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Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE, Washington, DC 20549-1090

**Re: SR-FINRA-2024-001 (Proposed Rule Change to Amend FINRA Rule 3240
(Borrowing From or Lending to Customers))**

Dear Secretary Countryman:

The Cornell Securities Law Clinic ("Clinic") submits this comment letter in support of the proposal ("Rule Proposal") to amend FINRA Rule 3240 (Borrowing From or Lending to Customers) to strengthen the general prohibition against borrowing and lending arrangements, narrow some of the existing exceptions to that general prohibition, modernize the immediate family exception, and enhance the requirements for giving notice to members and obtaining members' approval of such arrangements.

The Clinic is a Cornell Law School curricular offering, in which law students provide representation to public investors and public education as to investment fraud in the largely rural "Southern Tier" region of upstate New York. For more information, please see: <http://securities.lawschool.cornell.edu>.

As explained in greater detail below, the Clinic supports the amendments contained in the Rule Proposal as an important step in providing greater effectiveness of regulations governing borrowing and lending arrangements between registered persons and customers.

I. Support of Narrowing Current Exceptions to Rule 3240's General Prohibitions

For the reasons stated below, the Clinic supports the amendment to the language of Rule 3240(a).

- a. **The Clinic supports clarifying that the general prohibition on borrowing and lending arrangements applies to situations where such arrangements pre-exist a new customer relationship.**

Currently, Rule 3240(a) establishes the criteria that restrict individuals associated with a member in any registered capacity from borrowing or lending money to any customer. While this rule serves to mitigate conflicts of interest and potential abuse within the financial industry, it fails to address a notable loophole wherein such arrangements already exist before the establishment of a new customer relationship.

FINRA's proposed amendment to Rule 3240(a) is a commendable effort to close this loophole by explicitly stating that the rule's general requirements, including the prohibition on borrowing and lending arrangements, are applicable to situations where these arrangements pre-date the initiation of a new broker-customer relationship. This proposed change enhances transparency and provides an additional safeguard against potential abuse.

The modification reinforces the rule's comprehensive scope, ensuring that registered persons are prohibited not only from maintaining existing arrangements but also from initiating new business relationships with individuals with whom they have pre-existing financial ties. By emphasizing that the prohibition extends not only to ongoing relationships with existing customers but also to situations where financial arrangements pre-date the formal establishment of a broker-customer relationship, the amendment aims to prevent potential conflicts of interest or abuses.

b. The Clinic supports the addition of Rule 3240.05

Proposed Rule 3240.05 is a significant step in strengthening the regulatory framework by extending the rule's requirements to cover situations where conflicts of interest arise due to borrowing or lending arrangements with persons related to the registered person or the customer. This expansion is crucial in closing potential loopholes and safeguarding against abuses that may occur when a registered person induces a customer to enter into financial arrangements with related individuals.

FINRA rightly recognizes that instructing or asking a customer to enter into such arrangements with a person related to the registered person, or vice versa, raises similar conflict of interest concerns as direct arrangements between the registered person and the customer. This alignment is a commendable effort to ensure consistency and prevent the exploitation of relationships with related individuals, such as immediate family members or outside business entities.

By explicitly stating that such arrangements would not be consistent with Rule 3240 unless specific conditions are met, the proposed amendment provides clear guidance to registered persons and reinforces the overarching principles of transparency and fairness in financial dealings.

c. The Clinic supports the modernization of the immediate family definition in Rule 3240(c).

FINRA is proposing to update the term "immediate family" to better suit modern circumstances. This includes replacing "husband or wife" with "spouse or domestic partner" and encompassing step and adoptive relationships. This adjustment acknowledges the growing societal acceptance of diverse partnerships, especially crucial in financial contexts where these relationships are common and carry legal and financial implications.

Additionally, refining the "any other person" clause to cover individuals living in the same household as the registered person, whom they financially support directly or indirectly to a significant extent, brings more precision to the rule. This change ensures that the exception for individuals in the same household is dependent on financial support, aligning the definition with practical considerations and reducing the potential for misuse.

The modernization of this definition showcases a dedication to inclusivity and adaptability. It also works to strengthen the rule, making sure it stays relevant to contemporary society and prevents individuals from exploiting technicalities. These proposed changes improve the rule's effectiveness in preventing potential abuses within the financial industry, reinforcing the core principles of transparency and fairness.

d. The Clinic supports strengthening personal and business relationship exceptions

The shift from the requirement stating that "the loan would not have been solicited, offered, or given had the customer and the registered person not maintained a relationship outside of the broker-customer relationship" to a "bona fide, close personal relationship between the registered person and the customer maintained outside of, and formed prior to, the broker-customer relationship," along with the addition of Rule 3240.04 providing factors for evaluation, holds significant advantages.

Firstly, replacing soliciting language with a bona fide requirement eliminates subjectivity and ambiguity. The determination of whether a loan was solicited could be open to interpretation and vary among individuals, whereas the bona fide requirement establishes an objective standard. This shift emphasizes the genuine and sincere nature of the relationship, focusing on authenticity and legitimacy.

Additionally, the factors test introduced by Rule 3240.04 offers clear criteria for evaluation, emphasizing specific aspects such as the duration and nature of the relationship. This clarity reduces ambiguity, providing a structured framework for assessing relationship legitimacy. The factors test eliminates potential subjective interpretations, closing loopholes and discouraging ambiguous behaviors.

