



NASAA

February 12, 2024

Submitted by SEC Webform¹

Sherry R. Haywood
Assistant Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: File No. SR-FINRA-2024-001: Notice of Filing of a Proposed Rule Change to Amend FINRA Rule 3240 (Borrowing From or Lending to Customers)

Dear Ms. Haywood:

On behalf of the North American Securities Administrators Association, Inc. (“NASAA”),² I am writing in response to U.S. Securities and Exchange Commission (“SEC” or the “Commission”) Release No. 34-99351, *Notice of Filing of a Proposed Rule Change to Amend FINRA Rule 3240 (Borrowing From or Lending to Customers)* (the “Notice”).³ NASAA has previously commented on the subject matter of this proposal.⁴ An outright prohibition of

¹ <https://www.sec.gov/comments/sr-finra-2024-001/notice-filing-a-proposed-rule-change-amend-finra-rule-3240-borrowing-or/#no-back>.

² Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA’s membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, the U.S. Virgin Islands, and Guam. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

³ The Notice is available at <https://www.sec.gov/files/rules/sro/finra/2024/34-99351.pdf>. The text of the proposed rule change, as filed with the Commission (“FINRA Proposal”), is available at <https://www.finra.org/sites/default/files/2024-01/SR-FINRA-2024-001.pdf>.

⁴ See Letter from Melanie Senter Lubin, NASAA President and Maryland Securities Commissioner, to Jennifer Piorko Mitchell, Office of the Corporate Secretary, FINRA (“2022 NASAA Letter”) (Feb. 14, 2022), <https://www.nasaa.org/wp-content/uploads/2022/02/NASAA-Comment-Letter-re-FINRA-Reg-Notice-21-43.pdf>;

borrowing from and lending to customers by an associated person of a broker-dealer would most efficiently and effectively address the serious conflicts inherent in such a relationship and the potential for investor harm. However, securities regulators, including some states and FINRA, have taken different approaches to this issue. Given the more permissive framework embodied in Rule 3240 as proposed, the rule must include more robust guardrails to prevent investor harm, particularly abuse or exploitation of vulnerable investors.

I. An outright prohibition would eliminate conflicts of interest and the potential for investor harm from borrowing or lending arrangements.

If amended as proposed, Rule 3240 would permit registered persons to maintain pre-existing loan arrangements or enter into new arrangements with customers as long as certain criteria are met.⁵ However, it would be simpler and more effective to prohibit such arrangements entirely. In 1983, NASAA members adopted such a prohibition as part of NASAA's Dishonest or Unethical Business Practices of Broker-Dealers and Agents model rule.⁶ Since that time, at least 44 U.S. jurisdictions have enacted the model rule, in whole or in part. There has been some divergence from the outright prohibition, although the majority of states that have addressed the issue by rule or statute have done so in alignment with the model rule and prohibited these practices without exception.⁷

When a registered person borrows money from, or lends money to, a customer (or when such an arrangement is carried forward into a new broker-customer relationship), the arrangement increases the potential for serious conflicts of interest. For example, a registered person who owes money to a customer may be inclined to recommend more transactions or sell more remunerative products in order to increase commissions and pay the loan back more quickly.⁸

These conflicts can be especially pronounced and even exacerbated in the case of older or vulnerable customers. These individuals may be socially isolated from family and friends, and NASAA members have seen problems arise where registered persons cross important professional

Letter from Christopher Gerold, NASAA President and Chief, New Jersey Bureau of Securities, to Jennifer Piorco Mitchell, Office of the Corporate Secretary, FINRA, at 5-7 ("2019 NASAA Letter") (Oct. 8, 2019), <https://www.nasaa.org/wp-content/uploads/2019/10/NASAA-Comment-Letter-Re-Reg-Notice-19-27-10-8-19.pdf>.

⁵ See Proposed amended Rule 3240(a), (b), FINRA Proposal at 131-33.

⁶ NASAA Model Rule, *Dishonest or Unethical Business Practices of Broker-Dealers and Agents*, at (2)(a) (last amended May 16, 2022), <https://www.nasaa.org/wp-content/uploads/2022/07/1956-Act-and-2002-Act-Broker-Dealer-Dishonest-or-Unethical-Practices-Rule-20220516.pdf>. NASAA model rules prohibit similar practices by investment advisers. See, e.g., NASAA Model Rule, *NASAA Prohibited Conduct of Investment Advisers, Investment Adviser Representatives and Federal Covered Investment Advisers Model Rule USA 2002 502(b)*, at (f), (g) (last amended May 16, 2022), <https://www.nasaa.org/wp-content/uploads/2022/07/2002-Act-Rule-502b-Prohibited-Conduct-20220516.pdf>.

