determined to adopt the proposed language as it will avoid having to amend the regulation to reflect expected future modifications to the standard settlement cycle. Moreover, the same term is used in the Board's Regulation T and has not engendered any confusion.

#### *Section 208.24(g) Securities Trading Policies and Procedures*

The amendments add § 208.24(g)(1)(iii) that requires State member banks to establish supervisory procedures and reporting lines for back office personnel that are separate from those established to oversee personnel accepting orders and effecting transactions. All comments received on this provision favored its adoption.

With respect to filing notices of personal securities transactions by bank officers and directors under § 208.24(g)(4), the Board notes that affected individuals that file similar reports under SEC rule 17j-1, 15 CFR 270.17j-1, for investment advisers, do not need to file a separate notice to satisfy Regulation H requirements.

#### *Regulatory Flexibility Act*

The Board certifies that the final rule will have no significant economic impact on a substantial number of small entities. While the final rule adds certain confirmation disclosure requirements, it also streamlines and reduces other confirmation, recordkeeping and regulatory burdens for State member banks engaged in certain securities transactions for customers.

#### *Paperwork Reduction Act*

In accordance with section 3506 of the Paperwork Reduction Act of 1995 (44 U.S.C. Ch. 35; 5 CFR 1320 Appendix A.1), the Board reviewed the rule under the authority delegated to the Board by the Office of Management and Budget. The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, this information collection unless it displays a currently

valid OMB control number. The OMB control number is 7100-0196.

The collection of information requirements in this regulation are found in 12 CFR 208.24. This information is required to evidence compliance with the requirements of section 208.24 of Regulation H. The respondents are for-profit financial institutions. Records must be retained for three years.

No comments specifically addressing the burden estimate were received.

The proposed amendments would provide for only a minor addition in disclosure practices of state member banks, would not increase the banks' reporting requirements to the Federal Reserve, and would have a negligible effect on respondent burden. The estimated burden is 3 minutes per response. There are 1,214 respondents and the number of their recordkeeping and notification occurrences varies with the amount and type of securities transactions. The total annual recordkeeping and disclosure burden for these respondents is estimated to be 165,520 hours. Based on an hourly cost of \$20, the annual cost to the public is estimated to be \$3,310,400.

Because the records would be maintained at state member banks and the notices are not provided to the Federal Reserve, no issue of confidentiality under the Freedom of Information Act arises.

The Federal Reserve has a continuing interest in the public's opinions of our collections of information. At any time, comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, may be sent to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, DC 20551; and to the Office of Management and Budget, Paperwork Reduction Project (7100-0196), Washington, DC 20503.

#### *List of Subjects in 12 CFR Part 208*

Accounting, Agriculture, Banks, banking, State member banks, Confidential business information, Crime, Currency, Federal Reserve System, Flood insurance, Mortgages, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, the Board amends 12 CFR Part 208 as set forth below:

### **PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)**

1. The authority citation for Part 208 continues to read as follows:

Authority: 12 U.S.C. 36, 248(a), 248(c), 321-338a, 371d, 461, 481-486, 601, 611, 1814, 1820(d)(8), 1823(j), 1828(o), 1831o, 1831p-1, 3105, 3310, 3331-3351, and 3906-3909; 15 U.S.C. 78b, 781(b), 781(g), 781(i), 78o-4(c)(5), 78q, 78q-1 and 78w; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106 and 4128.

#### **§ 208.8 [Amended]**

2. In § 208.8 paragraph (k) is removed and reserved.

3. A new § 208.24 is added to subpart A to read as follows:

#### **§ 208.24 Recordkeeping and confirmation of certain securities transactions effected by State member banks.**

(a) *Exceptions and safe and sound operations.*

(1) A State member bank may be excepted from one or more of the requirements of this section if it meets one of the following conditions of paragraphs (a)(1)(i) through (a)(1)(iv) of this section:

(i) *De minimis transactions.* The requirements of paragraphs (c)(2) through (c)(4) and paragraphs (e)(1) through (e)(3) of this section 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, exclusive of transactions in government securities;

(ii) *Government securities.* The recordkeeping requirements of paragraph (c) of this section shall not apply to banks effecting fewer than 500 government securities brokerage transactions per year; provided that this exception shall not apply to government securities transactions by a State member bank that has filed a written notice, or is required to file notice, with the Federal Reserve Board that it acts as a government securities broker or a government securities dealer;

(iii) *Municipal securities.* The municipal securities 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 section; and

(iv) *Foreign branches.* The requirements of this section shall not apply to the activities of foreign branches of a State member bank.

