

## ICI OPERATIONS

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# Operational Process Flows and Considerations Related to Dealer/Custodian Resignations

The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers.

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# Operational Process Flows and Considerations Related to Dealer/Custodian Resignations

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# Introduction

In recent years, changes in mutual fund distribution have often been driven by evolving business models designed to satisfy new regulatory requirements. An example of this is intermediaries' response to the (now defunct) Department of Labor (DOL) fiduciary rule.<sup>1</sup> Financial intermediaries<sup>2</sup> responded in part to the rule by reviewing their business models that support mutual fund shareholders—sometimes amending or adopting new policies regarding the categories of shareholders and the types of mutual fund accounts the intermediary supports.<sup>3</sup>

When intermediaries implemented their new or modified policies, some chose to resign as broker-dealer of record or as both broker-dealer of record and custodian on certain accounts, especially those that were tax-deferred accounts (e.g., individual retirement accounts [IRAs] and certain retirement plans). In other more limited instances, some mutual funds identified situations where their limited-purpose broker-dealer or self-directed retirement custodian needed to resign as a broker-dealer or custodian, respectively, on certain accounts. Changes made to intermediary and fund policies regarding the business relationships they support in response to the DOL fiduciary rule remain largely in effect even with the rule's demise.

Activity around resignations increased over a relatively short time frame driven by the DOL fiduciary rule's applicability date. To support the industry's implementation of strategies in response to the DOL fiduciary rule, an Investment Company Institute (ICI) industry working group published the initial version of this paper, documenting the high-level operational process flow and common protocols related to the dealer and custodian resignation processes. In 2018, a working group of the ICI Broker/Dealer Advisory Committee (BDAC) reviewed the document in lieu of the demise of the DOL fiduciary rule and found that the original considerations and practices outlined remain applicable to managing dealer and custodian resignations.

Each high-level process flow is outlined in separate flowcharts and processes to best address the potential scenarios based upon where the shareholder position resides—direct-at-fund (i.e., held directly on the fund's records) or held at the intermediary—and whether the account has a custodian involved. This document is not intended to provide any legal advice and should not be relied on for that purpose. It is intended to serve only as a tool to assist fund industry product and operations staff in their independent evaluation of their mutual fund products as they consider their options for facilitating effective implementation of and compliance with internal policies.

ICI will continue to update this document as industry practices warrant to assist ICI members and business partners in better understanding and addressing broker-dealer and custodial resignations.

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<sup>1</sup> The fiduciary rule, announced in April 2016, expanded the definition of “fiduciary” under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code when giving investment advice to certain retirement plans and IRA owners for a fee or other compensation. The United States Fifth Circuit Court of Appeals overturned the rule on March 15, 2018, and issued its mandate to vacate the rule in its entirety on June 21, 2018.

<sup>2</sup> *Financial intermediaries* refer to broker-dealers, financial advisers, retirement plan recordkeepers, banks, and trusts.

<sup>3</sup> Mutual fund shares are typically held in one of two models: an intermediary-controlled model, where the intermediary holds fund shares on behalf of the underlying shareholder, provides all shareholder servicing, and may provide investment advice (depending on intermediary channel); or a direct-at-fund model, where the mutual fund itself holds the shareholder's account on its books in the name of the shareholder and acts as the shareholder servicing agent. In the latter model, a financial adviser providing investment advice is often associated with the account.

## Resignation as Broker-Dealer of Record Only

Appendix A reflects the high-level operational process flow and critical steps required for a party to resign as broker-dealer of record only in mutual fund and 529 plan accounts.<sup>4</sup> It is anticipated that, in most cases, an intermediary will be the party resigning as broker-dealer of record, and the fund's limited purpose broker-dealer, or no broker-dealer at all, will be associated with the account going forward. However, there may be instances where the intermediary will want to pull an account on the fund's books and records into its omnibus position (e.g., the intermediary is placing the shareholder into its advisory platform). In such circumstances, the fund's limited purpose broker-dealer will be the entity resigning as broker-dealer of record. Therefore, the high-level process flow provided in Appendix A and the considerations outlined below are intended to cover both situations.

