

INFORMATIONAL

Restrictions On Unregistered Persons

Withdrawal Of Proposed Rule And Reminder Of Restrictions On Use Of Unregistered Persons

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Internal Audit
- Legal & Compliance
- Operations
- Registered Representatives
- Registration
- Senior Management
- Training

KEY TOPICS

- Cold Calling
- Telemarketing
- Unregistered Persons

Executive Summary

In light of recent federal law, NASD Regulation, Inc. (NASD RegulationSM) has withdrawn its rule proposal addressing the permissible marketing activities and supervision of unregistered persons. NASD Regulation does not anticipate rule making in this area at the present time. With this *Notice*, NASD Regulation is reminding members of its current policy with respect to the permissible marketing activities of unregistered persons, as previously set forth in *Notice to Members 88-50 (NtM 88-50)*.

Questions/Further Information

Questions concerning this *Notice* may be directed to Gary L. Goldsholle, Associate General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8104.

Background And Summary

NtM 88-50 provides guidance on the circumstances under which an unregistered person may contact a prospective brokerage customer. Specifically, *NtM 88-50* states that unregistered persons may contact prospective customers for three purposes only:

- (1) to extend invitations to firm-sponsored events;
- (2) to inquire whether the customer wishes to discuss investments with a registered person; and
- (3) to inquire whether the customer wishes to receive investment literature.

NtM 88-50 also contains supervisory guidelines, including requirements for orientation and

training, background investigations, and a limitation on compensation of unregistered personnel.

In an effort to replace *NtM 88-50*, in September 1997, NASD Regulation issued *Notice to Members 97-58* requesting comment on a proposed Interpretive Material regarding the registration of certain persons who solicit securities business on behalf of member firms. In short, the proposal would have required all persons associated with a member who communicate with the public for the purpose of soliciting the purchase of securities or related services or identifying prospective customers to register as a representative of the member firm.

In 1998, based upon the comments received and input provided by NASD Regulation standing committees, NASD Regulation developed an alternative proposal that codified the restrictions governing the permissible activities of unregistered persons contained in *NtM 88-50* and established comprehensive supervisory responsibilities of members towards such persons. The proposal was filed with the Securities and Exchange Commission on July 2, 1998, and published for comment in the *Federal Register* on December 18, 1998.¹

The proposal encountered opposition from banks and bank-affiliated member firms, which asserted, among other things, that the National Association of Securities Dealers, Inc. (NASD[®]) did not have jurisdiction over bank employees. NASD Regulation disagreed and believed that the restrictions on a member's use of unregistered persons should apply uniformly without regard to whether such persons are also employees of a bank.

This issue was resolved with the passage of the Gramm-Leach-Bliley Financial Services Modernization Act (GLB), which was signed into law on November 12, 1999. The GLB contains provisions that, effective May 13, 2001, repeal the general bank exclusion from the definition of broker under the Securities Exchange Act of 1934. In its place, the GLB leaves a number of targeted exclusions, including one for "networking" or "third party brokerage" arrangements. A networking or third party brokerage arrangement is one in which a bank enters into a contract or other written arrangement with a registered broker/dealer for the provision of brokerage services.

Under the GLB, a bank that enters into a third party brokerage arrangement will be exempt from registration as a broker only if it meets certain conditions. These conditions include that bank employees (other than persons associated with a member who are qualified pursuant to the rules of a self-regulatory organization) perform only clerical or ministerial functions in connection with brokerage transactions including scheduling appointments with associated persons, except that the employees may forward customer funds or securities, and may describe in general terms the types of investment vehicles available from the bank and the broker/dealer. The Conference Report to the GLB in discussing the networking exclusion states that NASD Regulation's proposal concerning the permissible activities of unregistered persons is inconsistent with the new legislation and should be revised to exempt banks and their employees from the proposal's coverage.²

In view of the language of the GLB and the Conference Report, NASD Regulation has withdrawn the proposal. Rather than continue to pursue adoption of a rule at this time, NASD Regulation has decided to remind members of the restrictions on the use of unregistered persons as set forth in *NtM 88-50*.

Permissible Activities Of Unregistered Persons

NASD Rule 1031(b) defines a "representative" as "[p]ersons associated with a member . . . who are engaged in the investment banking or securities business for the member including the functions of supervision, solicitation or conduct of business in securities" This definition 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, including persons who solicit accounts on behalf of members.

As stated in *NtM 88-50*, and reiterated here, unregistered persons may contact prospective customers for three purposes only:

- extending invitations to firm-sponsored events at which any substantive presentations and account or order solicitation will be conducted by appropriately registered personnel;
- inquiring whether the prospective customer wishes to discuss investments with a registered person; and
- determining whether the prospective customer wishes to receive investment literature from the firm.

In addition, the following guidelines are applicable to firms employing unregistered persons to perform these functions:

- (1) Pursuant to Rule 1031, 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 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.
- (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 ensure that the activities of unregistered persons are consistent with applicable state statutes and rules and with the rules of other self-regulatory organizations.
- (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.

Clarification Of Guidelines

In addition, NASD Regulation is making several clarifications with respect to these guidelines, which were originally published in *NtM 88-50*. With respect to item (1), above, unregistered persons may describe in general terms the types of investment vehicles available from the member, but may not discuss the attributes or merits of

any particular investment vehicle or service or class of vehicles or services. With respect to item (4), above, the payment of performance bonuses or other forms of incentive compensation, such as through participation in a member's profit sharing plan, are permitted so long as such bonuses or incentives are not tied to transactions, commission activity, or referrals generated by the unregistered person.

Members are advised to review the activities of unregistered persons to ascertain that such persons are not functioning in a manner requiring registration.

Endnotes

¹63 Fed. Reg. 70173 (Dec. 18, 1998).

²See H.R. Conf. Rep. No. 434, 106th Cong., 1st Sess., 145 Cong. Rec. H11,255 (1999).

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