(2) Every State member bank qualifying for an exemption under paragraph (a)(1) of this section that conducts securities transactions for

customers shall, to ensure safe and sound operations, maintain effective systems of records and controls regarding its customer securities transactions that clearly and accurately reflect appropriate information and provide an adequate basis for an audit of the information.

(b) *Definitions.* For purposes of this section:

(1) *Asset-backed security* shall mean a security that is serviced primarily by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the security holders.

(2) *Collective investment fund* shall mean funds held by a State member bank as fiduciary and, consistent with local law, invested collectively as follows:

(i) 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

(ii) 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 (26 U.S.C.).

(3) *Completion of the transaction* effected by or through a state member bank shall mean:

(i) For purchase transactions, the time when the customer pays the bank any part of the purchase price (or the time when the bank makes the book-entry for any part of the purchase price if applicable); however, if the customer pays for the security prior to the time payment is requested or becomes due, then the transaction shall be completed when the bank transfers the security into the account of the customer; and

(ii) For sale transactions, the time when the bank transfers the security out of the account of the customer or, if the security is not in the bank's custody, then the time when the security is delivered to the bank; however, if the customer delivers the security to the bank prior to the time delivery is requested or becomes due then the transaction shall be completed when the bank makes payment into the account of the customer.

(4) *Crossing of buy and sell orders* shall mean a security transaction in which the same bank acts as agent for both the buyer and the seller.

(5) *Customer* shall mean any person or account, including any agency, trust, estate, guardianship, 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, bank acting as a broker or dealer, municipal securities broker or dealer, or issuer of the securities which are the subject of the transactions.

(6) *Debt security* as used in paragraph (c) of this section shall mean any security, such as a bond, debenture, note or any other similar instrument which evidences a liability of the issuer (including any security of this type that is convertible into stock or similar security) and fractional or participation interests in one or more of any of the foregoing; provided, however, that securities issued by an investment company registered under the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq., shall not be included in this definition.

(7) *Government security* shall mean:

(i) A security that is a direct obligation of, or obligation guaranteed as to principal and interest by, the United States;

(ii) A security that is issued or guaranteed by a corporation in which the United States has a direct or indirect interest and which is designated by the Secretary of the Treasury for exemption as necessary or appropriate in the public interest or for the protection of investors;

(iii) A security issued or guaranteed as to principal and interest by any corporation whose securities are designated, by statute specifically naming the corporation, to constitute exempt securities within the meaning of the laws administered by the Securities and Exchange Commission; or

(iv) Any put, call, straddle, option, or privilege on a security as described in paragraphs (b)(7) (i), (ii), or (iii) of this section other than a put, call, straddle, option, or privilege that is traded on one or more national securities exchanges, or for which quotations are disseminated through an automated quotation system operated by a registered securities association.

(8) *Investment discretion* with respect to an account shall mean if the State member bank, directly or indirectly, is authorized to determine what securities or other property shall be purchased or sold by or for the account, or 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.

(9) *Municipal security* shall mean a security which is a direct obligation of, or obligation guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any political subdivision thereof, or any municipal corporate instrumentality of one or more States, or any security which is an industrial development bond (as defined in 26 U.S.C. 103(c)(2) the interest on which is excludable from gross income under 26 U.S.C. 103(a)(1), by reason of the application of paragraph (4) or (6) of 26 U.S.C. 103(c) (determined as if paragraphs (4)(A), (5) and (7) were not included in 26 U.S.C. 103(c)), paragraph (1) of 26 U.S.C. 103(c) does not apply to such security.

(10) *Periodic plan* shall mean:

(i) A written authorization for a State member bank to act as agent to purchase or sell for a customer a specific security or securities, in a specific amount (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 or the manner of calculating them (including dividend reinvestment plans, automatic investment plans, and employee stock purchase plans); or

(ii) Any prearranged, automatic transfer or sweep of funds from a deposit account to purchase a security, or any prearranged, automatic redemption or sale of a security with the funds being transferred into a deposit account (including cash management sweep services).

