

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-99988; File No. SR-FINRA-2024-001)

April 18, 2024

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend FINRA Rule 3240 (Borrowing From or Lending to Customers) to Strengthen the General Prohibition Against Borrowing and Lending Arrangements.

I. Introduction

On January 2, 2024, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change (SR-FINRA-2024-001) to amend FINRA Rule 3240 (Borrowing From or Lending to Customers). As stated in the Notice, the proposed rule change would 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.³

The proposed rule change was published for public comment in the Federal Register on January 22, 2024.⁴ The public comment period closed on February 12, 2024. The Commission received comment letters in response to the Notice.⁵ On February 21, 2024, FINRA consented to

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Exchange Act Release No. 99351 (Jan. 16, 2024), 89 FR 3968 (Jan. 22, 2024) (File No. SR-FINRA-2024-001) (“Notice”), <https://www.govinfo.gov/content/pkg/FR-2024-01-22/pdf/2024-01068.pdf>.

⁴ Notice at 3968-3979.

⁵ The comment letters are available at <https://www.sec.gov/comments/sr-finra-2024-001/srfinra2024001.htm>.

an extension of the time period in which the Commission must approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change to April 19, 2024.⁶

The Commission is publishing this order pursuant to Section 19(b)(2)(B) of the Exchange Act⁷ to institute proceedings to determine whether to approve or disapprove the proposed rule change.

II. Description of the Proposed Rule Change

A. Background

FINRA Rule 3240 generally prohibits, with exceptions, registered persons from borrowing money from, or lending money to, their customers. The rule has five tailored exceptions,⁸ available only when the registered person's member firm has written procedures allowing the borrowing and lending of money between such registered persons and customers of the member,⁹ the borrowing or lending arrangements meet the conditions applicable to the relevant exception and, when required, the registered person notifies the member of a borrowing or lending arrangement, prior to entering into such arrangement, and obtains the member's pre-approval in writing.¹⁰ FINRA stated that the exceptions are for limited situations where the likelihood that the registered person and customer entered into the borrowing or lending arrangement by virtue of the broker-customer relationship is reduced, and the potential risks are

⁶ See letter from Ilana Reid, Associate General Counsel, FINRA, to Daniel Fisher, Branch Chief, Division of Trading and Markets, Commission, dated February 21, 2023 [sic], <https://www.finra.org/sites/default/files/2024-02/SR-FINRA-2024-001-Extension1.pdf>.

⁷ 15 U.S.C. 78s(b)(2)(B).

⁸ See Rule 3240(a)(2)(A) (the "immediate family exception"); Rule 3240(a)(2)(B) (the "financial institution exception"); Rule 3240(a)(2)(C) (the "registered persons exception"); Rule 3240(a)(2)(D) (the "personal relationship exception"); Rule 3240(a)(2)(E) (the "business relationship exception").

⁹ See Rule 3240(a)(1).

¹⁰ See Rules 3240(a)(3) and 3240(b).

outweighed by the potential benefits of allowing registered persons to enter into arrangements with such customers.¹¹

B. Proposed Rule Change

1. The General Prohibition on Borrowing From or Lending to Customers

The proposed rule change would amend the title of FINRA Rule 3240 from “Borrowing From or Lending to Customers” to “Prohibition on Borrowing From or Lending to Customers,” and change the title of Rule 3240(a) from “Permissible Lending Arrangements; Conditions” to “General Prohibition; Permissible Borrowing or Lending Arrangements; Conditions.”¹²

The proposed rule change would also make the following substantive changes to the general prohibition.

a. Pre-existing Relationships

The proposed rule change would amend Rule 3240(a) to clarify that the rule’s general requirements concerning borrowing and lending arrangements—including the general prohibition—apply to arrangements that pre-exist a new broker-customer relationship.¹³ Specifically, the proposed rule change would amend the introductory clause in Rule 3240(a) to prohibit registered persons from initiating a broker-customer relationship with a person with whom the registered person has an existing borrowing or lending arrangement.¹⁴

¹¹ See Notice at 3969.

¹² Proposed Rule 3240 and Proposed Rule 3240(a).

