

NASD NOTICE TO MEMBERS 97-58

NASD Regulation
Requests Comment On
Proposed Interpretive
Material 1031 Regarding
Cold Calling Activity;
**Comment Period
Expires October 31,
1997**

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Government Securities
- Institutional
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training
- Variable Contracts

Executive Summary

In the following document, NASD Regulation, Inc. (NASD RegulationSM) requests comment on proposed NASD[®] Interpretive Material 1031 (IM-1031), which would: (1) require registration as a representative for all persons associated with a member who communicate with members of the public, except existing customers of the member, for the purpose of soliciting the purchase of securities or related services or identifying prospective customers and (2) prohibit any member from engaging or using any unregistered person to communicate on behalf of the member with members of the public, except existing customers of the member, to solicit the purchase of securities or related services or identify prospective customers. IM-1031 would permit unregistered persons to contact existing customers for three limited purposes only: (A) extending invitations to firm-sponsored events at which any substantive presentations and account or order solicitation will be conducted by appropriately registered personnel, (B) inquiring whether the existing customer wishes to discuss investments with a registered person, and (C) determining whether the existing customer wishes to receive investment literature from the firm.

Questions concerning this *Request For Comment* should be directed to Gary L. Goldsholle, Senior Attorney, Office of General Counsel, NASD Regulation, at (202) 728-8104.

Request For Comment

NASD Regulation encourages all members and interested parties to respond to the issues raised in this *Notice*. Comments should be mailed to:

Joan Conley
Office of the Corporate Secretary
NASD Regulation, Inc.
1735 K Street, NW
Washington, D.C. 20006-1500;

or e-mailed to:
pubcom@nasd.com

Comments must be received by **October 31, 1997**. Before becoming effective, any interpretive material or rule change developed as a result of comments received must be adopted by the NASD Regulation, Inc. Board of Directors, may be reviewed by the NASD Board of Governors, and must be approved by the SEC.

NASD REGULATION REQUEST FOR COMMENT 97-58

Executive Summary

NASD Regulation, Inc. (NASD RegulationSM) requests comment on proposed NASD[®] Interpretive Material 1031 (IM-1031), which would require registration as a representative for all persons associated with a member who communicate with members of the public, except existing customers of the member, for the purpose of soliciting the purchase of securities or related services or identifying prospective customers. IM-1031 also would prohibit any member from engaging or using any unregistered person to communicate on behalf of the member with members of the public, except existing customers of the member, to solicit the purchase of securities or related services or identify prospective customers. Lastly, IM-1031 would permit unregistered persons to contact existing customers for three limited purposes only: (1) extending invitations to firm-sponsored events at which any substantive presentations and account or order solicitation will be conducted by appropriately registered personnel; (2) inquiring whether the existing customer wishes to discuss investments with a registered person; and (3) determining whether the existing customer wishes to receive investment literature from the firm. Notwithstanding these provisions, IM-1031 is not meant to restrict a member's administrative personnel, in the normal course of their duties, from contacting customers regarding routine administrative matters.

Questions concerning this *Request For Comment* should be directed to Gary L. Goldsholle, Senior Attorney, Office of General Counsel, NASD Regulation, at (202) 728-8104.

Background

Proposed IM-1031 is designed to prohibit unregistered persons from communicating with members of the

public to solicit the purchase of securities or related services or identify prospective customers. The interpretation is directed primarily to "cold calling" activity, *i.e.*, solicitation of persons who are not existing customers. The National Association of Securities Dealers, Inc. (NASD) has prohibited cold calling by unregistered persons in a variety of contexts. In *Notice to Members 85-48*, the NASD explained that the term "representatives" refers to "persons associated with a member who are engaged in the investment banking or securities business for the member, including the function of supervision, solicitation or conduct of business in securities . . ." The NASD further added that the definition of representatives:

has been consistently interpreted by the NASD to require registration of persons who engage in activities that only constitute a portion of registered representatives' traditional dealings with public customers. Thus, for example, members are required to register persons who . . . solicit accounts on behalf of members, notwithstanding any limitation of such solicitations to prepared scripts discussing generic products and services offered by the member.

NTM 85-48; see also NTM 88-24; NTM 88-50.

The NASD, however, has also stated that the registration requirements are not intended to "restrict a member's administrative personnel, in the normal course of their duties, from contacting customers regarding routine administrative matters involving customers' accounts, such as investment seminars at which any substantive presentations and accounts or order solicitations will be made by appropriately registered personnel." *NTM 88-24.*

In *Notice to Members 88-50*, the NASD set forth the limited circumstances in which a member may employ unregistered persons to contact prospective customers. Specifically, *NTM 88-50* states that unregistered persons may contact prospective customers for purposes of: (1) extending invitations to firm-sponsored events at which any substantive presentations and account or order solicitation will be conducted by appropriately registered personnel; (2) inquiring whether the prospective customer wishes to discuss investments with a registered person; and (3) determining whether the prospective customer wishes to receive investment literature from the firm.