⁷ See Appendix, *infra*.

⁸ See 2019 NASAA Letter at 6.

boundaries, such as borrowing and lending. Even when the relationship begins with the best intentions, it can quickly become exploitative if the customer begins making financial decisions they would not otherwise make. For example, a registered person might befriend an older or vulnerable customer, who later decides that they want to “help” the registered person by lending them money once the customer learns of some financial hardship being experienced by the registered person. Such an arrangement could result in significant customer harm if the customer is on a fixed or limited income, relies on the registered person for information necessary to determine their financial wherewithal to make such a loan, or is convinced to forgive the loan or characterize it as a “gift” to benefit the registered person.

A prohibition is also consistent with the Commission’s approach to conflicts of interest in Regulation Best Interest (“Reg BI”). As the Commission recognized when adopting Reg BI, some conflicts of interest are “so pervasive such that they cannot be reasonably mitigated and must be eliminated in their entirety, as we believe they create too strong of an incentive for the associated person to make a recommendation that places their financial and other interest ahead of the interest of retail customers’ interests”⁹ The direct personal incentives inherent in lending and borrowing arrangements, and the desire to collect or the duty to pay a customer, are concerns of an equal caliber. While investment advisers’ fiduciary duties help to protect their clients from the impact of such conflicts, the SEC’s decision not to apply that standard to broker-dealers and their registered persons means that those persons require a different approach.

Unfortunately, family members and close personal relations are not immune from, and may in fact be more susceptible to, exploitive activities and bad actors.¹⁰ While statistics on familial fraud are limited,¹¹ data consistently indicates that financial exploitation of older adults is most commonly perpetrated by family members, including adult children, followed by friends and neighbors.¹² These concerns are equally salient with regard to so-called “close personal

⁹ SEC Rel. No. 34-86031, *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, 351-52 (June 5, 2019). For example, Reg BI requires the elimination of product- and time-specific sales contests, sales quotas, and certain compensation arrangements. *Id.*

¹⁰ See Proposed amended Rule 3240(a)(2)(A), FINRA Proposal at 132 (excepting arrangements between a registered person and a “customer [who] is a member of such person’s immediate family”).

¹¹ See Strategic Finance, *Shattered Trust: Fraud in the Family*, Stephen Pedneault and Bonita Peterson Kramer (May 1, 2015), <https://sfmagazine.com/post-entry/may-2015-shattered-trust-fraud-in-the-family/>; see also AARP, *Older Americans Hit Hard by Financial Fraud*, Katherine Skiba (Feb. 28, 2019), available at <https://www.aarp.org/money/scams-fraud/info-2019/cfpb-report-financial-elder-abuse.html> (noting that nearly 40% of reported elder financial abuse came from a family member or fiduciary).

¹² National Council on Aging, *Elder Abuse Facts* (Feb. 23, 2021), <https://www.ncoa.org/public-policy-action/elder-justice/elder-abuse-facts/> (“In almost 60% of elder abuse and neglect incidents, the perpetrator is a family member.”); Jesse R. Morton and Scott Rosenbaum, *An Analysis of Elder Financial Exploitation: Financial Institutions Shirking Their Obligations to Prevent, Detect, and Report the “Hidden” Crime*, 27 *Elder L. J.* 261, 265 (2020) (“Unfortunately, the most common abuser is someone who is entrusted to care for the elder, and of those abusers, 60% of abusers are family members.”); Janey C. Peterson *et al.*, *Financial Exploitation of Older Adults: A Population-Based Prevalence Study*, 29(12) *J. Gen. Intern. Med.* 1615, 1618 (2014), available at

relationships,” such as “childhood or long-term friend[s] or godparent[s].”¹³ Nothing about these relationships suggests that they confer any additional protections from the kinds of conflicted, exploitative, and abusive practices that the rules should be designed to prevent. Ultimately, a prohibition of borrowing and lending arrangements would be easiest to enforce and would be effective in preventing investor harm, especially in the context of vulnerable adults. Given the stakes – namely, investor protection from predatory lending or undue influence in a broker-customer relationship – any permission to borrow or lend granted in these circumstances must be accompanied by strong safeguards.

