

NASD NOTICE TO MEMBERS 97-1

Approval Of Telemarketing Amendments

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Executive Summary

On December 2, 1996, the Securities and Exchange Commission (SEC) approved new NASD[®] Conduct Rule 2211 to impose time restrictions and disclosure requirements regarding telephone calls to customers by members and their associated persons. The SEC also approved amendments to NASD Conduct Rule 3110 to require members and their associated persons to follow certain procedures regarding customer authorization of a demand draft.¹ The new telemarketing rules are effective immediately.

Questions concerning this Notice may be directed to Robert J. Smith, Senior Attorney, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8176.

Discussion

In June 1995, NASD Regulation, Inc. (NASD Regulation) adopted a "cold call" rule to implement certain rules of the Federal Communication Commission (FCC rules) promulgated under the Telephone Consumer Protection Act that require telemarketers to establish and maintain a list of persons who have requested that they not be contacted by the telemarketer (do-not-call list).² Subsequently, the Federal Trade Commission adopted detailed rules (FTC rules) under the Telemarketing and Consumer Fraud and Abuse Prevention Act (Prevention Act) to prohibit deceptive and abusive telemarketing acts and practices, effective December 31, 1995. The FTC rules, among other things, (i) require the maintenance of do-not-call lists and procedures, (ii) prohibit abusive, annoying, or harassing telemarketing calls, (iii) prohibit telemarketing calls before 8 a.m. or after 9 p.m., (iv) require a telemarketer to identify himself, the company he works for, and the purpose of the call, and (v) require express written authorization or other verifiable authorization from the cus-

tomers before use of negotiable instruments called "demand drafts."

The FCC and FTC rules, though applicable to members that engage in telephone solicitation to market their products and services, are not enforceable by the SEC or securities self-regulatory organizations (SROs). Under the Prevention Act, the SEC was required to promulgate or require SROs to promulgate rules substantially similar to the FTC rules, unless the SEC determined that such rules were not necessary or appropriate for the protection of investors or the maintenance of orderly markets, or that existing SEC rules already provided for such protection. NASD Regulation has implemented requirement (ii) above by issuing an interpretation that such conduct violates existing rules.³ New Rule 2211 and amended Rule 3110 are intended to implement requirements (iii), (iv), and (v).

Description Of Amendments Time Limitations, Disclosure, And Exemptions

Rule 2211, under paragraph (a), prohibits members and their associated persons from calling an individual's residence for the purpose of soliciting the purchase of securities or related services at any time other than between 8 a.m. and 9 p.m. local time at the individual's residence, without the prior consent of the person. Rule 2211, under paragraph (b), also requires members and their associated persons to promptly and clearly disclose to the individual the caller's identity, firm, telephone number, or address at which the caller may be contacted, and that the purpose of the call is to solicit the purchase of securities or related services.

Under paragraph (c) to Rule 2211, exemptions from the time-of-day and disclosure requirements of para-

graphs (a) and (b), respectively, are available for telephone calls by an associated person (or another associated person acting at his or her direction) to other brokers and dealers and to existing customers who have maintained active accounts. An “existing customer” is defined under paragraph (c) as a customer for whom the broker or dealer, or a clearing broker or dealer on behalf of such customer, carries an account. An account is active for purposes of the new Rule if, under subparagraph (c)(1), an existing customer has effected a securities transaction in or made a deposit of funds or securities into the account within the preceding 12 months or, under subparagraph (c)(2), the customer has **at any time** effected a securities transaction in or made a deposit of funds or securities into the account, **and** the account has earned interest or dividend during the preceding 12 months. Also, in order to use this exemption, the customer account must have been under the control of the associated person making the telephone call at the time of the securities transaction or deposit of funds or securities.

These exemptions reflect the importance for many customers of personal and timely contact with a broker/dealer, particularly in the emerging environment of 24-hour trading in multiple time zones, which gives rise to a need for prompt contact with customers to respond to market developments. Consistent with this purpose, the exemption applies only to existing customers and does not cover calls to those customers whose accounts do not meet certain minimum levels of activity.

Subparagraphs (c)(1) and (2) together exclude only some calls to existing customers from the time-of-day and disclosure requirements of the new Rule. Thus, calls to certain older or inactive accounts may fall outside these parameters and not be covered by the exemptions.