¹³ See Notice at 3969.

¹⁴ Proposed Rule 3240(a).

b. Definition of Customer

The proposed rule change would extend the rule’s limitations to borrowing or lending arrangements entered into within six months after a broker-customer relationship terminates.¹⁵ Specifically, the proposed rule change would add new FINRA Rule 3240.02 (Customer) to define “customer,” for purposes of Rule 3240, as including any customer who has, or in the previous six months had, a securities account assigned to the registered person at any member.¹⁶

c. Borrowing and Lending Arrangements with Related Parties

The proposed rule change would extend the rule’s requirements to borrowing or lending arrangements that involve similar conflicts as ones presented by arrangements directly between registered persons and their customers.¹⁷ Specifically, the proposed rule change would add new FINRA Rule 3240.05 (Arrangements with Persons Related to Either the Registered Person or the Customer) to provide that “[a] registered person instructing or asking a customer to enter into a borrowing or lending arrangement with a person related to the registered person (e.g., the registered person’s immediate family member or outside business) or to have a person related to the customer (e.g., the customer’s immediate family member or business) enter into a borrowing or lending arrangement with the registered person would present similar conflict of interest concerns as borrowing or lending arrangements between the registered person and the customer and would not be consistent with this Rule [3240] unless the conditions set forth in [Rule 3240(a)(1), (2), and (3)] are satisfied.”¹⁸

¹⁵ See Notice at 3969.

¹⁶ Proposed Rule 3240.02.

¹⁷ See Notice at 3969.

¹⁸ Proposed Rule 3240.05.

d. Owner-Financing Arrangements

The proposed rule change would add Rule 3240.03 (Owner-Financing Arrangements) to state that, for purposes of Rule 3240, “borrowing or lending arrangements include owner-financing arrangements.”¹⁹ For example, Rule 3240 would apply to situations where a registered person purchases real estate from his customer, the customer agrees to finance the purchase, and the registered person provides a promissory note for the entire purchase price or arranges to pay in installments.²⁰

2. The “Immediate Family” Definition

Currently, one exception to Rule 3240’s general prohibition is for borrowing or lending arrangements with a customer who is a member of the registered person’s immediate family.²¹ Rule 3240(c) defines “immediate family” to mean “parents, grandparents, mother-in-law or father-in-law, husband or wife, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, children, grandchildren, cousin, aunt or uncle, or niece or nephew, and any other person whom the registered person supports, directly or indirectly, to a material extent.”²²

The proposed rule change would modernize the “immediate family” definition.²³ Specifically, the proposed rule change would amend Rule 3240(c) to replace “husband or wife” with “spouse or domestic partner” and amend the definition so that it “includes step and adoptive relationships.”²⁴ In addition, the proposed rule change would amend the “any other person”

¹⁹ Proposed Rule 3240.03.

²⁰ See Notice at 3969.

²¹ See Rule 3240(a)(2)(A).

²² Rule 3240(c).

²³ See Notice at 3970.

²⁴ Proposed Rule 3240(c).

clause to limit it to “any other person who resides in the same household as the registered person and the registered person financially supports, directly or indirectly, to a material extent.”²⁵

3. The Personal Relationship and Business Relationship Exceptions

Currently, Rule 3240 provides an exception to the rule’s general prohibition for arrangements based on a “personal relationship with the customer, such 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” (the “personal relationship exception”).²⁶ The proposed rule change would narrow the personal relationship exception to arrangements that are based on a “bona fide, close personal relationship between the registered person and the customer maintained outside of, and formed prior to, the broker-customer relationship.”²⁷ Similarly, current Rule 3240 provides an exception to the rule’s general prohibition for arrangements based on a “business relationship outside of the broker-customer relationship” (the “business relationship exception”).²⁸ The proposed rule change would also narrow the business relationship exception to arrangements that are based on a “bona fide business relationship outside of the broker-customer relationship.”²⁹

In addition to narrowing the personal relationship and business relationship exceptions, the proposed rule change would add new Rule 3240.04 (Close Personal Relationships; Business Relationships), which would provide factors for evaluating whether a borrowing or lending arrangement is based on a close personal relationship or a business relationship. The proposed

²⁵ Id.

