

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-61302; File No. SR-FINRA-2009-095)

January 6, 2010

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

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that 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”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing 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 Rulebook<sup>3</sup> 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 also would add a Supplementary Material section regarding record retention requirements to proposed FINRA Rule 3240.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See supra note 4 and accompanying text.

The text of the proposed rule change is available on FINRA's Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

As part of the process of developing a new consolidated rulebook ("Consolidated FINRA Rulebook"),<sup>4</sup> FINRA is proposing to adopt NASD Rule 2370 as FINRA Rule 3240 in the Consolidated FINRA Rulebook with certain changes as described below. The proposed rule change also would delete Incorporated NYSE Rules 352(e) through (g)<sup>5</sup> from the Transitional

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<sup>4</sup> 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).

<sup>5</sup> For convenience, the Incorporated NYSE Rules are referred to as the NYSE Rules.

Rulebook.<sup>6</sup> Further, the proposed rule change would add a Supplementary Material section regarding record retention requirements to proposed FINRA Rule 3240.

### Background

The purpose of NASD Rule 2370, which became effective in November 2003, is to give members 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. More 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 immediate family;<sup>7</sup> (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

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<sup>6</sup> 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).

<sup>7</sup> 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.

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.

With respect to 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.<sup>8</sup> Further, the member need not investigate such lending 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-

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<sup>8</sup> 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).

approval requirements of the rule for loans totaling \$100 or less between registered persons of the same firm.

### Proposal

FINRA proposes to adopt NASD Rule 2370 as FINRA Rule 3240 in the Consolidated FINRA Rulebook, subject to the following changes. FINRA proposes to amend 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 proposes to amend 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 proposes to amend 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 is proposing 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 proposes to amend 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 proposes to add 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 proposes to delete 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.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>9</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change will further the purposes of the Act by giving members the opportunity to evaluate the appropriateness of certain lending arrangements between their registered persons and others, to the extent permitted by a member, and the potential that these lending arrangements could create certain conflicts of interest.

### B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

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<sup>9</sup> 15 U.S.C. 78o-3(b)(6).

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2009-095 on the subject line.

##### Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2009-095. This file number should be included on the subject line if e-mail 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 Web site (<http://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 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 inspection and copying 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. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2009-095 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>10</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>10</sup> 17 CFR 200.30-3(a)(12).