The introduction of specific factors not only reduces ambiguity but also offers clear criteria for members to reference when determining whether a relationship qualifies for an exception. This clarity minimizes the potential for misinterpretation or subjective judgments, providing a more straightforward and objective evaluation process.

II. The Clinic Supports of the Proposed Notification and Approval Additions and Amendments

For the reasons stated below, the Clinic supports the amendment to the language of Rule 3240(b)(1).

a. The Clinic supports the proposed amendment to Rule 3240(b)(1) to require a registered person to provide notice to a member firm of a potential arrangement prior to entering into such arrangement.

Rule 3240(b)(1) provides that a registered person shall notify the member of borrowing or lending arrangements prior to entering into the close personal relationship, business relationship, or registered persons exceptions, and that the member “shall” pre-approve in writing. This could convey the false implication that the member *must* approve the arrangement or modification, without the ability to disapprove it.

FINRA proposes to amend Rule 3240(b)(1) to clarify that, although registered persons are required to obtain the member's prior approval of arrangements within the close personal relationship, business relationship, or registered persons exceptions, the member is not required to approve such arrangements. The proposed rule change would delete the “shall pre-approve” language. The registered person would instead be required to provide the member with notice of the arrangements or modifications “prior to entering into such arrangements” or “prior to the modification of such arrangements” and to “obtain the member's approval.”

Arrangements between registered representatives and customers risk conflicts of interest, especially for elder investors. Conflicts of interest that can occur when a representative prioritizes their own interests over their clients. Elder investors are particularly at risk of potential conflicts of interest due to a lack of access to all of the information they need to make informed decisions. Proposed Rule 3240(b)(1) would mitigate the risk of a conflict of interest by clarifying that member firms are empowered to approve or disapprove a proposed arrangement.

b. The Clinic supports the proposed amendment to Rule 3240(b)(2).

With respect to the immediate family member exception, Rule 3240(b)(2) provides that a member's written procedures may state that registered persons are not required to notify the member or receive member approval. Rule 3240(b)(2) does not specify that notice must be given in writing, and the existing record-retention provision in Rule 3240.01 requires members only to preserve written approvals.

Proposed Rule 3240(b)(1)(B) would require registered persons, prior to the initiation of a broker-customer relationship at the member with a person with whom the registered person has an existing borrowing or lending arrangement, to notify the member in writing of existing arrangements within the registered persons, personal relationship and business relationship exceptions and obtain the member's approval in writing of the broker-customer relationship. Further, the proposed rule change would require that all notices, in addition to written approvals, required under Rule 3240 be in writing and retained by the member. Members would be required to preserve records of such written notice for at least three years.

The requirement of all notices and approval to be in writing and preserved for at least three years benefits investors because it will provide documentation that can be referred to in potential cases of registered-member complaints or disciplinary actions. This modification is protective of investors because conflicts of interest would exist in the relationship regardless of whether the arrangement existed before or after the broker-customer relationship is established. Accordingly, heightened scrutiny of accounts where brokers hold a position of trust is preferred, irrespective when the relationship was formed.

In any situation where there is a loan agreement between a client and registered person, the firm should put the registered person on heightened supervision due to conflicts of interest and place additional reviews on trades and transactions in the account to ensure that the registered person is making suitable recommendations.

c. The Clinic supports the new obligations outlined in Proposed Rule 3240.06.

Proposed Rule 3240.06 would provide that upon receiving written notice under Rule 3240, the member must perform a “reasonable assessment” of the risks created by the borrowing or lending arrangement with a customer, modification to the borrowing or lending arrangement with a customer, or existing borrowing or lending arrangement with a person who seeks to be a customer of the registered person. Further, the member must also make a “reasonable determination” of whether to approve any of the aforementioned arrangements.

Proposed Rule 3240.06 would be similar to Rule 3241(b)(1), which requires members to perform a “reasonable assessment” and “reasonable determination” when receiving notice of a registered person being named a customer's beneficiary or holding a position of trust for a customer, and to supplementary material to FINRA Rule 3270 that provides factors members must consider upon receiving written notice of an outside business activity.¹

¹ Specifically, a member's “reasonable assessment” would take into consideration several factors, such as: (1) any potential conflicts of interest in the registered person being in a borrowing or lending arrangement with a customer; (2) the length and type of relationship between the customer and registered person; (3) the material terms of the borrowing or lending arrangement; (4) the customer's or the registered person's ability to repay the loan; (5) the customer's age; (6) whether the registered person has been a party to other borrowing or lending arrangements with customers; (7) whether, based on the facts and circumstances observed in the member's business relationship with the customer, the customer has a mental or physical impairment that renders the customer unable to protect his or her own interests; (8) any disciplinary history or indicia of improper activity or conduct with respect to the customer or the customer's account (e.g., excessive trading); and (9) any indicia of customer vulnerability or undue influence of the registered person over the customer.

While a listed factor may not be applicable to a particular situation, the factors that a member considers should allow for a reasonable assessment of the associated risks so that the member can make a reasonable determination of whether to approve the borrowing or lending arrangement, modification to the borrowing or lending arrangement. Lastly, Proposed Rule 3240.06 would harmonize the review process outlined in Rule 3241 with the proposed process in Rule 3240, resulting in greater statutory understanding and adherence. This could result in more questionable arrangements being scrutinized, leading to improved investor protection.

Conclusion

For the reasons set forth above, the Clinic supports the Rule Proposal.

Respectfully submitted,

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