Regulatory Notice 10-18

Master Accounts and Sub-Accounts

FINRA Issues Guidance on Master and Sub-Account Arrangements

April 2010

Notice Type

- Guidance

Suggested Routing

- Compliance
- Legal
- Operations
- Regulatory Reporting
- Senior Management

Key Topics

- Master/Sub-Accounts

Executive Summary

FINRA reminds firms that maintain master/sub-account arrangements that, depending on the facts and circumstances of such arrangements, a firm may be required to recognize the sub-accounts as separate customer accounts for the purposes of applying FINRA rules, the federal securities laws and other applicable federal laws.[1]

Questions concerning this *Notice* should be directed to:

- Kris Dailey, Vice President, Risk Oversight & Operational Regulation, at (646) 315-8434;
- Glen Garofalo, Director, Credit Regulation, at (646) 315-8464; or
- Kathryn M. Moore, Assistant General Counsel, Office of General Counsel, at (202) 974-2974.

Background & Discussion

The application of many FINRA rules, federal securities laws and other applicable federal laws depends on the nature of the account and the identity of its beneficial owners. At times, an account may take the form of a master/sub-account arrangement where the beneficial ownership interests in the various sub-accounts may or may not be identified to the firm. FINRA recognizes there are bona fide reasons to establish master/sub-account arrangements whereby the same beneficial owner maintains multiple sub-accounts (for example, to employ different trading strategies or to trade in different asset classes). However, certain master/sub-account arrangements raise questions regarding whether the master account and all sub-accounts have the same beneficial owner and, therefore, whether they can legitimately be viewed as one customer account for purposes of FINRA rules, the federal securities laws and other applicable federal laws.

FINRA
Financial Industry Regulatory Authority

In some instances, an investment adviser or introducing firm may establish a master account that maintains multiple sub-accounts that differentiate and identify the beneficial ownership of each sub-account. In such instances, the firm knows the identity of each beneficial owner of the sub-accounts and must recognize such sub-accounts as separate customer accounts for purposes of applying FINRA rules, the federal securities laws and other applicable federal laws.

However, there are other legitimate business arrangements where the identities of the beneficial owners are not disclosed to the firm. For example, FINRA recognizes that an "investment adviser" as defined by the Investment Advisers Act of 1940 and acting in such bona fide capacity (referred to as a "bona fide IA"), may employ sub-accounts for each account it advises without identifying the beneficial owner of each account for which it advises. Similarly, in omnibus clearing arrangements, a broker-dealer that is registered with the Securities and Exchange Commission (SEC) pursuant to the Securities Exchange Act of 1934 (referred to as a "registered IBD") may procure clearing services for the customer accounts it services on a basis in which the identities of the sub-account owners are not disclosed to the clearing broker-dealer. In these limited cases involving a bona fide IA or a registered IBD, FINRA generally will permit a firm to rely upon the information provided to it by the bona fide IA or the registered IBD as to whether to treat a master/sub-account as having a single beneficial owner.

Apart from the general principles outlined above, if a firm has actual notice that the sub-accounts of a master account have different beneficial ownership (but does not know the identities of the beneficial owners) or the firm is privy to facts and/or circumstances that would reasonably raise the issue as to whether the sub-accounts, in fact, may have separate beneficial owners (and therefore is on "inquiry notice"), then the firm must inquire further and satisfy itself as to the beneficial ownership of each such sub-account. A firm would be on inquiry notice if, for example:

1. the sub-accounts are separately documented and/or receive separate reports from the firm;
2. the firm addresses the sub-accounts separately in terms of transaction, tax or other reporting;
3. the services provided to the sub-accounts engender separate surveillance and supervision of the sub-account for compliance with rules or for risk management purposes consistent with the review of separately owned accounts;
4. the firm has financial arrangements or transactions with the sub-accounts, or separate account terms, that reasonably raise questions concerning whether such accounts represent separate beneficial owners;
5. the sub-accounts incur charges for commissions, clearance and similar expenses, separately, based upon the activity only of that subject sub-account;

6. the firm has evidence of financial transactions or transfers of assets or cash balances that would reasonably evidence separate beneficial ownership of the sub-accounts;
7. the firm is aware of or has access to a master account or like agreement that evidences that the sub-accounts have different beneficial owners;
8. the firm has evidence that a party maintaining a master/sub-account arrangement has interposed sub-accounts that have or are intended to have the effect of hiding the beneficial ownership interest; or
9. the number of sub-accounts maintained is so numerous as to reasonably raise questions concerning whether such accounts represent separate beneficial owners.
10. Items 3, 4, 5, 6, 8 and 9 above would not apply in the case of a registered IBD or a bona fide IA arrangement described in this *Notice*.

This list is not exhaustive and is only included to reflect some types of "red flags" that would put a firm on inquiry notice that the sub-accounts may have separate beneficial owners.

When a firm becomes aware of the identities of the beneficial owners of the sub-accounts pursuant to its duties arising from actual notice or inquiry notice outlined above, the firm will be required to recognize the sub-accounts as separate customer accounts for purposes of applying FINRA rules, the federal securities laws and other applicable federal laws.

Endnotes

1 For purposes of this *Notice*, reference to the term "laws" shall include any rules and regulations that apply in furtherance of those provisions.