It should be noted that the process to resign as broker-dealer of record will vary based on where recordkeeping responsibilities related to the account lie and where the account is held, directly on the books and records of the fund's transfer agent<sup>5</sup> or on the books and records of the intermediary.<sup>6</sup> Please refer to Appendix A when reviewing the following section for all of the critical steps in the broker-dealer resignation process.

### Accounts Held Direct-at-Fund<sup>7</sup>

#### Communication

Clear, concise, and timely communication between the parties is critical throughout the resignation process. Before resigning as broker-dealer of record, it is expected that the resigning party (e.g., intermediary) will notify the receiving party (e.g., fund) of its intent to resign. At the time of notification, the parties should address:

- » Timing of the resignation: When will the resignation take place?
- » Number and types of accounts affected: The receiving party will want to understand the scope of accounts<sup>8</sup> involved and may request that a detailed listing be provided by the resigning party.
- » Notification to affected shareholders: The receiving party will want to know when the affected shareholders were (or will be) notified by the resigning party of its intention to resign as broker-dealer of record. The parties may choose to negotiate who will assume responsibility for the notification process, including how the affected shareholders will be notified, when notification will occur, and which parties need to review and preapprove any related communications.

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<sup>4</sup> In 2018, a working group of the ICI Broker/Dealer Advisory Committee reviewed the recommended process flows considering 529 plan account structures and relationships. Because the custodian of 529 plan assets remains the plan itself regardless of where assets are held, a custodial resignation would not apply to 529 plan accounts.

<sup>5</sup> For purposes of this paper, *direct-at-fund* includes accounts opened by check and application with a named broker-dealer, as well as National Securities Clearing Corporation (NSCC) Networking Matrix Level 0 (non-Trust Networked) and 4 accounts, and accounts without a matrix level assigned.

<sup>6</sup> *Held at the intermediary* includes NSCC Networking Matrix Level 3, Trust Networked Level 0, and omnibus accounts.

<sup>7</sup> For purposes of this paper, it is assumed that the accounts involved are active accounts in good standing on the fund's books and that the fund has critical shareholder data on file (e.g., name, address, Social Security number, date of birth).

<sup>8</sup> The receiving party may have restrictions or limitations on receiving certain types of accounts (e.g., foreign accounts, small balance accounts). Negotiations may be needed to address how such accounts will be handled and by which party.

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- » Mechanics of the resignation process: When will the receiving party remove the resigning party from the account? Will the removal occur via the NSCC or manually by the receiving party?

## Necessary Data Points

After agreement has been reached regarding responsibilities and following completion of the notification process, the receiving party may consider a review of the relevant accounts to ensure that all necessary data points<sup>9</sup> are on file to permit acceptance of the broker-dealer resignation. If the receiving party identifies accounts where the minimum required data are missing, the receiving party will follow its normal policies and procedures to solicit the information directly from the shareholders.

## Processing of Resignation

If the accounts are held direct-at-fund, the receiving party (e.g., the fund) will be responsible for removing the resigning party from the accounts as broker-dealer of record and will either designate the fund's limited purpose broker-dealer as associated with the account or will not have any broker-dealer connected to the account. This decision will be based on the fund's policies and procedures. At this point, the receiving party should communicate with the affected shareholders as appropriate.

## Accounts Held by Intermediary<sup>10</sup>

### Communication

Clear, concise, and timely communication between the parties is critical throughout the resignation process. Before resigning as broker-dealer of record, it is expected that the resigning party (e.g., intermediary) will notify the receiving party (e.g., fund) of its intent to resign. For Trust Networked accounts,<sup>11</sup> the designated Trust entity must be included in the communication process, whether it's a tri-party consultation or a conversation between the resigning party and the Trust. At the time of notification, conversations should take place between all parties addressing:

- » Timing of the resignation: When will the resignation take place?
- » Number and types of accounts affected: The receiving party will want to understand the number of and types of accounts<sup>12</sup> involved and may request that a detailed listing be provided by the resigning party.
- » Preliminary file of affected accounts: The parties should consider if the resigning party needs to send a pre-file of affected accounts for the receiving party to review.