(11) *Security* shall mean:

(i) Any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, for a security, any put, call, straddle, option, or privilege on any security, or group or index of securities (including any interest therein or based on the value thereof), any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing.

(ii) But does not include a deposit or share account in a federally or state insured depository institution, a loan participation, a letter of credit or other form of bank indebtedness incurred in the ordinary course of business, currency, 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, units of a collective investment fund, interests in a variable amount (master) note of a borrower of prime credit, or U.S. Savings Bonds.

(c) *Recordkeeping.* Except as provided in paragraph (a) of this section, every State member bank effecting securities transactions for customers, including transactions in government securities, and municipal securities transactions by banks not subject to registration as municipal securities dealers, shall maintain the following records with respect to such transactions for at least three years. Nothing contained in this section shall require a bank to maintain the records required by this 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. Records may be maintained in hard copy, automated, or electronic form provided the records are easily retrievable, readily available for inspection, and capable of being reproduced in a hard copy. A bank may contract with third party service providers, including broker/dealers, to maintain records required under this part.

(1) 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 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;

(2) 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;

(3) A separate memorandum (order ticket) of each order to purchase or sell securities (whether executed or cancelled), which shall include:

(i) The account(s) for which the transaction was effected;

(ii) Whether the transaction was a market order, limit order, or subject to special instructions;

(iii) The time the order was received by the trader or other bank employee responsible for effecting the transaction;

(iv) The time the order was placed with the broker/dealer, or if there was

no broker/dealer, the time the order was executed or canceled;

(v) The price at which the order was executed; and

(vi) The broker/dealer utilized;

(4) 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; and

(5) A copy of the written notification required by paragraphs (c) and (d) of this section.

(d) *Content and time of notification.*

Every State member bank effecting a securities transaction for a customer shall give or send to such customer either of the following types of notifications at or before completion of the transaction or; if the bank uses a broker/dealer's confirmation, within one business day from the bank's receipt of the broker/dealer's confirmation:

(1) A copy of the confirmation of a broker/dealer relating to the securities transaction; and 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

(2) A written notification disclosing:

(i) The name of the bank;

(ii) The name of the customer;

(iii) 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;

(iv) 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 specifying 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 customer;

(v) 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;

(vi) 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 Government securities and municipal securities, this paragraph (d)(2)(vi) shall apply only with respect

to remuneration received by the bank in an agency transaction. If the bank elects not to disclose the source and amount of remuneration it has or will receive from a party other than the customer pursuant to this paragraph (d)(2)(vi), the written notification must disclose whether the bank has received or will receive remuneration from a party other than the customer, and that the bank will furnish within a reasonable time the source and amount of this remuneration upon written request of the customer. This election is not available, however, if, with respect to a purchase, the bank was participating in a distribution of that security; or with respect to a sale, the bank was participating in a tender offer for that security;

(vii) 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;

(viii) In the case of a transaction in a debt security subject to redemption before maturity, a statement to the effect that the debt security may be redeemed in whole or in part before maturity, that the redemption could affect the yield represented and that additional information is available on request;

(ix) In the case of a transaction in a debt security effected exclusively on the basis of a dollar price:

(A) The dollar price at which the transaction was effected;

(B) The yield to maturity calculated from the dollar price; provided, however, that this paragraph (c)(2)(ix)(B) shall not apply to a transaction in a debt security that either has a maturity date that may be extended by the issuer with a variable interest payable thereon, or is an asset-backed security that represents an interest in or is secured by a pool of receivables or other financial assets that are subject to continuous prepayment;

(x) In the case of a transaction in a debt security effected on the basis of yield:

(A) The yield at which the transaction was effected, including the percentage amount and its characterization (e.g., current yield, yield to maturity, or yield to call) and if effected at yield to call, the type of call, the call date, and the call price; and

(B) The dollar price calculated from the yield at which the transaction was effected; and

(C) If effected on a basis other than yield to maturity and the yield to maturity is lower than the represented yield, the yield to maturity as well as

the represented yield; provided, however, that this paragraph (c)(2)(x)(C) shall not apply to a transaction in a debt security that either has a maturity date that may be extended by the issuer with a variable interest rate payable thereon, or is an asset-backed security that represents an interest in or is secured by a pool of receivables or other financial assets that are subject to continuous prepayment;

(xi) In the case of a transaction in a debt security that is an asset-backed security which represents an interest in or is secured by a pool of receivables or other financial assets that are subject continuously to prepayment, a statement indicating that the actual yield of such asset-backed security may vary according to the rate at which the underlying receivables or other financial assets are prepaid and a statement of the fact that information concerning the factors that affect yield (including at a minimum, the estimated yield, weighted average life, and the prepayment assumptions underlying yield) will be furnished upon written request of such customer; and

(xii) In the case of a transaction in a debt security, other than a government security, that the security is unrated by a nationally recognized statistical rating organization, if that is the case.

