INFORMATIONAL

Operations

SEC Approves NASD Rule Proposal Relating to Operations; Effective Date: **September 12**, **2001**

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Executive Representatives
- Legal & Compliance
- Operations
- Senior Management

KEY TOPICS

- ACATS Rules
- Uniform Practice Code

Executive Summary

On September 12, 2001, the Securities and Exchange Commission (SEC) approved amendments to National Association of Securities Dealers, Inc. (NASD®) Rule 11870(c) and Rule 11870(d)¹ that are designed to expedite the transfer of customer accounts that contain proprietary or third-party products (e.g., mutual funds or money market funds) that the receiving member cannot receive or carry.

The text of the amendments as provided in Attachment A became effective on September 12, 2001.

Questions/Further Information

Questions concerning this *Notice* may be directed to Susan DeMando, Director, Financial Operations, Member Regulation, NASD Regulation, at (202) 728-8411, or Shirley H. Weiss, Associate General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8844.

Discussion

NASD Regulation has amended Uniform Practice Code Rules 11870(c) and 11870(d) to conform to recent modifications to the Automated Account Transfer Service (ACATS).2 The new procedures will expedite the transfer of accounts containing third-party and/or proprietary products.3 The account transfer process starts when a customer whose account is carried by a member firm ("carrying member") wishes to transfer the account to another member (the "receiving member") and submits a signed broker-to-broker transfer instruction to the receiving member. The receiving member submits the instruction to the

carrying member, and the carrying member has three business days either to validate and return the transfer instruction to the receiving member (with an attachment reflecting all positions and money balances as shown on its books) or to take exception to the instruction. Specifically, the carrying member: (1) identifies any assets in the account that it knows are nontransferable, including any asset that is a proprietary product of the carrying member, (2) identifies these assets to the customer in writing, and (3) requests instructions from the customer with respect to the disposition of such assets. The customer may ask the carrying member to liquidate the asset. continue to retain the asset, or transfer the asset in the customer's name to the customer.

A customer's account may also contain third-party products (e.g., mutual fund/money market fund) that the receiving firm can neither receive nor carry because it does not maintain the necessary relationship or arrangement with appropriate third parties. The carrying member would not have identified those assets as non-transferable because it would not know whether the receiving member could receive/carry the asset.

Under the prior rules, the carrying member attempted to transfer all third-party assets with the rest of the account within three business days following the validation of a transfer instruction. When the receiving member could not receive or carry the asset, it would reverse the transfer of those assets and send them back to the carrying member. In turn, customers received statements with multiple entries for assets that were unsuccessfully transferred and returned.

NASD Notice to Members 01-66

Under the amendments to Rule 11870(c) and 11870(d), the receiving member will review the asset validation report, designate those proprietary and/or third-party assets it is unable to receive/carry, provide the customer with a list of those assets, and request instructions from the customer regarding their disposition. The customer may instruct the receiving member to liquidate the asset, continue to retain the asset, transfer the asset in the customer's name to the customer, or transfer the asset to the third party that is the original source of the product. Most importantly, the transfer of the other assets in the account will occur simultaneously with the receiving member's designation of nontransferable assets.

These procedures should eliminate the need for reversing the transfer of third-party and/or proprietary products, thereby reducing delay and the cost of customer transfers incurred by members under the current system. These procedures also will substantially reduce customer confusion in that customers will no longer receive multiple account statements from the carrying and receiving firms as they transfer and then reverse transactions.

Under Rule 11870(d)(3)(C), a member may take exception to a transfer instruction if the account number was invalid, *i.e.*, the account number was not on the carrying member's books. Rule 11870(d)(3)(C), as amended, makes clear that the carrying member is responsible for tracking account number changes. An account number that has been

changed due to internal reassignment of an account to another broker or account executive with the carrying member will not be considered invalid for purposes of taking exception to a transfer instruction.

Effective Date of Amendments

These amendments became effective on September 12, 2001.

Endnotes

- See SEC Release No. 34-44787 (Sept. 12, 2001), 66 FR 48301 (Sept. 19, 2001) (File No. SR-NASD-2001-53) ("SEC Approval Order").
- ACATS is administered by the National Securities Clearing Corporation (NSCC).
- 3 These changes also conform to a recent amendment to the Interpretation of New York Stock Exchange (NYSE) Rule 412. See SEC Release No. 34-44596 (July 26, 2001), 66 FR 40306 (Aug. 2, 2001).

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NASD Notice to Members 01-66

ATTACHMENT A

New language is underlined; deletions are in brackets.

Uniform Practice Code

11870. Customer Account Transfer Contracts

- (a) and (b) No change
- (c) Transfer Instructions
- (1) Account transfers accomplished pursuant to this Rule are subject to the following conditions, which the customer must be informed of, affirm, or authorize through their inclusion in the transfer instruction form required to be completed and signed to initiate the account transfer:
 - (A) No change.
 - (B) The customer will be contacted in writing by the carrying member, <u>and/or by the receiving</u> <u>member</u>, with respect to the disposition of any assets in the account that are nontransferable.
 - (C) and (D) No change.
 - (E) The carrying member and the receiving member must promptly resolve and reverse any nontransferable assets [which] that were not properly identified during validation. In all cases, each member shall promptly update [their] its records and bookkeeping systems and notify the customer of the action taken.
- (2) A proprietary product of the carrying member shall be deemed nontransferable unless the receiving member has agreed to accept transfer of the product. Upon receipt of the asset validation report, the receiving member shall designate any assets that are 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. The carrying member, upon receipt of such designation, may treat such designated assets as nontransferable and refrain from transferring the designated assets.
- [(2)] (3) If an account includes any nontransferable assets that are proprietary products of the carrying member, the carrying member must provide the customer with a list of the specific assets and request, in writing and prior to or at the time of validation of the transfer instruction, further instructions from the customer with respect to the disposition of such assets. In particular, such request [,] should provide, where applicable, the customer with the following alternative methods of disposition for nontransferable assets:
 - (A) through (C) No change.
- (4) If an account to be transferred includes any nontransferable assets that the receiving member has designated as assets that are 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

NASD Notice to Members 01-66

customer's account, the receiving member must provide the customer with a list of the specific assets and request, in writing and prior to the time it makes such designation, further instructions from the customer with respect to the disposition of such assets. In particular, such request should, where applicable, provide the customer with the following alternative methods of disposition for 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.
 - (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.
- [(3)] (5) If the customer has authorized liquidation or transfer of [such] assets <u>deemed to be</u> <u>nontransferable</u>, the carrying member must distribute[d] the resulting money balance to the customer or initiate the transfer within five (5) business days following receipt of the customer's disposition instructions.
- [(4)] (6) With respect to transfers of retirement plan securities accounts, the customer authorizes the custodian/trustee for the account:
 - (A) and (B) No change.

(d) Validation of Transfer Instructions

- (1) and (2) No change.
- (3) A carrying member may take exception to a transfer instruction only if:
 - (A) and (B) No change.
- (C) the account number is invalid (account number is not on carrying member's books); however, if the carrying member has changed the account number for purposes of internally reassigning the account to another broker or account executive, it is the responsibility of the carrying firm to track the changed account number, and such reassigned account number shall not be considered invalid for purposes of fulfilling a transfer instruction.
 - (D) through (L) No change.
- (4) through (8) No change.
- (e) through (n) No Change