<sup>9</sup> Refer to Appendix C for the minimum data points necessary under each resignation scenario.

<sup>10</sup> It is assumed that the accounts involved are active accounts in good standing on the intermediary's books and that the intermediary has critical shareholder data on file (e.g., name, address, Social Security number, date of birth).

<sup>11</sup> *Networked* refers to the NSCC's Networking service, which supports the exchange and reconciliation of investor account activity data. The Networking service is segmented into three levels, with Level 3 (accounts controlled by broker-dealers) being the most common. For Trust Networked Accounts (Networked Level 0), the bank as the designated Trust generally provides all investor servicing and reporting.

<sup>12</sup> The receiving party may have restrictions or limitations on receiving certain types of accounts (e.g., foreign accounts, small balance accounts, or certain retirement plans where the receiving party may not offer or support the appropriate prototype plan document). Negotiations may be needed to address how such accounts will be handled and by which party.

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- » Notification to affected shareholders: The receiving party will want to know if the affected shareholders have been notified by the resigning party of its intention to resign as broker-dealer of record. The parties may choose to negotiate who will assume responsibility for the notification process,<sup>13</sup> including how the affected shareholders will be notified and at what point in the process the notification will occur.
- » Indemnification: The receiving party may require indemnification from the resigning party regarding the transaction and involved accounts.
- » Mechanics of the resignation process: Will the transfer of accounts be initiated by the resigning party through the NSCC? Is a supplemental data file needed? Which party will establish the new accounts? Will there be manual intervention at any point in the process?

## Necessary Data Points

After agreement has been reached regarding responsibilities and following completion of the notification process, the resigning party will send a file of affected accounts to the receiving party, along with the appropriate data points.<sup>14</sup> The receiving party may consider a review of the affected accounts to ensure that all data points needed for acceptance of the broker-dealer resignation have been received. If the receiving party identifies accounts where the minimum required data are missing, that party should follow its normal policies to solicit the information directly from the shareholder.

## Processing of Resignation

If the accounts are held by the intermediary, the resigning party is responsible for establishing the new account and transferring the shares to the receiving party. Once the new account has been established, the receiving party is responsible for removing the resigning party from the account as broker-dealer of record<sup>15</sup> and will either designate its own limited-purpose broker-dealer as associated with the account or, based on its policies and procedures, the receiving party may not associate any broker-dealer with the account. The receiving party should then communicate with the affected shareholders as appropriate.

Industry recommended practice is for the resigning party to establish the new account and then transfer the shares through NSCC Networking using B50/F51 (new account/new account acknowledgment) and B52/F53 (transfer/transfer acknowledgment) records. For IRAs and other retirement accounts, as applicable, the resigning party should include beneficiary information as appropriate in the applicable Networking record fields normally used to report 529 plan beneficiary information. In some cases, the receiving party's service provider may not be able to automatically pull in the beneficiary information. Therefore, the receiving party may need to create a report of the beneficiary information to be used for manual data entry.

<sup>13</sup> When the accounts are held by the intermediary, the receiving party (i.e., the fund) generally does not have access to the shareholder details necessary to send a notification. Therefore, if it is agreed that the receiving party will assume responsibility for the notification, the intermediary will need to provide the necessary shareholder information. If the intermediary does not provide the shareholder information, the notification will take place later in the resignation process.

<sup>14</sup> Refer to Appendix C for the minimum data points necessary under each resignation scenario.

<sup>15</sup> The intermediary may reach an agreement with the fund that the intermediary will establish the new account with the fund's limited purpose broker-dealer listed as the broker-dealer of record, rather than having the fund update the broker-dealer of record after the fact.

