

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-61537 File No. SR-FINRA-2009-095)

February 18, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change to Adopt FINRA Rule 3240 (Borrowing From or Lending to Customers) in the Consolidated FINRA Rulebook

I. Introduction

On December 31, 2009, Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to adopt NASD Rule 2370 (Borrowing From or Lending to Customers) as FINRA Rule 3240 (Borrowing From or Lending to Customers) in the Consolidated FINRA Rulebook³ with certain changes and to delete Incorporated NYSE Rules 352(e) (Limitations on Borrowing From or Lending to Customers), (f) (Loan Procedures) and (g). The proposed rule change would also add a Supplementary Material section regarding record retention requirements to proposed FINRA Rule 3240. The proposed rule change was published for comment in the Federal Register on

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (“Incorporated NYSE Rules”) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the “Transitional Rulebook”). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (“Dual Members”). The FINRA Rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see Information Notice, March 12, 2008 (Rulebook Consolidation Process).

January 12, 2010.⁴ The Commission received no comments on the proposed rule change. This order approves the proposed rule change.

II. Description of the Proposed Rule Change

FINRA proposed adopting NASD Rule 2370 as FINRA Rule 3240 in the Consolidated FINRA Rulebook with certain changes as described below. FINRA also proposed deleting Incorporated NYSE Rules 352(e) through (g)⁵ from the Transitional Rulebook.⁶ Further, the proposed rule change would also add a Supplementary Material section regarding record retention requirements to proposed FINRA Rule 3240.

A. Background

The purpose of NASD Rule 2370 is to give FINRA member broker-dealers the opportunity to evaluate the appropriateness of particular lending arrangements between their registered persons and customers, to the extent permitted by the member, and the potential for conflicts of interests between both the registered person and his or her customer and the registered person and the member with which he or she is associated.

To that end, NASD Rule 2370 prohibits registered persons from borrowing money from or lending money to their customers (collectively referred to as “lending arrangements”) unless certain conditions are met. Specifically, under Rule 2370, no registered person may borrow money from or lend money to his or her customer unless the firm has written procedures allowing such lending arrangements and (1) the customer is a member of the registered person’s

⁴ See Securities Exchange Act Release No. 61302 (January 6, 2010), 75 FR 1672 (January 12, 2010).

⁵ For convenience, the Incorporated NYSE Rules are referred to as the NYSE Rules.

⁶ NYSE Rules 352(a) through (d) were deleted as part of a prior rule change. See Securities Exchange Act Release No. 60701 (September 21, 2009), 74 FR 49425 (September 28, 2009) (Order Approving File No. SR-FINRA-2009-014).

immediate family;⁷ (2) the customer is in the business of lending money; (3) the customer and the registered person are both registered persons of the same firm; (4) the lending arrangement is based on a personal relationship outside of the broker-customer relationship; or (5) the lending arrangement is based on a business relationship outside of the broker-customer relationship. In addition, with the exception of lending arrangements between immediate family members and lending arrangements between registered persons and customers in the business of lending money, FINRA members are required to pre-approve in writing the other lending arrangements described above.

With respect to lending arrangements between immediate family members, a FINRA member's written procedures may indicate that the member permits such lending arrangements and that registered persons need not notify the member or receive member approval for such lending arrangements.

For lending arrangements between registered persons and customers in the business of lending money, a member's written procedures may indicate that registered persons are not required to notify the member or receive member approval for such lending arrangements, provided that such lending arrangements have been made on commercial terms that the customer generally makes available to members of the general public who are similarly situated as to need, purpose and creditworthiness.⁸ Further, the member need not investigate such lending

⁷ NASD Rule 2370 defines the term "immediate family" to include 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.

⁸ The fact that a registered person can negotiate a better rate or terms for a loan that is not the product of the broker-customer relationship would not vitiate the idea that the loan occurred on terms generally offered to the public. See Notice to Members 04-14 (March 2004).

arrangements, but may rely on the registered person's representation that the terms of the loan meet these standards.

It is important to note that members can choose to permit registered persons to borrow money from or lend money to their customers consistent with the requirements of the rule or prohibit the practice in whole or in part.

NYSE Rules 352(e) through (g) also govern lending arrangements between registered persons and their customers. These provisions are substantially similar to the provisions of NASD Rule 2370, with one exception. NYSE Rule 352(f) provides an exception from the pre-approval requirements of the rule for loans totaling \$100 or less between registered persons of the same firm.

B. Proposal

FINRA proposed adopting NASD Rule 2370 as FINRA Rule 3240 in the Consolidated FINRA Rulebook, subject to the following changes. FINRA proposed amending paragraph (a) (Permissible Lending Arrangements; Conditions) of the rule to indicate more explicitly that such arrangements are subject to the procedural requirements set forth in paragraph (b) (Notification and Approval) of the rule. FINRA also proposed amending paragraph (a)(2)(B) of the rule regarding permissible lending arrangements between registered persons and customers in the business of lending money to indicate more explicitly that such customers must be acting in the course of such business.

Further, FINRA proposed amending paragraph (b)(1) of the rule to require expressly that registered persons notify their member firms of the lending arrangements that require member pre-approval (FINRA proposed this change for purposes of consistency with paragraphs (b)(2) and (3) of the rule, which provide that a registered person is not required either to notify the

member or receive member approval for certain specified lending arrangements) and to clarify that any modifications to such lending arrangements (including any extension of the duration of such arrangements) are also subject to notification and member pre-approval.

In addition, FINRA proposed amending the definition of “immediate family” in paragraph (c) (Definition of Immediate Family) of the rule to replace the reference that the term “includes” the enumerated persons to reflect that the term “means” such persons. Finally, FINRA proposed adding Supplementary Material .01 (Record Retention) requiring that members preserve the written pre-approval required by the rule for at least three years after the date that the lending arrangement has terminated or for at least three years after the registered person’s association with the member has terminated. FINRA proposed deleting NYSE Rules 352(e) through (g) as the provisions of the NYSE rules are substantially similar to NASD Rule 2370.

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. The implementation date will be no later than 180 days following Commission approval.

III. Discussion and Findings

After a careful review of the proposal, the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to FINRA.⁹ In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Exchange Act,¹⁰ which requires, among other things, that FINRA’s rules be designed to prevent fraud and manipulative practices and to promote just and equitable principles of trade and, in general, to protect investors and the public

⁹ In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁰ 15 U.S.C. 78q-3(b)(6).

interest. The Commission believes that the proposed rule change is reasonably designed to achieve these ends by providing FINRA member broker-dealers the opportunity to evaluate the appropriateness of certain lending arrangements between their registered persons and others, to the extent permitted by a FINRA member broker-dealer, and the potential that these lending arrangements could create certain conflicts of interest.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,¹¹ that the proposed rule change (SR-FINRA-2009-095) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹²

Florence E. Harmon
Deputy Secretary

¹¹ 15 U.S.C. 78s(b)(2).

¹² 17 CFR 200.30-3(a)(12).