

# Notice to Members

AUGUST 2004

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Senior Management

## KEY TOPICS

Automated Customer Account Transfer  
Service (ACATS)  
Rule 11870

GUIDANCE

## Partial Customer Account Transfers

SEC Grants Accelerated Approval of Rule Change  
Relating to Transfers of Specifically Designated Customer  
Account Assets through the Automated Customer  
Account Transfer Service (ACATS); **Effective Date:  
September 13, 2004**

### Executive Summary

On July 14, 2004, the Securities and Exchange Commission (SEC) granted accelerated approval of amendments to Rule 11870 making the procedures for transferring specifically designated customer account assets through the ACATS system consistent with the procedures for transferring securities account assets in their entirety through the ACATS system unless the customer authorizes a partial transfer of assets to be facilitated outside of ACATS.<sup>1</sup> The amendments also permit customers to authorize an account transfer, in whole or in part, via electronic signature in a format recognized as valid under federal law to conduct interstate commerce. These changes conform to recent amendments to New York Stock Exchange Rule 412 and the Interpretation of Rule 412. The amendments become effective on September 13, 2004, to allow firms sufficient time to develop and implement any necessary systems changes. The text of the amendments is provided in Attachment A.

### Questions/Further Information

Questions concerning this *Notice* may be directed to the Financial Operations Department at (202) 728-8211.

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## Discussion

ACATS is a system administered by the National Securities Clearing Corporation (NSCC) that automates and standardizes procedures for the transfer of assets in a customer account from one firm to another. Rule 11870 mandates the use of ACATS when both the carrying member and the receiving member are participants in a registered clearing agency having automated customer securities account transfer capabilities and are eligible to use such capabilities, and sets forth the procedures for members to use when transferring customer assets between members.

The amendments to Rule 11870 clarify that the procedures for transferring specific assets in a customer account through ACATS are consistent with the procedures for transferring the entire account through ACATS, unless the customer specifically requests and authorizes a transfer of assets outside of ACATS. Under Rule 11870, as amended, customers continue to have the option of submitting alternate authorized instructions (e.g., Letters of Authorization or LOAs) to a carrying firm in order to effect the transfer of "specifically designated assets," *i.e.*, partial transfers from one broker-dealer to another outside of the ACATS system. The transfers of such assets outside of the ACATS system continue to be subject to the requirement that members process such transfers expeditiously.<sup>2</sup>

Because customer and broker-dealer obligations resulting from the transfer of an entire account differ from the obligations arising from the transfer of specified assets within an account that will remain active at the delivering firm, the amendments to Rule 11870 distinguish between the transfer of security account assets "in whole" (*i.e.*, transfer of entire accounts) and security account assets "in specifically designated part" (*i.e.*, partial transfers). For example, it would not be necessary for a customer to instruct the delivering firm as to the disposition of his or her non-transferable mutual fund holdings if the customer is not transferring the account in whole.

Previously, Rule 11870 specified that a customer who wishes to transfer his or her account to another member must give "written notice of that fact to the receiving member" and must "sign" a broker-to-broker transfer instruction form. The amendments to Rule 11870 permit customers to authorize an account transfer, in whole or in part, via electronic signature "in a format recognized as valid under federal law to conduct interstate commerce."<sup>3</sup> Thus, under amended Rule 11870, customer authorization of a transfer instruction can be either the customer's actual signature or a valid electronic signature. Further, Rule 11870, as amended, no longer requires specific formats with respect to transfer instructions or reports, since the NSCC no longer requires specific formats with respect to transfer instructions or reports for use with the ACATS system.

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## Endnotes

- 1 See Release No. 34-50018 (July 14, 2004), 69 FR 43873 (July 22, 2004) (File No. SR-NASD-2004-058).
- 2 See Rule 11870(a).
- 3 See "Electronic Signatures in Global and National Commerce Act" 15 U.S.C. §§ 7001 *et seq.* (2004).

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## ATTACHMENT A

Below is the text of the proposed rule change. Additions are underlined; deletions are in brackets.