NTM 88-50 requires persons who use unregistered persons for these three activities to observe the following guidelines: (1) pursuant to Rule 1031(b) (formerly Section (1)(b), Part III of Schedule C to the By-Laws), unregistered persons may not discuss general or specific investment products or services offered by the firm, pre-qualify prospective customers as to financial status and investment history and objectives, or solicit new accounts or orders; (2) the member should provide unregistered persons with orientation and training that specifically addresses the limitations of their permissible activities, the regulatory consequences of exceeding these limitations, and the fact that such persons are associated persons of the member, subject to the rules of the NASD and its disciplinary authority; (3) the member should conduct a reasonable investigation of such persons' backgrounds to determine that they are not statutorily disqualified from becoming associated with the member; (4) unregistered persons are regarded as employees of the member and should not be compensated on any basis other than a salary or hourly wage; (5) the member should take reasonable steps to

assure that the activities of unregistered persons are consistent with applicable state statutes and rules and with the rules of other self-regulatory organizations; and (6) the member should be able, upon request, to demonstrate that its supervisory procedures include procedures reasonably designed to prevent violative conduct by unregistered persons.

Based upon experience gained from recent investigations, including a recent review of sales practice activities of selected firms by the staffs of the NASD, the SEC, the New York Stock Exchange, and representatives of the North American Securities Administrators Association, Inc., NASD Regulation staff are concerned that the policy embodied in *NTM 88-50* and the current restrictions on the use of unregistered cold callers may not be effective in preventing abusive cold calling practices. NASD Regulation staff have discovered evidence of abusive cold calling practices, such as high pressure and aggressive sales pitches, often delivered by unregistered persons using specially designed scripts. Customers who are solicited by these unregistered persons may not be given all the protections and disclosures that would be afforded them if they were contacted by registered persons.

To address these violations, protect investors, and to provide the NASD with a greater ability to discipline firms and individuals who engage in improper cold calling practices, NASD Regulation is considering altering its policy and practice with respect to cold calling to require registration of all persons who contact prospective customers concerning the purchase of securities or related services or for the purpose of identifying potential customers. This change is intended to assure that persons who contact prospective customers have the appropriate qualifications

and training regarding solicitations and the sale of securities.

NASD Regulation staff also preliminarily believe that IM-1031, with its absolute prohibition against cold calling prospective customers by unregistered persons, would provide members with greater clarity and consistency with respect to the registration requirements. NASD Regulation staff have observed an increasing number of inquiries concerning the scope of permissible cold calling activities under *NTM 88-50*, and are concerned that members may not be consistently applying the current cold calling prohibitions and registration requirements.

Moreover, an absolute prohibition against cold calling prospective customers by unregistered persons would make violations much easier to detect, and thus aid enforcement of the registration requirements. Under IM-1031, unregistered persons cold calling prospective customers would *per se* violate NASD rules.

NASD Regulation does not, however, believe that unregistered persons should be prohibited from contacting existing customers in appropriate circumstances. Accordingly, proposed IM-1031 permits unregistered persons to contact existing customers for the limited purposes contained in *NTM 88-50*, which include extending invitations to firm-sponsored events, and inquiring whether the customer wishes to discuss investments with a registered person or receive investment literature. Further, IM-1031 would not prohibit a member's administrative personnel, in the normal course of their duties, from contacting customers regarding routine administrative matters such as confirming mailing addresses and acknowledging receipt of communications.

NASD Regulation has previously recognized a distinction between potential and existing customers in the context of the "telemarketing rules." The "telemarketing rules," NASD Conduct Rules 2211 and 3110, were adopted on December 2, 1996, pursuant to the Telemarketing and Consumer Fraud and Abuse Prevention Act, under which the NASD was required to adopt rules similar to those adopted by the Federal Trade Commission prohibiting deceptive and abusive telemarketing acts and practices. In particular, NASD Conduct Rule 2211 exempts the time-of-day and disclosure requirements normally placed on cold calls from calls made to an "existing customer," which is defined to include "a customer for whom the broker or dealer, or a clearing broker or dealer or dealer on behalf of such broker or dealer, carries an account." NASD Regulation preliminarily believes that a similar distinction is appropriate with respect to cold calling registration requirements.

Description

Paragraph (a)(1) of proposed IM-1031 provides that any person associated with a member who communicates with members of the public for the purpose of soliciting the purchase of securities or related services, or for the purpose of identifying potential customers, is engaged in the securities business and is required to register as a representative. Paragraph (a)(2) provides that no member shall engage or use any person to communicate on behalf of the member with members of the public to solicit the purchase of securities or related services, or to identify prospective customers, unless such person is registered as a broker or dealer under the Securities Act of 1934, or is registered as a representative. Under this provision, third-party telemarketing firms that solicit on behalf of broker-dealers would themselves be

required to register as either a broker or dealer, and their employees engaged in soliciting activity would be required to register as representatives.