(e) *Notification by agreement; alternative forms and times of notification.* A State member bank may elect to use the following alternative procedures if a transaction is effected for:

(1) 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 as to the time and content of the notification; provided, however, that such agreement makes clear the customer's right to receive the written notification pursuant to paragraph (c) of this section at no additional cost to the customer;

(2) 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, give or send to such person the written notification within a reasonable time. The bank may charge such person a reasonable fee for providing this information;

(3) Accounts, where the bank exercises investment discretion in an agency capacity, in which instance:

(i) The bank shall give or send to each customer not less frequently than once 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

(ii) If requested by the customer, the bank shall give or send to each customer within a reasonable time the written notification described in paragraph (c) of this section. The bank may charge a reasonable fee for providing the information described in paragraph (c) of this section;

(4) 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;

(5) A periodic plan, in which instance the bank:

(i) Shall (except for a cash management sweep service) give or send to the customer a written statement not less than every three months if there are no securities transactions in the account, showing the customer's 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; or

(ii) Shall for a cash management sweep service or similar periodic plan as defined in § 208.24(b)(10)(ii) give or send its customer a written statement in the same form as prescribed in paragraph (e)(i) above for each month in which a purchase or sale of a security takes place in a deposit account and not less than once every three months if there are no securities transactions in the account subject to any other applicable laws or regulations;

(6) Upon the written request of the customer the bank shall furnish the information described in paragraph (c) of this section, 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 paragraph (d) of this section.

(f) Settlement of securities transactions. All contracts for the purchase or sale of a security shall provide for completion of the transaction within the number of business days in the standard settlement cycle for the security followed by registered broker dealers in the United States unless otherwise agreed to by the parties at the time of the transaction.

(g) Securities trading policies and procedures. Every State member bank effecting securities transactions for customers shall establish written policies and procedures providing:

(1) Assignment of responsibility for supervision of all officers or employees who:

(i) Transmit orders to or place orders with broker/dealers;

(ii) Execute transactions in securities for customers; or

(iii) Process orders for notification and/or settlement purposes, or perform other back office functions with respect to securities transactions effected for customers; provided that procedures established under this paragraph (g)(1)(iii) should provide for supervision and reporting lines that are separate from supervision of personnel under paragraphs (g)(1)(i) and (g)(1)(ii) of this section;

(2) 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;

(3) 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

(4) 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. For purposes of this paragraph (g)(4), the term securities does not include government securities.

By order of the Board of Governors of the Federal Reserve System, February 27, 1997.

William W. Wiles,

*Secretary of the Board.*

[FR Doc. 97-5423 Filed 3-4-97; 8:45 am]

BILLING CODE 6210-01-P

## FEDERAL DEPOSIT INSURANCE CORPORATION

### 12 CFR Part 344

RIN 3064-AB74

#### Recordkeeping and Confirmation Requirements for Securities Transactions

**AGENCY:** Federal Deposit Insurance Corporation.

**ACTION:** Final rule.

**SUMMARY:** The Federal Deposit Insurance Corporation (FDIC) is amending its regulations governing the procedures for recordkeeping and confirmation requirements with respect to effecting securities transactions for customers of an insured state nonmember bank or a foreign bank having an insured branch (Bank). The final rule updates, clarifies and streamlines the FDIC regulations and reduces unnecessary regulatory costs and other burdens. The final rule also reorganizes and clarifies the regulation in areas where it previously was confusing. In addition, the FDIC has incorporated significant interpretive positions and updated various provisions to address market developments and regulatory changes by other regulators that affect requirements for recordkeeping and confirmation of securities transactions by Banks.

**DATES:** *Effective date.* The final rule is effective April 1, 1997. *Early compliance.* These revisions may be followed immediately by the affected party.