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If the parties are not able to process the establishment and transfer of accounts through NSCC Networking, the resigning party should provide all relevant data points using the standard spreadsheet layout provided in Appendix C.

## Resignation as Broker-Dealer of Record and as Custodian

Appendix B reflects the high-level operational process flow and critical steps for a party to resign as broker-dealer of record and as custodian. In such a scenario, the fund's custodian and its limited purpose broker-dealer or no broker-dealer at all will be associated with the account going forward. However, there may be instances where the intermediary pulls an account from the fund's books and records in-house. When this occurs, the fund's limited purpose broker-dealer will resign as broker-dealer of record and the fund's custodian will resign as custodian on the account. The high-level process flow provided in Appendix B and the considerations outlined below are intended to cover both situations.

It should be noted that the process to resign as broker-dealer of record will vary based on where recordkeeping responsibilities related to the account lie and where the account is held—directly on the books and records of the fund's transfer agent<sup>16</sup> or on the books and records of the intermediary.<sup>17</sup> Please refer to Appendix B when reviewing the following section for all of the critical steps tied to the broker-dealer and custodial resignation process.

### Accounts Held Direct-at-Fund<sup>18</sup>

#### Communication

Clear, concise, and timely communication between the parties is critical throughout the resignation process. Before resigning as broker-dealer of record and custodian, it is expected that the resigning party (e.g., intermediary) will notify the receiving party (e.g., fund) of its intent to resign. At the time of notification (and before resignation), conversations should take place between the parties addressing:

- » Timing of the resignation: When will the resignation take place?
- » Appointment of a successor custodian: Has the resigning custodian identified and appointed<sup>19</sup> a successor custodian?
- » Number and types of accounts affected: The receiving party will want to understand the number and types of accounts<sup>20</sup> affected and may request that a detailed listing be provided by the resigning party.

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<sup>16</sup> *Direct-at-fund* includes NSCC Networking Matrix Level 0 (non-Trust Networked) and 4 accounts as well as accounts without a matrix level assigned.

<sup>17</sup> *Held at the intermediary* includes NSCC Networking Matrix Level 3, Trust Networked Level 0, and omnibus accounts.

<sup>18</sup> It is assumed that the accounts involved are active accounts in good standing on the fund's books and that the fund has critical shareholder data on file (e.g., name, address, Social Security number, date of birth).

<sup>19</sup> Appointment assumes that the designated successor custodian has agreed to serve in that role.

<sup>20</sup> The receiving party may have restrictions or limitations on receiving certain types of accounts (e.g., foreign accounts, small balance accounts). Negotiations may be needed to address how such accounts will be handled and by which party.

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- » Notification to affected shareholders: The receiving party will want to know when the affected shareholders were (or will be) notified by the resigning party of its intention to resign as broker-dealer of record and custodian and which parties require pre-review and approval of the communication. Parties resigning as custodian should review their custodial agreements and documents and consult with legal counsel to ensure that they follow proper resignation protocol (e.g., Can the notice of resignation be provided by negative consent or is positive consent required? What is the required number of days in advance that notice must be provided?).<sup>21</sup>
- » Preliminary file of affected accounts: The parties should consider the value of sending a pre-file of relevant accounts for the receiving party to review.
- » Mechanics of the resignation process: Which party will establish the new account and process the transfer of assets? Will the process occur via the NSCC or be processed manually by the receiving party?

## Necessary Data Points

Upon completion of the notification process and when agreement has been reached regarding both responsibilities and the mechanics of the process, the receiving party may consider a review of the affected accounts to ensure that all necessary data points<sup>22</sup> are on file for acceptance of the broker-dealer and custodial resignation. If the receiving party identifies accounts where the minimum required data are missing, it should work with the resigning party to obtain necessary information.