II. FINRA should implement stronger guardrails before the proposed rule change can be approved.

To the extent that FINRA’s approach will be to continue to permit certain borrowing and lending arrangements, NASAA generally supports the amendments that have been proposed. In particular, NASAA supports extending the rule to borrowing or lending arrangements that predate the broker-customer relationship, requiring member firms to “perform a reasonable assessment” before approving a new arrangement or broker-customer relationship, and the proposed modernization of the term “immediate family.”¹⁴ However, the rule must include stronger guardrails to adequately protect investors.

a. The rule should impose consistent notification requirements.

As proposed, amended Rule 3240 would require a registered person to provide notification and receive approval before establishing a borrowing or lending arrangement, or carrying such an arrangement into a new broker-customer relationship, with a customer who is another registered person of the member firm, a person that has a “close personal relationship” with the registered person, or a person that has an outside business relationship with the registered person.¹⁵ Although the rule purports to allow firms not to require notification and approval of an arrangement or new broker-customer relationship with a customer that is a financial institution lender, the rule conditions such an allowance based on the terms of the loan, and therefore effectively requires some degree of notice to the member firm.¹⁶

https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4242880/pdf/11606_2014_Article_2946.pdf (finding that “[f]amily members were the most common perpetrators of FEOA events (57.9%), and were most often adult children (24.6%)” and “[t]he next most common perpetrators were friends and neighbors (16.9%) . . .”).

¹³ Proposed amended Rule 3240(a)(2)(D), FINRA Proposal at 132 (excepting arrangements “based on a bona fide, close personal relationship between the registered person and the customer,” and removing language requiring that the relationship be such that “the loan would not have been solicited, offered, or given” but for that relationship); proposed Rule 3240.04, FINRA Proposal at 134-35 (prescribing “factors that are relevant” to this determination and providing examples).

¹⁴ See Notice at 4, 6-7.

¹⁵ Proposed amended Rule 3240(a)(2)(C)-(E), (b)(1), FINRA Proposal at 131-33.

¹⁶ Proposed amended Rule 3240(a)(2)(B), (b)(3), FINRA Proposal at 131-33.

Given the risk of financial exploitation even in familial relationships, particularly in the context of older or vulnerable investors,¹⁷ it is essential that Rule 3240 require *at least* the same notification and approval for arrangements with immediate family as it requires for other registered persons and “close personal” and business relationships. There is no compelling reason for a difference in treatment of the two circumstances. NASAA previously recommended to FINRA that such arrangements should at minimum be subject to firm scrutiny and approval,¹⁸ and we maintain that position. Even if FINRA is correct in its belief that such arrangements are generally low risk,¹⁹ the rules need to be designed to catch those situations where that assumption does not hold true. Further, if FINRA is correct, then it would likely pose a minimal burden to the firm to determine that the proposed arrangement or broker-customer relationship can be approved. This problem would be easy to resolve by revising paragraph (b)(1) to read: “*With respect to borrowing or lending arrangements described in paragraphs (a)(2) (A), (C), (D), or (E) of this Rule . . .*” and deleting paragraph (b)(2).²⁰ There is little reason to distinguish arrangements with immediate family from those with other customers. At minimum, Rule 3240 should require notice and approval of those arrangements.

**b. The rule should set minimum standards
for member firms’ review and approval.**

Proposed Rule 3240.06 would require member firms, upon receiving written notification under the rule, to “perform a reasonable assessment of the risks” and “make a reasonable determination” of whether to approve or modify the arrangement or broker-customer relationship (as applicable). Although FINRA “expects” member firms to include certain factors in its “reasonable assessment,”²¹ the rule does not require firms to take any particular consideration into account and these factors are nowhere in the rule text or any of the Supplementary Material. The principles-based requirement that member firms have “reasonably designed” policies and procedures²² must not be an invitation for firms to establish controls according to their individual risk tolerance. “Reasonable” is an objective standard and it is incumbent on FINRA to clearly define common-sense boundaries to this concept, especially those that are clear enough that FINRA has already identified them.