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### 11870. Customer Account Transfer Contracts

#### (a) Responsibility to Expedite Customer's Request

(1) When a customer whose securities account[(s)] is carried by a member (the "carrying member") wishes to transfer [the entire] securities account[(s)] assets, in whole or in specifically designated part, to another member (the "receiving member") and gives [written notice of that fact] authorized instructions to the receiving member, both members must expedite and coordinate activities with respect to the transfer.

(2) If a customer desires to transfer a portion of [an] his or her account outside of ACATS, [a letter of authorization] authorized alternate instructions should be transmitted to the carrying member indicating such intent and specifying the [portion of the account] designated assets to be transferred. Although such transfers are not subject to the provisions of this [r]Rule, members must expedite all authorized [partial transfers of customer securities accounts] account asset transfers, whether through ACATS or via other means permissible under this Rule, and coordinate their activities with respect thereto. Unless otherwise indicated, [T]the automated customer account transfer capabilities referred to in paragraph (m)(1) of this Rule shall be utilized for partial transfers.

(3) For purposes of this Rule, customer authorization pursuant to a transfer instruction could be the customer's actual signature, or an electronic signature in a format recognized as valid under federal law to conduct interstate commerce.

#### (b) Transfer Procedures

(1) Upon receipt from the customer of [a signed] an authorized broker-to-broker transfer instruction form ("TIF") to receive such customer's securities account[(s)] assets in whole or in specifically designated part, from the carrying member, the receiving member must immediately submit such instruction to the carrying member. The carrying member must, within three business days following receipt of such instruction, or receipt of a TIF received directly from the customer authorizing the transfer of assets in specifically designated part: (A) validate [and return] the transfer instruction to the receiving member (with an attachment reflecting all positions and money balances to be transferred as shown on its books); or (B) take exception to the transfer instruction for reasons other than securities positions or money balance discrepancies and advise the receiving member of the exception taken.

(2) The carrying member and the receiving member must promptly resolve any exceptions taken to the transfer instruction.

### (c) Transfer Instructions

(1) Securities [A] account asset transfers accomplished pursuant to this Rule are subject to the following conditions, which the customer must be informed of, affirm, or authorize (as the case may be) through their inclusion in the transfer instruction [form] the customer is required to [be completed and signed] authorize to initiate the account asset transfer:

(A) To the extent any account assets [in the account] are not readily transferable, with or without penalties, such assets may not be transferred within the time frames required by [the] this Rule.

(B) The customer will be contacted in writing by the carrying member, and/or by the receiving member, with respect to the disposition of [any] nontransferable assets [in the account that are nontransferable.] other than proprietary money market fund assets (if any), indicated in an instruction to transfer specifically designated account assets. (See subparagraph (c)(D)(3) below for customer notification requirements pertaining to transfers of securities account assets in whole.)

(C) If [With respect to transfers of] securities accounts assets in whole other than retirement plan [securities] account[s] assets are being transferred, the customer must affirm[s] that he or she has destroyed or returned to the carrying member any credit/debit cards and/or unused checks issued in connection with the account.

(D) For purposes of this Rule, a “nontransferable asset” shall mean 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 the proper denominations 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.

(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 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.

(3) If [an] securities account assets to be transferred in whole include[s] 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) 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) Transfer, physically and directly, in the customer's name to the customer.

(4) If [an] securities account assets to be transferred in whole include[s] 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 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. The indication must also refer the customer to the fund prospectus or to their registered representative at the carrying firm 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.

(5) If the customer has authorized liquidation or transfer of assets deemed to be nontransferable, the carrying member must distribute the resulting money balance to the customer or initiate the transfer within five (5) business days following receipt of the customer's disposition instructions.

(6) With respect to transfers of retirement plan securities account[s] assets, the customer authorizes the custodian/trustee for the account:

(A) to deduct any outstanding fees due the custodian/trustee from the credit balance in the account, or

(B) if the account does not contain a credit balance, or if the credit balance in the account is insufficient to satisfy any outstanding fees due the custodian/trustee, to liquidate assets in the account to the extent necessary to satisfy any outstanding fees due the custodian/trustee.

#### **(d) Validation of Transfer Instructions**

(1) Upon validation of an [transfer] instruction to transfer securities account assets in whole, a carrying member must "freeze" the account to be transferred, i.e., all open orders, with the exception of option positions [which] that expire within seven (7) business days, must be canceled and no new orders may be taken.