Note: In situations where the receiving party has agreed to serve as successor custodian, the receiving party should consider at what point during the resignation process it will provide its prototype custodial agreement to the relevant shareholders. To allow the registration process to be as automated as possible, the receiving party should consider negative consent as a possible alternative for delivering the new prototype custodial agreement to shareholders.<sup>23</sup>

## Processing of Resignation

In this scenario, the receiving party (e.g., the fund) will be responsible for transferring the shares to a new account (with the successor custodian) and removing the resigning party from the account as broker-dealer of record and designating its limited purposed broker-dealer as associated with the account or stating that no broker-dealer is connected to the account based on its policies and procedures. At this point, the receiving party should consider any communications or reach out to the affected shareholder as appropriate.

<sup>21</sup> Parties resigning as custodian should develop a process/procedure to address the small number of shareholders who may choose to opt out of the appointment of a successor custodian.

<sup>22</sup> Refer to Appendix C for the minimum data points necessary under each resignation scenario.

<sup>23</sup> Funds/intermediaries should consult legal counsel when considering this option.

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## Accounts Held by Intermediary<sup>24</sup>

### Communication

Clear, concise, and timely communication between the parties is critical throughout the resignation process. Before resigning as broker-dealer of record and custodian, it is expected that the resigning party (e.g., intermediary) will notify the receiving party (e.g., fund) of its intent to resign. For Trust Networked accounts,<sup>25</sup> the Trust entity must be included in the communication process, whether it is a tri-party consultation or a conversation between the resigning party and the Trust. At the time of notification (and before resignation), conversations should take place between all parties addressing:

- » Timing of the resignation: When will the resignation take place?
- » Appointment of a successor custodian: Has the resigning custodian identified and appointed<sup>26</sup> a successor custodian?
- » Number and types of accounts<sup>27</sup> affected: The receiving party will want to understand the number of and types of accounts affected and may request that a detailed listing be provided by the resigning party.
- » Preliminary file of affected accounts: The parties should consider if the resigning party needs to send an initial file of affected accounts for the receiving party to review.
- » Notification to affected shareholders: The receiving party will want to know if the affected shareholders have been notified by the resigning party of its intention to resign as broker-dealer of record and custodian. Parties resigning as custodian should review their custodial agreements and documents and consult legal counsel to ensure that they follow proper resignation protocol (e.g., Can the notice of resignation be provided by negative consent or is positive consent required? What is the required number of days in advance that notice must be provided?).<sup>28</sup>
- » Indemnification: The receiving party may require indemnification from the resigning party regarding the transaction and affected accounts.
- » Mechanics of the resignation process: Will the transfer of accounts be initiated by the resigning party through the NSCC? Is a supplemental data file needed? Which party will establish the new account? Will manual intervention be needed at any point in the process?

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<sup>24</sup> For purposes of this paper, it is assumed that the accounts involved are active accounts in good standing on the intermediary's books and that the intermediary has critical shareholder data on file (e.g., name, address, Social Security number, date of birth).

<sup>25</sup> *Networked* refers to the NSCC's Networking service, which supports the exchange and reconciliation of investor account activity data. The Networking service is segmented into three levels, with Level 3 (accounts controlled by broker-dealers) being the most common. For Trust Networked Accounts (Networked Level 0), the bank as the designated Trust generally provides all investor servicing and reporting.

<sup>26</sup> Appointment assumes that the designated custodian has agreed to serve as successor custodian.

<sup>27</sup> The receiving party may have restrictions or limitations on receiving certain types of accounts (e.g., foreign accounts, small balance accounts, or certain retirement plans where the receiving party may not offer or support the appropriate prototype plan document). Negotiations may be needed to address how such accounts will be handled and by which party.

<sup>28</sup> Parties resigning as custodian should develop a process/procedure to address the small number of shareholders who may choose to opt out of the appointment of a successor custodian.

## Necessary Data Points

After agreement has been reached regarding responsibilities and the process and following completion of the notification process, the resigning party will send to the receiving party a file of affected accounts and the appropriate data points.<sup>29</sup> The receiving party may consider a review of the affected accounts to ensure all necessary data points have been received for acceptance of the broker-dealer and custodian resignation. If the receiving party identifies accounts where the minimum required data are missing, it should work with the resigning party to obtain necessary information.

