

## Enhancement to ACATS “Receiver Delete” Functionality for Alternative Investments

### FINRA Reminds Members of Their Obligations Under FINRA Rule 11870

#### Summary

The NSCC<sup>1</sup> administers ACATS, a system that automates and imposes specified duties and performance timeframes to facilitate the transfer of accounts, in whole or in part, from one firm to another. The NSCC recently announced a change to ACATS that will allow a receiving member (the firm slated to receive the customer’s account) to use the “receiver delete” function to remove alternative investments from an ACATS transfer.<sup>2</sup>

This *Notice* reminds members of their obligations under FINRA Rule 11870 (Customer Account Transfer Contracts), including that:

- ▶ members must expedite and coordinate their activities when a customer gives authorized instructions to transfer securities account assets;
- ▶ notwithstanding the availability of the receiver delete function, a member may not remove an asset from an ACATS transfer unless the member has determined that the asset is a “nontransferable asset” as defined in Rule 11870; and
- ▶ a receiving member that uses the receiver delete function to remove certain nontransferable assets from an ACATS transfer is required to provide the customer with a list of the nontransferable assets and request in writing, and prior to the time it designates the assets as nontransferable, instructions from the customer with respect to the disposition of the assets.

Questions concerning this *Notice* should be directed to:

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#### Notice Type

- ▶ Reminder

#### Suggested Routing

- ▶ Compliance
- ▶ Continuing Education
- ▶ Legal
- ▶ Operations
- ▶ Senior Management

#### Key Topics

- ▶ Automated Customer Account Transfer Service (ACATS)
- ▶ Customer Account Transfer Contracts
- ▶ National Securities Clearing Corporation (NSCC)

#### Referenced Rules & Notices

- ▶ FINRA Rule 11870
- ▶ NSCC Important Notice A9188
- ▶ NSCC Important Notice A9038

## Background & Discussion

FINRA Rule 11870 governs the process by which customers can request a transfer of their securities account assets from one broker-dealer firm to another broker-dealer firm and includes timeframes that align with those in ACATS.<sup>3</sup> Most customer account assets move between broker-dealers through ACATS. In general, transfers involving assets such as cash, stocks and bonds of domestic companies, and listed options, are readily transferable through ACATS.<sup>4</sup> The prompt and efficient transfer of customer assets is of critical importance to both investors and the industry. Both firms involved in a customer's transfer request are required to "expedite and coordinate activities with respect to" such transfer.<sup>5</sup>

Specifically, Rule 11870 applies when a customer whose account is carried by a member (the carrying member) wishes to transfer securities account assets, in whole or in part (*i.e.*, in specifically designated part), to the receiving member.<sup>6</sup> If both the receiving member and the carrying member are NSCC members and eligible to use ACATS, and the customer gives the receiving member authorized instructions, the rule requires them to use ACATS to accomplish the account transfer (unless the customer has instructed the transfer to occur outside of ACATS).<sup>7</sup> To meet the fundamental responsibility to expedite and coordinate activities under Rule 11870, it is important for firms to adhere to ACATS protocols and performance timeframes to facilitate account transfers in accordance with the rule.

Rule 11870 recognizes that certain assets ("nontransferable assets") in a customer's account may be incapable of being transferred from the carrying member to the receiving member.<sup>8</sup> A customer authorizing a transfer of securities account assets must be informed (or must affirm or authorize) through inclusion in a transfer instruction that, among other terms, the customer will be contacted in writing by the carrying member or the receiving member with respect to the disposition of nontransferable assets (other than proprietary money market fund assets, if any), indicated on an instruction to transfer specifically designated assets.<sup>9</sup>

Nontransferable assets in a customer's account may include "an asset that is a product of a third party (*e.g.*, mutual fund/money market fund) with which the receiving member does not maintain the relationship or arrangement necessary to receive/carry the asset for the customer's account."<sup>10</sup> If the list of positions to be transferred provided by the carrying member includes such a nontransferable asset, the receiving member must designate that asset as nontransferable.<sup>11</sup> Prior to making such designation, the receiving member must provide the customer with a list of the specific assets that are a product of a third party with which the receiving member does not maintain the relationship or arrangement necessary to receive or carry the asset for the customer's account and request, in writing, further instructions from the customer with respect to the disposition of such assets.<sup>12</sup>

The request should, where applicable, provide the customer with the following alternative methods for the disposition of the specified nontransferable assets:

(A) Liquidation, with a specific indication of any redemption or other liquidation-related fees that may result from such liquidation and that those fees may be deducted from the money balance due the customer. The indication must also refer the customer to the fund prospectus or to their registered representative at the carrying member for specific details regarding any such fees.