The rule should require a minimum amount of disclosure and scope of evaluation, from which the firms can elevate to a higher standard, to ensure adequate consideration among similar situations across similarly situated firms. Setting minimum standards is not inconsistent with the principles-based approach to supervision in Rule 3110. Registered persons entering into these

¹⁷ See *supra* nn.11-12 and accompanying text.

¹⁸ See 2022 NASAA Letter at 3.

¹⁹ See Notice at 29.

²⁰ See Proposed amended Rule 3240(b)(1), (2), FINRA Proposal at 132-33.

²¹ See Notice at 12-13.

²² See Notice at 35.

agreements should be required, at a minimum, to provide the “expect[ed]” data points to the firm as part of the required notification. At minimum, any “reasonable assessment” should include that information, as well as documentation of:

- the steps the member firm undertook to assess the risk prior to the registered person being approved to enter into the loan agreement;
- the steps the member firm will take to minimize the conflict of interest;
- how the member firm communicated to the customer the risk created by the loan agreement and repayment terms so that the customer appreciates the risk; and
- an outline of the supervisory measures that will be taken by the member firm.

These measures should be required in addition to the non-exclusive list of potential factors suggested by FINRA. Requiring defined disclosures and assessment considerations would allow regulators to assess and compare approval and supervision practices across firms.

As NASAA recommended in previous comments to FINRA, a reasonable assessment and determination process should also include an interview (preferably by a firm compliance officer) with the customer outside of the presence of the registered person.²³ This practice would help ensure that the customer understands the terms of the loan agreement, has not been coerced, and does not show indicia of vulnerability or undue influence. Where it is not possible to interview the customer (either in person or online), the firm should at least be required to verify that the customer benefits from and entered into the loan of his or her own volition and did not feel pressure to do so.

c. The rule should require heightened supervision of accounts when there is a borrowing or lending arrangement.

If a firm approves a borrowing or lending arrangement, or approves a new broker-customer relationship where there is a preexisting arrangement, FINRA rules should require the firm to apply heightened scrutiny to the underlying accounts or impose other appropriate conditions. Heightened supervision is appropriate as a guard against the conflicts of interest that come with these relationships, including where the registered person and customer have a familial or “close personal” relationship. This should include, *inter alia*, enhanced review of trades and transactions in the account to ensure that the registered person is making recommendations or trades that are truly best for the customer, not for themselves. At minimum, Rule 3240 should require such measures when the customer is elderly or otherwise vulnerable to exploitation. Such a tailored requirement would not be unduly burdensome, given the high potential for customer harm and

²³ See 2022 NASAA Letter at 5.

member firms' existing obligations under other FINRA rules,²⁴ nor have broker-dealers proven incapable of identifying such circumstances.²⁵

III. Conclusion

NASAA appreciates the opportunity to comment as the Commission considers whether to approve the proposed rule change. While NASAA generally supports the amendments proposed, the permissive approach of Rule 3240 should include robust guardrails to prevent investor harm, particularly abuse or exploitation of older or vulnerable investors. These guardrails should include consistent notice requirements for the different categories of permitted borrowing or lending arrangements, minimum standards for member firms to review and approve such arrangements, and heightened supervision of registered persons' conduct in connection with the underlying accounts.

Thank you for considering these views. NASAA looks forward to continuing to work with the SEC and FINRA in the shared mission to protect investors. Should you have any questions about this letter, please contact either the undersigned or NASAA's General Counsel, Vince Martinez, at (202) 737-0900.

Sincerely,



Claire McHenry
NASAA President and
Deputy Director
Nebraska Bureau of Securities

²⁴ See, e.g., FINRA Rules 2010, 2090, and 2111-2165.

²⁵ See NASAA 2022 Enforcement Report, Based on an Analysis of 2021 Data, at 8 (Sept. 2022), available at <https://www.nasaa.org/wp-content/uploads/2022/09/2022-Enforcement-Report-FINAL.pdf> (noting year-over-year increase in reporting of suspected exploitation pursuant to the NASAA Model Act to Protect Vulnerable Adults from Financial Exploitation, as well as subsequent regulatory investigations and enforcement). See also NASAA Model Act to Protect Vulnerable Adults from Financial Exploitation, Legislative Text and Commentary (last updated July 2023), <https://www.nasaa.org/wp-content/uploads/2022/08/NASAA-Legislative-Commentary-for-the-Model-Act-to-Protect-Vulnerable-Adults-from-Financial-Exploitation-7.18.23.pdf>.