Note: In situations where the receiving party has agreed to serve as successor custodian, the receiving party should consider at what point during the resignation process it will provide its prototype custodial agreement to the relevant shareholders. To allow the registration process to be as automated as possible, the receiving party should consider negative consent as a possible alternative for delivering the new prototype custodial agreement to shareholders.<sup>30</sup>

## Processing of Resignation

In this scenario, the resigning party is responsible for establishing the new account and transferring the shares to the receiving party, ideally via NSCC. Once the new account has been established, the receiving party is responsible for removing the resigning party from the account as broker-dealer of record<sup>31</sup> and designating its own limited purpose broker-dealer as associated with the account. Or, based on its policies and procedures, the receiving party may not connect any broker-dealer to the account. The receiving party should then communicate with the affected shareholders as appropriate.

The industry recommended practice is for the resigning party to establish the new account and then transfer the shares through NSCC Networking using B50/F51 (new account/new account acknowledgment) and B52/F53 (transfer/transfer acknowledgment) records. The resigning party should include beneficiary information as appropriate in the applicable Networking record fields normally used to report 529 plan beneficiary information. In some cases, the receiving party's service provider may not be able to automatically pull in the beneficiary information. Therefore, the receiving party may need to create a report of the beneficiary information to be used for manual data entry.

If the parties are not able to process the establishment and transfer of accounts through the NSCC, the resigning party should provide the relevant data points using the standard spreadsheet layout provided in Appendix C.

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<sup>29</sup> Refer to Appendix C for the minimum data points necessary under each resignation scenario.

<sup>30</sup> Funds/intermediaries should consult legal counsel when considering this option.

<sup>31</sup> The intermediary may reach an agreement with the fund that the intermediary will establish the new account with the fund's limited purpose broker-dealer listed as the broker-dealer of record, rather than having the fund update the broker-dealer of record after the fact.