(B) Retention by the carrying member for the customer's benefit.

(C) Shipment, physically and directly, in the customer's name to the customer.

(D) Transfer to the third party that is the original source of the product, for credit to an account opened by the customer with that third party.

ACATS provides a "receiver delete" function that a receiving member may use to designate an asset as a nontransferable asset and remove it from the list of assets to be transferred. This function had been limited to assets identified by the carrying member as mutual funds (MFNM or MFMM) or annuities (ANNU) and are assets that the receiving member cannot accept. The enhancement to ACATS, which is underway and is expected to become operational in the fourth quarter of 2022, will expand the scope of this function so that receiving members can also apply the receiver delete function to assets identified by the carrying member as alternative investments (ALT).<sup>13</sup>

FINRA reminds members that a receiving member may not use the receiver delete function to remove an alternative investment (or any other asset) from the list of assets to be included in an ACATS transfer unless the receiving member has determined that it is a nontransferable asset as defined in Rule 11870(c)(1)(D)(ii) — *i.e.*, a product of a third party with which the receiving member does not maintain the relationship or arrangement necessary to receive or carry the asset for the customer's account (or another type of nontransferable asset specified in Rule 11870(c)(1)(D)). Members are also reminded that their obligations do not end with the designation of an asset as nontransferable through the use of this function; they must also comply with their obligations under Rule 11870 to request, in writing, instructions for the disposition of nontransferable assets, and to expedite and coordinate their response to customer instructions with respect to the transfer of customer account assets.

## Endnotes

1. NSCC is a wholly owned subsidiary of The Depository Trust and Clearing Corporation (DTCC).
2. See NSCC Important Notice A9188 (Aug. 8, 2022); see also NSCC Important Notice A9038 (Aug. 11, 2021).
3. See also NSCC Rule 50 (Automated Customer Account Transfer Service).
4. When it is not possible to use ACATS, either because the assets in the account are nontransferable through ACATS, or because one or both of the parties to the transfer do not participate in ACATS, customer account transfers are handled manually. Manual transfers follow similar procedures but can take longer than those occurring electronically.
5. See Rule 11870(a)(1). Members are also required to “promptly resolve” any exception taken to a transfer instruction. See Rule 11870(b)(2).
6. See Rule 11870(m)(1) provides: “When both the carrying member and the receiving member are participants in a registered clearing agency having automated customer securities account asset transfer capabilities and are eligible to use such capabilities, the securities account asset transfer procedure, including the establishing and closing out of fail contracts, must be accomplished in accordance with the provisions of this Rule and pursuant to the rules of and through such registered clearing agency with the exception of specifically designated assets transferred pursuant to the submittal of a customer’s authorized alternate instructions to the carrying member.” Rule 11870(a)(2), however, provides that if “a customer desires to transfer a portion of his or her account outside of [ACATS], authorized alternate instructions should be transmitted to the carrying member indicating such intent and specifying the designated assets to be transferred.” Members are still obligated to expedite all authorized account asset transfers and coordinate their activities with respect thereto.
7. See note 6, *supra*.
8. A “nontransferable asset” is defined in Rule 11870(c)(1)(D) as:
  - an asset that is incapable of being transferred from the carrying member to the receiving member because it is:
    - (i) an asset that is a proprietary product of the carrying member;
    - (ii) an asset that is a product of a third party (e.g., mutual fund/money market fund) with which the receiving member does not maintain the relationship or arrangement necessary to receive/carry the asset for the customer’s account;
    - (iii) an asset that may not be received due to regulatory limitations on the scope of the receiving member’s business;
    - (iv) an asset that is a bankrupt issue for which the carrying member does not possess (which shall be deemed to include possession at a securities depository for the carrying member’s account) the proper denominations or quantity of shares necessary to effect delivery and no transfer agent is available to re-register the shares;
    - (v) an asset that is an issue for which the proper denominations cannot be obtained pursuant to governmental regulation or the issuance terms of the product (e.g., foreign securities, baby bonds, etc.);
    - (vi) limited partnership interests in retail accounts.
9. See Rule 11870(c)(1)(B).
10. See Rule 11870(c)(1)(D)(ii).
11. See Rule 11870(c)(2).
12. See Rule 11870(c)(4).
13. See NSCC Important Notice A9188 (Aug. 8, 2022).

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