(2) A carrying member may not take exception to a transfer instruction, and therefore deny validation of the transfer instruction, because of a dispute over securities positions or the money balance in the account to be transferred. Such alleged discrepancies notwithstanding, the carrying member must transfer the securities positions and/or money balance reflected on its books for the account.

(3) A carrying member may take exception to a transfer instruction only if:

(A) additional documentation is required (additional legal documents such as death or marriage needed);

(B) the account is "flat" and reflects no transferable assets;

(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) it is a duplicate request;

(E) violates member's credit policy;

- (F) unrecognized residual credit asset (receiving member cannot identify client);
- (G) client rescinds instruction (client submitted written request to cancel transfer);
- (H) S.S. number/Tax ID mismatch (number does not correspond to carrying member's);
- (I) account title mismatch (receiving member's account title does not correspond to carrying member's);
- (J) account type mismatches (receiving member's account type does not correspond to carrying member's);
- (K) missing or improper [A]authorization [Signature] (TIF requires an additional client [signature] authorization or successor custodian's acceptance [signature] authorization or custodial approval); or
- (L) Client takes possession (account assets in question [(entire account is) are in transfer to deliver direct to customer).

(4) If a carrying member takes exception to a transfer instruction because the account is "flat", as provided in subparagraph (3)(B) above, the receiving member may re-submit the transfer instruction only if the most recent customer statement is attached.

(5) (A) Upon validation of [a] an [transfer] instruction[,] to transfer securities account assets in whole or in specifically designated part, the carrying member must return the transfer instruction to the receiving member with an attachment indicating all securities positions, [any] safekeeping positions, and [any] money balances to be transferred [in the account] as shown on the books of the carrying member. Except as hereinafter provided, the attachment must include a then-current market value for all assets [in the account] so indicated. If a then-current market value for an asset cannot be determined (e.g., a limited partnership interest), the asset must be valued at original cost. However, delayed delivery assets, nontransferable assets, and assets in transfer to the customer, i.e., in possession of the transfer agent at the time of receipt of the transfer instruction by the carrying member for shipment, physically and directly to the customer, need not be valued, although the "delayed delivery," "nontransferable," or "in-transfer" status, respectively, of such assets must be indicated on the attachment.

(B) For purposes of this Rule, a "safekeeping position" shall mean any security held by a carrying member in the name of the customer.

(6) Upon validation of [a] an [transfer] instruction to transfer securities account assets in whole or in specifically designated part, the carrying member must indicate on the instruction, or by attachment, any Regulation T calls outstanding as of the date of validation with respect to the account assets to be transferred.

(7) A carrying member must provide the following description, at a minimum, as asset data with respect to any municipal securities positions to be transferred that have not been assigned a CUSIP number: [in an account it is to transfer:]

(A) name of the issuer;

(B) interest rate and dated date;

(C) maturity date and put date, if applicable, and if the securities are limited tax, subject to redemption prior to maturity (callable), or revenue bonds; an indication to such effect, including in the case of revenue bonds, the type of revenue, if necessary for a materially complete description of the securities; and

(D) if necessary for a materially complete description of the securities, the name of any company or other person in addition to the issuer obligated, directly or indirectly, with respect to debt service, or if there is more than one such obligor, the statement "multiple obligors" may be shown.

(8) After validation of the transfer instruction by the carrying member, a receiving member may reject a[n account] transfer of account assets in whole only if the account is not in compliance with the receiving member's credit policies or minimum asset requirements. (A receiving member may deem an account not in compliance with Regulation T requirements as not in compliance with its credit policies.) A receiving member, however, may only reject [an] the entire account for such reasons; it may not reject only a portion of the account assets (e.g., the particular assets not in compliance with the member's credit policies or minimum asset requirement) while accepting the remainder.

#### **(e) Completion of the Transfer**

Within three business days following the validation of a transfer instruction, the carrying member must complete the transfer of the customer's security account[(s)] assets to the receiving member. The receiving member and the carrying member must immediately establish fail-to-receive and fail-to-deliver contracts at then-current market values upon their respective books of account against the long/short positions [in the customer's account[(s)]] that have not been [physically] delivered/received and the receiving/carrying member must debit/credit the related money amount. The customer's security account[(s)] assets shall thereupon be deemed transferred.