**FOR FURTHER INFORMATION CONTACT:** Miguel D. Browne, Manager—Risk Policy Development, (202) 898-6789; Keith A. Ligon, Chief, Policy Unit, (202) 898-3618; and John F. Harvey, Review Examiner (Trust), Securities, Capital Markets and Trust Branch, Division of Supervision (202) 898-6762; and Patrick J. McCarty, Counsel, Regulations and

Legislation Section, Legal Division, (202) 898-8708.

#### SUPPLEMENTARY INFORMATION:

##### Background

In 1979, the FDIC adopted part 344 to require Banks under its jurisdiction to establish uniform procedures and recordkeeping and confirmation requirements with respect to effecting securities transactions for customers. The requirements reflected, in part, the recommendations of the Securities and Exchange Commission's (SEC) Final Report of the Securities and Exchange Commission on Bank Securities Activities (June 30, 1977). Part 344's recordkeeping and confirmation requirements were patterned after the SEC's rules applicable to broker/dealers and were intended to serve similar purposes for Banks involved in effecting customers' securities transactions. See 44 FR 43261 (July 24, 1979). The Board of Governors of the Federal Reserve System (FRB) and the Office of the Comptroller of the Currency (OCC) also adopted regulations substantially identical to part 344 in 1979.<sup>1</sup>

The FDIC and the other federal banking agencies are required by section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRI) to review and streamline their regulations to improve efficiency, reduce unnecessary costs and eliminate unwarranted constraints on credit availability. 12 U.S.C. 4803(a). Section 303(a) also requires the federal banking agencies to work jointly to make uniform all regulations and guidelines implementing common statutory or supervisory policies.

On December 22, 1995, the OCC published a notice of proposed rulemaking (60 FR 66517) to revise 12 CFR part 12, the OCC's Recordkeeping and Confirmation Requirements for Securities Transactions regulation. The purpose of the proposal was to modernize part 12, address various market developments and regulatory changes, and reduce regulatory burden, where possible. The OCC published its final rule on December 2, 1996. See 61 FR 63958. The FRB published a substantially similar yet somewhat differently worded proposed rule on December 26, 1995. See 60 FR 66759.

The FDIC published an advance notice of proposed rulemaking on May 24, 1996, soliciting comment on issues similar to those raised in the OCC's and FRB's proposed rules, as well as issues

which the OCC and FRB proposals did not address. See 61 FR 26135. On December 24, 1996, the FDIC published a notice of proposed rulemaking (61 FR 67729) to amend part 344 to address various market developments and regulatory changes, and reduce regulatory burden, where possible. Consistent with Section 303 of CDRI, the FDIC reviewed the OCC rule and the FRB proposal in connection with the preparation of its notice of proposed rulemaking. The FDIC has endeavored to create a rule that is uniform with the other agencies. As part of that effort, the staff of the FDIC has been in contact with the staffs of the FRB and the OCC in connection with the drafting of the final rule. The FDIC's final rule is closer in structure, definitions, language and form to the FRB's proposal than the OCC's final rule, however, all of the agencies' rules are substantively very similar.

#### Comments Received and Changes Made

The FDIC received six comments on the proposal. One comment came from a bank, one from a bank holding company and four comments came from trade associations representing banks, investment companies and accountants. In general, the commenters strongly supported the proposal as promoting uniformity among the Federal bank regulatory agencies, reducing regulatory burdens as well as addressing recent developments in the securities market. Most commenters specifically supported the provision of the proposal that excluded from the scope of part 344 customer transactions conducted directly with a broker/dealer where the customer has a written account agreement with the broker-dealer and the broker-dealer is fully disclosed to the customer. This change would exclude from part 344's coverage commonly utilized contractual relationships between banks and broker/dealers whereby the broker/dealers conducts securities transactions on bank premises, known as networking arrangements.

In addition, certain of the commenters requested specific changes to the proposal. The FDIC has considered each of the comments carefully and has made a number of changes in response to the comments received. Overall, the final rule adopts most of the changes to part 344 as proposed by the FDIC although certain changes have been made in an attempt to increase uniformity with regard to recordkeeping and confirmation requirements among the federal banking regulatory agencies. The section-by-section discussion of this preamble describes the final regulation

<sup>1</sup> See 12 CFR 208.8(k), 44 FR 43258 (July 24, 1979) (FRB regulation); 12 CFR part 12, 44 FR 43254 (July 24, 1979) (OCC regulation).