APPENDIX

Prohibition without exception:

1. Alaska -- Alaska Admin. Code tit. 3, § 08.047(b)(1)²⁶
2. Arkansas -- Ark. Admin. Code § 003.14.2-308.01(p)
3. Delaware -- 6 Del. Admin. Code § SEC 609(c)(1)
4. District of Columbia -- D.C. Mun. Regs. tit. 26-B, § 119.3(a)
5. Georgia -- Ga. Comp. R. & Regs. 590-4-5-.16(2)(b)(1)
6. Hawaii -- Haw. Code R. § 16-39-470(b)(21)
7. Kansas -- Kan. Admin. Regs. 81-3-6(e)(22)
8. Kentucky -- 808 Ky. Admin. Regs. 10:440, Sec. 2(4)
9. Louisiana -- 10 La. Admin. Code Pt. XIII, 1203(A)(22)
10. Massachusetts -- 950 Mass. Code Regs. 12.204(1)(b)(1)
11. Missouri -- Mo. Code Regs. Ann. tit. 15, § 30-51.170(1)(V)
12. Montana -- Mont. Admin. R. 6.10.401(2)(a)
13. New Mexico -- N.M. Admin. Code 12.11.4.16(A)
14. Pennsylvania -- 10 Pa. Code § 305.019(c)(2)(i)
15. Rhode Island -- 230 R.I. Code R. 50-05-2.10(A)(2)(a)
16. South Carolina -- S.C. Code Ann. Regs. 13-501(B)(1)
17. South Dakota -- S.D. Admin. R. 20:08:03:06(2)(a)
18. Tennessee -- Tenn. Comp. R. & Regs. 0780-04-03-.02(6)(b)(1)
19. Utah -- Utah Admin. Code r. R164-6-1g(D)(1)
20. Vermont -- Vt. Admin. Code § 4-4-8:3-2(e)(22)
21. Virginia -- 21 Va. Admin. Code 5-20-280(B)(1)
22. Washington -- Wash. Admin. Code 460-22B-090(1)
23. Wyoming -- Wyo. Admin. Code 002.0017.5 § 5

Prohibition, excepting certain institutional customers or customers in the business of lending:

1. Mississippi -- 1 Code Miss. R. Pt. 14, R. 5.21(B)(1)
2. New Jersey -- N.J. Admin. Code § 13:47A-6.3(a)(43), (44)
3. North Carolina -- 18 N.C. Admin. Code 6A.1414(c)(1)
4. Ohio -- Ohio Admin. Code 1301:6-3-19(A)(11)
5. West Virginia -- W. Va. Code Ann. § 32-2-204(c)(1)
6. Wisconsin -- Wis. Admin. Code § DFI-Sec 4.06(2)(a)

²⁶ Proposed rule change, available at <https://aws.state.ak.us/OnlinePublicNotices/Notices/Attachment.aspx?id=133948>.

Prohibition, excepting certain relatives and family members:

1. Arizona -- Ariz. Admin. Code § R14-4-130(A)(15)²⁷
2. Idaho -- Idaho Admin. Code r. 12.01.08.104(21), (22)²⁸
3. Iowa -- Iowa Admin. Code r. 191-50.16(2)(a)
4. Nebraska -- 48 Neb. Admin. Code Ch. 12, 005.01, 005.01A
5. North Dakota -- N.D. Admin. Code 73-02-09-03(1)

Regulation incorporates Rule 3240 by reference

1. Colorado -- Colo. Code Regs. 704-1 § 51-4.7(H)(2)
2. Florida -- Fla. Admin. Code Ann. r.69W-600.013(2)(a)
3. Nevada -- Nev. Admin. Code §§ 90.327(1)(d)(1), 90.321(1)

Regulation framework similar to Rule 3240

1. Connecticut -- Conn. Agencies Regs. § 36b-31-15b(a)(1)
2. Maine -- Me. Code R. tit. 02-032, Ch. 504, § 8(36)
3. Michigan -- Mich. Admin. Code r.451.4.27(3)(a)

No express regulation or statute directly on point:

1. Alabama
2. California
3. Illinois
4. Indiana
5. Maryland
6. Minnesota
7. New Hampshire
8. New York
9. Oklahoma
10. Oregon
11. Texas

²⁷ Also excepts customers in the business of lending.

²⁸ Also excepts certain institutional customers.