**(f) Fail Contracts Established**

(1) Any fail contracts resulting from this securities account asset transfer procedure shall be included in a member's fail file and, not later than 10 business days following the date delivery was due, the member shall take steps to obtain physical possession or control of securities so failed to receive by initiating a buy-in procedure or otherwise; provided, that with respect to the following types of securities or instruments, not later than 30 business days following the date delivery was due, the member shall take steps to obtain physical possession or control of securities so failed to receive by initiating a buy-in procedure or otherwise:

- (A) banker's acceptances;
- (B) bond anticipation notes;
- (C) certificates of deposit;
- (D) commercial paper;
- (E) FMAC certificates;
- (F) FNMA certificates;
- (G) foreign securities;
- (H) GNMA certificates;
- (I) limited partnership interests;
- (J) municipal bonds;
- (K) mutual fund shares (transferable);
- (L) revenue anticipation notes;
- (M) SBA certificates; and
- (N) tax anticipation notes.

(2) A carrying member may not reject ("DK") a fail contract, including a Receive/Deliver Instruction generated by an automated customer account transfer system, in connection with assets in an account transferred that have not been delivered to the receiving member.

(3) All fail contracts established pursuant to the requirements of this Rule should be clearly marked or captioned as such. This paragraph will not apply if a fail contract participates in a repricing and reconfirmation service offered by a registered clearing agency.

(4) All fail contracts required to be established on safekeeping positions must be so indicated.

(5) Open fail contracts established pursuant to the requirements of this Rule should be marked-to-market regularly.

(6) Nontransferable assets and assets in transfer to the customer are exempt from the requirement in paragraph (e) of this Rule that fail-to-receive and fail-to-deliver contracts must be established for positions in a customer's securities account that have not been [physically] delivered.

(7) Members may agree to close out fail contracts established pursuant to the requirements of this [r]Rule through the delivery of securities that are substantially comparable to those owed with prior consent of the customer.

(8) A receiving member should reject a delivery of a security that cannot be deemed a safekeeping position against a fail contract as such.

(9) A receiving member must deem receipt of a duly executed limited partnership change of trustee form with respect to limited partnership interests or a mutual fund re-registration form with respect to mutual fund shares as adequate delivery for purposes of transferring such assets pursuant to the Rule.

**(g) Prompt Resolution of Discrepancies**

(1) Any discrepancies relating to positions or money balances that exist or occur after transfer of a customer's securities account assets must be resolved promptly.

(2) The carrying member must promptly distribute to the receiving member any transferable assets [which] that accrue to the account after the transfer of a customer's securities account.

(3) When a member receives a [written] claim [letter] notice relating to a[n] securities account asset transfer, the member must resolve the claim within five (5) business days from receipt of such [letter] claim or [respond in writing] take exception to the claiming member by setting forth specific reasons for denying the claim.

**(h) and (i)** No change

**(j) Exemptions**

(1) Pursuant to the Rule 9600 Series, [the Association] NASD may exempt from the provisions of this Rule, either unconditionally or on specified terms and conditions, (A) any member or (B) any type of account, security or financial instrument.

(2) The following assets are deemed subject to delayed delivery and are exempt from paragraph (e) of this Rule that valued fail-to-receive and fail-to-deliver contracts must be established for positions in a customer's securities account that have not been [physically] delivered:

- (A) insurance policies (annuities);
- (B) stripped coupons;
- (C) when-issued or when-distributed securities.

(3) Zero value fail-to-receive and fail-to-deliver instructions shall be generated for the assets specified in paragraph (j)(2) hereof.

#### **(k) Retirement Plan Securities Accounts**

(1) It is the responsibility of the receiving member to obtain the approval of its custodian/trustee accepting a customer's retirement plan securities account before submitting a transfer instruction for such [an] account assets to the carrying member or its custodian/trustee to facilitate transfer of the account assets.