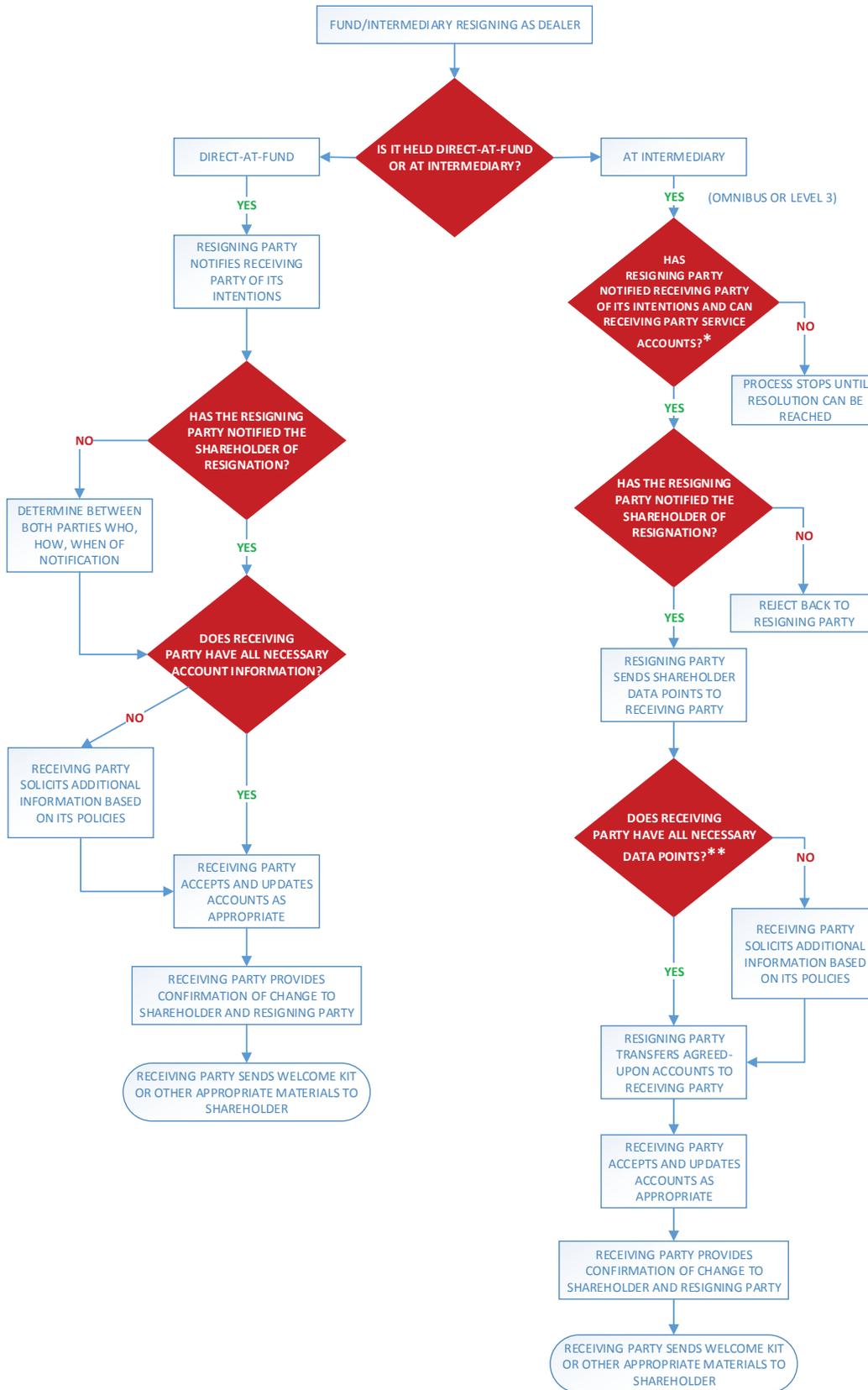
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## Summary

This paper was designed as a tool to assist fund and intermediary operations staff in developing processes and procedures to address circumstances where financial intermediaries, and mutual funds, may choose to resign as broker-dealer of record or as both broker-dealer of record and custodian on certain tax-deferred accounts. The key theme that carries through the scenarios outlined above is the need for proactive, detailed communication between all affected parties. Clear, concise, comprehensive communication is critical to the successful and smooth transition of accounts between parties. Funds and intermediaries should use the information in this paper to inform their communication plans and related processes and procedures for dealer and custodial resignations.