Finally, under paragraph (c), it is made clear that the scope of Rule 2211 is limited to telemarketing calls covered by the Rule, and that the terms of the Rule do not impose on members any additional requirements with respect to the relationship between a member and a customer or between a person associated with a member and a customer. In other words, the Rule is not intended to affect the definition of “customer” or the nature of member-customer or salesperson-customer relationships outside the context of the Rule.

Demand Draft Authorization And Recordkeeping

Rule 3110 was amended to: (i) prohibit a member from obtaining from a customer or submitting for payment a check, draft, or other form of negotiable paper drawn on a customer’s checking, savings, share, or similar account (demand draft) without that person’s express written authorization, which may include the customer’s signature on the instrument, and (ii) require that such authorization be retained for a period of three years. The three-year retention provision does not require retention of negotiable instruments or copies thereof.

A demand draft is a method for obtaining funds from a customer’s bank account without that person’s signature on a negotiable instrument. Under this method, a customer provides a potential payee with bank account identification information that permits the payee to create a piece of paper that will be processed like a check, including the words “signature on file” or “signature pre-approved” in the location where the customer’s signature normally appears. Most potential payees obtain a written authorization for the use of such a demand draft, but the FTC found that in certain cases only oral authorization was provided by the

customer. The new language in subparagraph (g)(2) of Rule 3110 is drawn substantially from the FTC rule.

Text Of Amendments

(Note: New language is underlined; deletions are bracketed)

CONDUCT RULES

2000. BUSINESS CONDUCT

2200. COMMUNICATIONS WITH CUSTOMERS AND THE PUBLIC

2211. Telemarketing

No member or person associated with a member shall:

(a) make outbound telephone calls to the residence of any person for the purpose of soliciting the purchase of securities or related services at any time other than between 8 a.m. and 9 p.m. local time at the called person’s location, without the prior consent of the person; or

(b) make an outbound telephone call to any person for the purpose of soliciting the purchase of securities or related services without disclosing promptly and in a clear and conspicuous manner to the called person the following information:

(1) the identity of the caller and the member firm;

(2) the telephone number or address at which the caller may be contacted; and

(3) that the purpose of the call is to solicit the purchase of securities or related services.

(c) The prohibitions of paragraphs (a) and (b) shall not apply to telephone calls by any person associated with a

member, or another associated person acting at the direction of such person for the purpose of maintaining and servicing the accounts of existing customers of the member under the control of or assigned to such associated person:

(1) to an existing customer who, within the preceding twelve months, has effected a securities transaction in, or made a deposit of funds or securities into, an account that, at the time of the transaction or the deposit, was under the control of or assigned to, such associated person;

(2) to an existing customer who previously has effected a securities transaction in, or made a deposit of funds or securities into, an account that, at the time of the transaction or deposit, was under the control of or assigned to, such associated person, provided that such customer's account has earned interest or dividend income during the preceding twelve months, or

(3) to a broker or dealer.

For the purposes of paragraph (c), 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. The scope of this rule is limited to the telemarketing calls described herein; the terms of this Rule shall not otherwise expressly or by implication impose on members any additional requirements with respect to the relationship between a member and a customer or between a person associated with a member and a customer.

3000. RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS, EMPLOYEES, AND OTHERS' EMPLOYEES

3100. BOOKS AND RECORDS, AND FINANCIAL CONDITION

3110. Books and Records

(g) [Cold Call] Telemarketing Requirements

(1) Each member shall make and maintain a centralized do-not-call list of persons who do not wish to receive telephone solicitations from such member or its associated person.

(2) No member or person associated with a member shall obtain from a

customer or submit for payment a check, draft, or other form of negotiable paper drawn on a customer's checking, savings, share, or similar account, without that person's express written authorization, which may include the customer's signature on the negotiable instrument.

(3) Each member shall maintain the authorization required by subparagraph (2) for a period of three years. This provision shall not, however, require maintenance of copies of negotiable instruments signed by customers.

Endnotes

¹ Securities Exchange Act Rel. No. 34-38009 (December 2, 1996).

² New Rule 3110(g) took effect on June 9, 1995.

³ In *Notice to Members 96-44*, NASD Regulation set forth the interpretation requested by the SEC that abusive communications from members or associated persons of members to customers is a violation of NASD Conduct Rule 2110.

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