(2) If, with respect to the transfer of a retirement plan securities account assets, outstanding fees are due the custodian/trustee for the account, such fees must be deducted from the credit balance in the account or, if the account does not contain a credit balance or if the credit balance is insufficient to satisfy such fees, assets in the account must be liquidated to the extent necessary to satisfy such fees. If liquidation of assets in the account is not practicable, such fees must then be transferred to and accepted by the receiving member as a debit item with the account.

#### **(l) Securities Account[s]**

For the purposes of this Rule, the term "securities account[(s)]" shall be deemed to include any and all of the account's[(s')] money market fund positions or the redemption value thereof.

#### **(m) Participant in a Registered Clearing Agency**

(1) 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 [r]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.

(2) When such registered clearing agency has the capability to transfer mutual fund positions or to employ functionalities including Partial Transfer Receive (PTR), Partial Transfer Delivery (PTD), Fail Reversal, Mutual Fund Fail Cleanup, or Reclaim Processing, such capability must be utilized with the exception of specifically designated assets transferred pursuant to the submittal of a customer's authorized alternate instructions to the carrying member. [both the carrying member and the receiving member are participants in a registered clearing agency having automated customer securities account transfer capabilities with an automated facility for transferring mutual fund positions such facilities must be utilized for transferring mutual fund positions.]

(3) When securities account assets are transferred in whole and [both the carrying member and the receiving member are participants in a] such registered clearing agency [having automated customer securities account transfer capabilities with a facility for] has the capability to transfer[ring] residual credit positions (both cash and securities) [which] that have accrued to an account after the account has been transferred (residual credit processing), such [facilities] capability must be utilized for transferring residual credit positions from the carrying member to the receiving member.

(4) When both the carrying member and the receiving member are participants in a registered clearing agency having automated customer securities account asset transfer capabilities with a facility permitting electronic transmittal of customer account assettransfer instructions, such facilities shall be used in accordance with the following:

(A) members using such facilities shall execute an agreement designated by the Committee specifying the rights, obligations and liabilities of all participants in or users of such facilities;

(B) customer account transfer instructions shall be transmitted in accordance with the procedures prescribed by the registered clearing agency;

(C) the transmittal of a transfer request through such electronic facilities shall constitute a representation by the receiving member that it has received a properly executed [Transfer Instruction Form] TIF or other actual authority to receive the customer's securities and funds[; and]

(D) transfer instructions transmitted through such facilities shall contain the information necessary for the clearing agency and the carrying member to respond to the transfer instruction as may be specified by this Rule and the clearing agency[.] and;

(E) non-standard ACAT processing, such as Partial Transfer Receives (PTR), Partial Transfer Deliver (PTD) Fail Reversal, and reclaim processing shall be transmitted through such facilities, if the facility permits.

(5) For purposes of this Rule, the term "registered clearing agency" shall be deemed to be a clearing agency as defined in the Act and registered in accordance with that Act.

#### **(n) Transfers Accomplished Ex-Clearing**

(1) If one or both of the members processing a customer account transfer pursuant to this Rule is not a member of a registered clearing agency, the fail-to-receive and fail-to-deliver contracts required to be established in paragraph (e) of this Rule must be established outside a clearing corporation on an "ex-clearing house" basis. Similarly, settlement of the fail contracts and any close-out executions must be made "ex-clearing house."

(2) Each member (including members that do not utilize automated customer securities account asset transfer facilities) is required, [to transfer,] for a minimum period of six (6) months after [an account] the transfer of securities account assets in whole is completed, to transfer credit balances (both cash and securities) that occur is such transferred account assets within (10) ten business days after the credit balances accrue to the account.

(3) A copy of each customer account transfer instruction issued pursuant to paragraph (b) on an “ex-clearing house” basis shall be forwarded to the local District Office of [the Association] NASD having jurisdiction over the carrying member.

[(4) Members must use the transfer instructions and provide the reports prescribed by the Association when accomplishing account transfers pursuant to this Rule. The Association deems the transfer instruction and reports required by the National Securities Clearing Corporation (“NSCC”) in connection with its automated customer account transfer system, and transfer instructions and reports that are substantially similar to those required by the NSCC as acceptable for the purpose of accomplishing transfers of accounts under this Rule; except that members must use the standard transfer forms required under Rule 11580 to transfer limited partnership securities unless exempted from the requirements of that Rule.]

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