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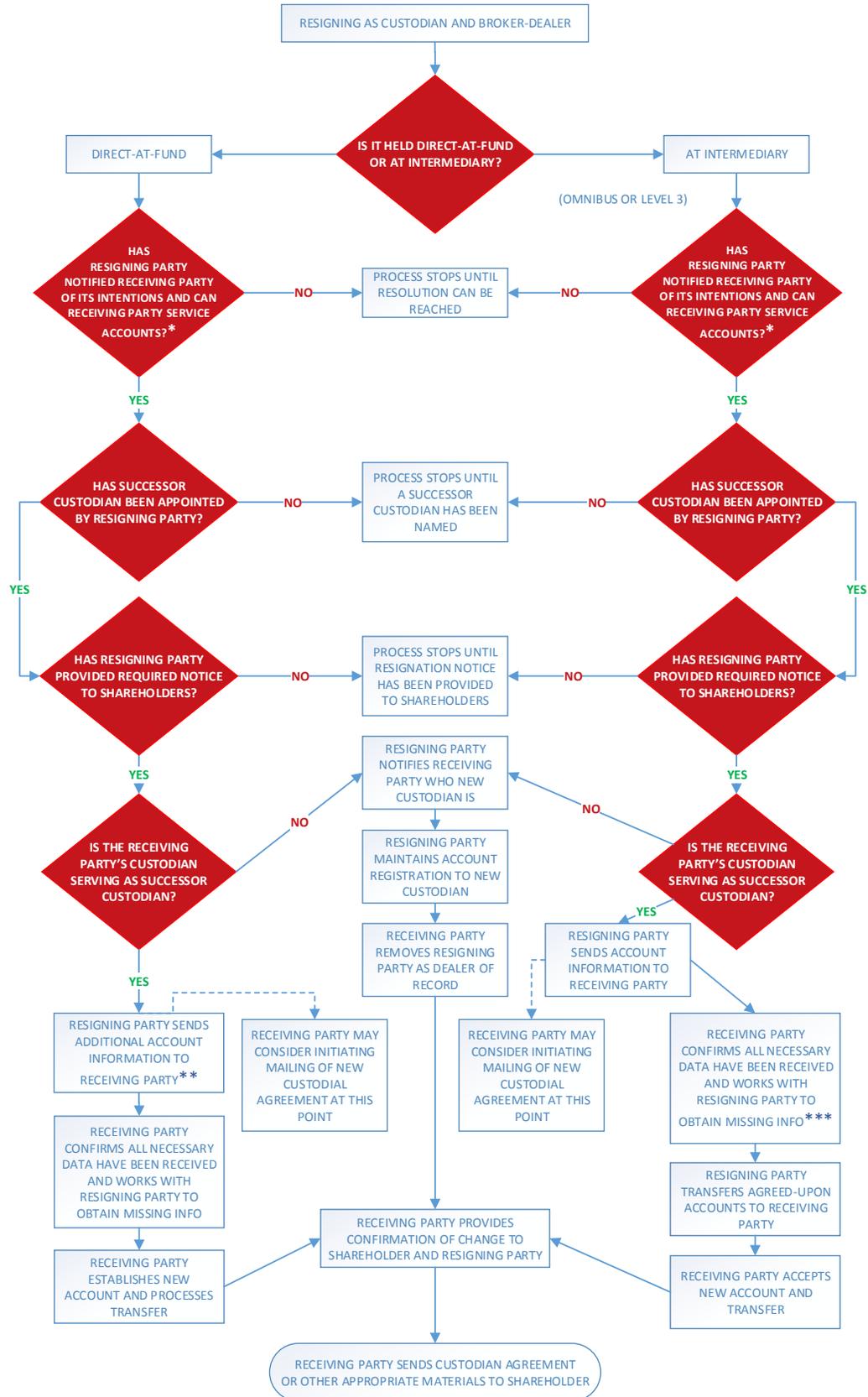
# Appendix A: Resigning as Broker-Dealer of Record Only



\* PARTIES MAY WANT TO CONSIDER WHETHER THERE IS VALUE IN SENDING A PRE-FILE WITH ACCOUNT DETAILS.

\*\* FUND MAY ALREADY HAVE SOME DATA POINTS ON FILE FOR DISCLOSED LEVEL 3 ACCOUNTS.

# Appendix B: Resigning as Broker-Dealer of Record and Custodian



\* PARTIES MAY WANT TO CONSIDER WHETHER THERE IS VALUE IN SENDING PRE-FILE WITH ACCOUNT DETAILS.  
 \*\* RECEIVING PARTY WILL GENERALLY REQUIRE ADDITIONAL INFORMATION RELATED TO ROLE AS CUSTODIAN (E.G., BENEFICIARY INFO).  
 \*\*\* FUND MAY ALREADY HAVE SOME DATA POINTS ON FILE FOR DISCLOSED LEVEL 3 ACCOUNTS.

## Appendix C: Minimum Required Data Points and File Layouts

The file layouts available by download below include the minimum required data points necessary for the receiving party to accept the resignation of a dealer of record or the resignation of a dealer of record and custodian. If the resignation process takes place outside of the NSCC, the file layouts should be used to facilitate the resignation and transfer process. Additionally, these file layouts may be used when sending pre-files to the receiving party in advance of the transfer process.

Download an [Excel file](#) of these sample layouts.