As noted above, NASD Regulation believes unregistered persons should be permitted to contact existing customers for the limited activities identified in *NTM 88-50*. Specifically, paragraph (b)(1) permits unregistered persons associated with a member to communicate with existing customers so long as their communications are limited to: (A) extending invitations to firm-sponsored events at which substantive presentations and account or order solicitation will be conducted by appropriately registered personnel; (B) inquiring whether the existing customer wishes to discuss investments with a registered person; and (C) determining whether the existing customer wishes to receive investment literature. Paragraph (b)(2) outlines the responsibilities of members employing or seeking to employ unregistered persons pursuant to section (b)(1). Lastly, paragraph (c) would adopt the same scope for the definition of "existing customer" for IM-1031 as is used in telemarketing Rule 2211. NASD Regulation requests comment on the nature and scope of permissible contact between unregistered persons and existing customers and whether the definition of existing customer should be the same as it is under the "telemarketing rules."

NASD Regulation also requests comment on whether an alternative registration category should be developed for cold calling activity. Separate registration categories for assistant representatives and limited representatives apply to associated persons who perform only limited activities. See NASD Conduct Rules 1041 and 1032. As proposed, IM-1031 would require registration as a general securities representative. However,

NASD Regulation is soliciting comment on whether an alternative registration category should be developed for persons who engage solely in cold calling activities, and if such an alternative category is used, how NASD Regulation may define the scope of conduct permissible under such category. Finally, if an alternative registration category is used, should the NASD develop a different Qualification Examination for the cold calling registration category?

Request For Comment

NASD Regulation encourages all members and interested parties to respond to the issues raised in this *Notice*. Comments should be mailed to:

Joan Conley
Office of the Corporate Secretary
NASD Regulation, Inc.
1735 K Street, NW
Washington, D.C. 20006-1500;

or e-mailed to:
pubcom@nasd.com

Comments must be received by **October 31, 1997**. Before becoming effective, any interpretive material or rule change developed as a result of comments received must be adopted by the NASD Regulation, Inc. Board of Directors, may be reviewed by the NASD Board of Governors, and must be approved by the SEC.

Text Of Proposed Interpretive Material

(Note: All language is new.)

IM-1031. Registration of Cold-Callers, Telemarketers and Related Persons

(a)(1) Persons associated with a member who communicate with members of the public for the purpose of soliciting the purchase of

securities or related services or for the purpose of identifying prospective customers are engaged in the securities business and are required to register as a representative.

(2) No member shall engage or use any person to communicate on behalf of the member with members of the public to solicit the purchase of securities or related services or to identify prospective customers unless such person is registered as a broker or dealer under the Securities Exchange Act of 1934, or is registered as a representative.

(b)(1) Notwithstanding the provisions of paragraph (a), persons associated with a member who communicate with existing customers for the purpose of soliciting the purchase of securities or related services are not required to be registered with the Association provided that their communications are limited solely to:

(A) extending invitations to firm-sponsored events at which any substantive presentations and account or order solicitation will be conducted by appropriately registered personnel;

(B) inquiring whether the existing customer wishes to discuss investments with a registered person; and

(C) determining whether the existing customer wishes to receive investment literature from the firm.

(2) Firms employing or seeking to employ unregistered persons pursuant to paragraph (b)(1) shall observe the following guidelines:

(A) Pursuant to Rule 1031(b), unregistered persons shall not discuss general or specific investment products or services offered by the firm, pre-qualify customers as to financial status and investment history and objectives, or solicit new accounts or orders;

(B) The member shall provide unregistered persons with orientation and training that specifically addresses the limitations of such persons' activities, the regulatory consequences of exceeding these limitations, and the fact that such persons are associated persons of the member, subject to the rules of the NASD and its disciplinary authority;

(C) The member shall conduct a reasonable investigation of such persons' backgrounds to determine that they are not statutorily disqualified from becoming associated with the member;

(D) Unregistered persons are regarded as employees of the member and shall not be compensated on any basis other than a salary or hourly wage;

(E) The member shall take reasonable steps to assure that the activities of unregistered persons are consistent with applicable state statutes and rules and with the rules of other self-regulatory organizations; and

(F) The member shall be able, upon request, to demonstrate that its supervisory procedures include procedures reasonably designed to prevent violative conduct by unregistered persons.

(c) For the purposes of paragraph (b), the term "existing customer" means a customer for whom the broker or dealer, or a clearing broker or dealer on behalf of such broker or dealer, carries an account.

© 1997, National Association of Securities Dealers, Inc. (NASD). All rights reserved.