²⁶ Rule 3240(a)(2)(D).

²⁷ Proposed Rule 3240(a)(2)(D).

²⁸ Rule 3240(a)(2)(E).

²⁹ Proposed Rule 3240(a)(2)(E).

factors would include, but would not be limited to, “when the relationship began, its duration and nature, and any facts suggesting that the relationship is not bona fide or was formed with the purpose of circumventing the purpose of Rule 3240.”³⁰ Proposed Rule 3240.04 would also provide examples of “close personal relationships,” including, “a childhood or long-term friend or a godparent.”³¹ Additionally, proposed Rule 3240.04 would provide examples of a “business relationship,” including “a loan from a registered person to a small outside business that the registered person co-owned for years for the sole purpose of providing the business with additional operating capital.”³²

4. Notification and Approval Requirements

Currently, Rule 3240(b) contains notification and approval requirements for borrowing or lending arrangements within the five exceptions, which vary depending on which exception applies.³³ The proposed rule change would make the following changes to the notification and approval requirements.

a. Notification and Approval Requirements with Respect to the Personal Relationship, Business Relationship, and Registered Persons Exceptions

Current Rule 3240(b)(1)(A) provides that a registered person shall notify the member of borrowing or lending arrangements made under the personal relationship exception,³⁴ business relationship exception,³⁵ or the registered persons exception³⁶ prior to entering into such

³⁰ Proposed Rule 3240.04.

³¹ Id.

³² Id.

³³ See Notice at 3970.

³⁴ Rule 3240(a)(2)(D).

³⁵ Rule 3240(a)(2)(E).

³⁶ Rule 3240(a)(2)(C).

arrangements, and that the member shall pre-approve in writing such arrangements.³⁷ The proposed rule change would amend Rule 3240(b)(1)(A) 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.³⁸ Specifically, the proposed rule change would delete the “shall pre-approve” language and instead require the registered person 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 “obtain the member’s approval.”³⁹

Further, the proposed rule change would amend Rule 3240(b)(1) to clarify that it also would apply to pre-existing arrangements. Specifically, 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.⁴⁰

b. Notification and Approval Requirements with Respect to the Immediate Family Member

Current Rule 3240(b)(2) provides, in pertinent part, that a member’s written procedures may indicate that registered persons are not required to notify the member or receive member approval of arrangements within the immediate family exception.⁴¹ The proposed rule change

³⁷ Rule 3240(b)(1)(A).

³⁸ See Notice at 3970.

³⁹ See proposed Rule 3240(b)(1)(A).

⁴⁰ See proposed Rule 3240(b)(1)(B).

⁴¹ Rule 3240(b)(2).

would amend Rule 3240(b)(2) to clarify that the same approach would apply to arrangements that pre-exist the broker-customer relationship.⁴² Specifically, the proposed rule change would amend Rule 3240(b)(2) to provide that the member’s procedures may indicate that registered persons are not required to notify the member or receive member approval of such arrangements either prior to or subsequent to initiating a broker-customer relationship.⁴³ FINRA stated, however, that proposed Rule 3240(b)(2) implies that members may choose to require such notice and approval of those arrangements.⁴⁴

c. Notification and Approval Requirements with Respect to the Financial Institution Exception

Current Rule 3240(b)(3) provides, in pertinent part, that a member’s written procedures may indicate that registered persons are not required to notify the member or receive member approval of arrangements within the financial institution exception,⁴⁵ provided that “the loan has been made on commercial terms that the customer generally makes available to members of the general public similarly situated as to need, purpose and creditworthiness.”⁴⁶ The proposed rule change would amend Rule 3240(b)(3) to clarify that it also would apply to arrangements that pre-exist the broker-customer relationship.⁴⁷ Specifically, the proposed rule change would amend Rule 3240(b)(3) to provide that the member’s procedures may also indicate that

⁴² See Notice at 3971.

⁴³ See proposed Rule 3240(b)(2).

⁴⁴ See Notice at note 21.

⁴⁵ The “financial institution exception” states that no person associated with a member in any registered capacity may borrow money from or lend money to any customer of such person, unless the customer (i) is a financial institution regularly engaged in the business of providing credit, financing, or loans, or other entity or person that regularly arranges or extends credit in the ordinary course of business and (ii) is acting in the course of such business. See Rule 3240(a)(2)(B).

⁴⁶ Rule 3240(b)(3).

⁴⁷ See Notice at 3971.

registered persons are not required to notify the member or receive member approval of such arrangements either prior to or subsequent to initiating a broker-customer relationship.⁴⁸

d. Notifications in Writing

Currently, Rule 3240 does not specify that notice must be given in writing, and the record-retention provision in Rule 3240.01 requires members only to preserve written approvals.⁴⁹ The proposed rule change would require that all notices required under Rule 3240 be in writing and retained by the member.⁵⁰ Specifically, the proposed rule change would require registered persons to give written notice and require members to preserve records of such written notice for at least three years.⁵¹ The proposed rule change would also amend Rule 3240.01 to provide that the record-retention requirements would be for purposes of complying with proposed Rule 3240(b) regarding notification and approval requirements for borrowing or lending arrangements within the five exceptions, if any apply, not just borrowing or lending arrangements within the exceptions referenced in current Rule 3240(b)(1).⁵²

e. Reasonable Assessment by Member of the Risks Created by the Borrowing or Lending Arrangement

The proposed rule change also would add new Rule 3240.06 (Obligations of Member Receiving Notice). Proposed Rule 3240.06 would provide that upon receiving written notice under Rule 3240, the member “shall 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

⁴⁸ See proposed Rule 3240(b)(3).

⁴⁹ See Notice at 3971.

⁵⁰ Id.

⁵¹ See proposed Rules 3240(b)(1)(A) and (b)(1)(B) and proposed Rule 3240.01.

⁵² See proposed Rule 3240.01.

seeks to be a customer of the registered person.”⁵³ It would further provide that the member “shall also make a reasonable determination of whether to approve the borrowing or lending arrangement, modification to the borrowing or lending arrangement, or, where there is an existing borrowing or lending arrangement with a person who seeks to be a customer of the registered person, the broker-customer relationship.”⁵⁴ FINRA stated that it expects that 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.⁵⁵

⁵³ Proposed Rule 3240.06

⁵⁴ Id.

⁵⁵ See Notice at 3971.

FINRA also stated that it would expect a member to try to discuss the arrangement with the customer, as part of the member's reasonable assessment of the risks.⁵⁶

III. Proceedings to Determine Whether to Approve or Disapprove File No. SR-FINRA-2024-001 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act to determine whether the proposed rule change should be approved or disapproved.⁵⁷ Institution of proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Exchange Act, the Commission is providing notice of the grounds for disapproval under consideration.⁵⁸ The Commission is instituting proceedings to allow for additional analysis and input concerning whether the proposed rule change is consistent with the Exchange Act and the rules thereunder.

IV. Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposed rule change. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change is consistent with the Exchange Act and the rules thereunder.

Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will

⁵⁶ See id. at 3972.

⁵⁷ 15 U.S.C. 78s(b)(2)(B).

⁵⁸ Id.

consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.⁵⁹

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change should be approved or disapproved by [INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [INSERT DATE 35 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER].

Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's internet comment form (<https://www.sec.gov/rules/sro.shtml>); or
- Send an email to rule-comments@sec.gov. Please include file number SR-FINRA-2024-001 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to file number SR-FINRA-2024-001. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (<https://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications

⁵⁹ Section 19(b)(2) of the Exchange Act, as amended by the Securities Acts Amendments of 1975, Pub. L. 94-29, 89 Stat. 97 (1975), grants the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Acts Amendments of 1975, Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 249, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. Do not include personal identifiable information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection. All submissions should refer to file number SR-FINRA-2024-001 and should be submitted on or before [INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER]. If comments are received, any rebuttal comments should be submitted on or before [INSERT DATE 35 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁶⁰

Sherry R. Haywood,

Assistant Secretary.

⁶⁰ 17 CFR 200.30-3(a)(12); 17 CFR 200.30-3(a)(57).