

## FINRA RULE 3240: Borrowing From or Lending to Customers

<http://brokeandbroker.com/PDF/FINRA3240BorrowingRule.pdf>

An analysis by Bill Singer, Esq. of the *BrokeAndBroker.com* Blog

Bill Singer's online resume: [http://www.rbdlaw.com/bios\\_singer.html](http://www.rbdlaw.com/bios_singer.html)

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3000. SUPERVISION AND RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS

3200. RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS

3240. Borrowing From or Lending to Customers

**Bill Singer's Comment:** Note that the *Borrowing Rule* addresses both borrowing and lending, but that such activities are proscribed here only to the extent that the contra-side of the arrangement is a customer. Member firms can choose to permit registered persons to borrow from or lend to their customers consistent with this rule OR the member may prohibit the practice in whole or in part. As such, simply because FINRA's Rule sets forth conditions that could permit borrowing/lending does not mean that a given FINRA member is required by the regulator to allow such activity.

### (a) Permissible Lending Arrangements; Conditions

No person associated with a member in any registered capacity may borrow money from or lend money to any customer of such person unless:

**Bill Singer's Comment:** Note that the specific proscription here is from borrowing/lending to any customer of "such person" -- the limitation is on contemplated activity with "your" customer and not merely a customer of your firm.

(1) the member has written procedures allowing the borrowing and lending of money between such registered persons and customers of the member;

**Bill Singer's Comment:** The threshold requirement is that you cannot borrow/lend with your customers unless your member firm has written procedures allowing borrowing/lending between registered persons and customers of the firm. If there are no written procedures, you can't get around this by walking into someone's office or making a phone call to some compliance type and getting a verbal "okay."

(2) the borrowing or lending arrangement meets one of the following conditions:

**Bill Singer's Comment:** Preliminarily, FINRA underscores that the Rule does not merely address borrowing from customers but also lending to them.

(A) the customer is a member of such person's immediate family;

**Bill Singer's Comment:** What constitutes an "immediate family" member? Good question, and one that is pointedly answered in section (c), below. Why is that critical definition not immediately provided here following the first use of the term? Hey, don't get me started with how rules are drafted. Bottom line, one of the five

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approved categories of your customers with which you can borrow/lend is an immediate family member.

(B) 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;

**Bill Singer's Comment:** In addition to financial institutions engaged in the three covered businesses of providing credit, financing, or loans (such transactions typically include, but are not limited to, mortgages, personal loans, home equity lines of credit, and credit card accounts, and also include lending arrangements with an affiliate of the customer), a registered person could conceivably lend to or borrow from a non-financial institution or human being provided that the contra-party regularly arranges/extends credit (but apparently not also financing or loans -- those seem limited to financial institutions) in the ordinary course of business AND is so acting. Clearly, FINRA is warning you that the contemplated borrowing/lending must be in the ordinary course of business.

(C) the customer and the registered person are both registered persons of the same member;

**Bill Singer's Comment:** Nothing like owing a co-worker money! Nonetheless, if the lender/borrower is your customer and also registered at your member, then that satisfies one of the five conditions under this section.

(D) the lending arrangement is 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;

**Bill Singer's Comment:** If you and your customer have a personal relationship outside of the mere broker-customer relationship (perhaps high-school buddies, weekend softball teammates, or members of the same church) that might qualify as a circumstance in which the loan would be viewed as not springing solely from the broker-client relationship.

or

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(E) the lending arrangement is based on a business relationship outside of the broker-customer relationship; and

**Bill Singer's Comment:** Similar to the "personal" relationship exception, if you have a separate business relationship that of broker-customer (perhaps your customer is a service provider to you in another business or a professional who handles some non-industry business matters for you) that may constitute the fifth condition.

(3) the requirements of paragraph (b) of this Rule are satisfied.

**(b) Notification and Approval**

**Bill Singer's Comment:** It can't be spelled out any plainer: This is about notifying your member AND getting your member's approval. It's not one or the other.

(1) The registered person shall notify the member of the borrowing or lending arrangements described in paragraphs (a)(2)(C), (D), and (E) above prior to entering into such arrangements

**Bill Singer's Comment:** First off, the notification requirement must always be satisfied when your customer is not an immediate family member, a financial institution, or an entity/individual in the business of extending credit. The other side of that equation, is that you must always first notify your firm of the arrangement, if your customer is another registered person at your firm, or if you are claiming a personal/business relationship exists. Separately, the contemplated notice is prior to entering into the arrangement.

and the member shall pre-approve in writing such arrangements

**Bill Singer's Comment:** The Rule requires the member firm to pre-approve in writing the requested arrangement. You should not rely upon an oral okay -- and I don't care who at your firm tells you that it's okay to go ahead on the oral say-so. Just watch how that person double-tracks if FINRA asks for a confirmation of that advice.

The registered person shall also notify the member and the member shall pre-approve in writing any modifications to such arrangements, including any extension of the duration of such arrangements.

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**Bill Singer's Comment:** Also, you can't play the old switcheroo. If you asked for permission to engage in X and you subsequently modify the loan (particularly an extension of the loan's term or repayment), then you have to go through the entire notification and pre-approval in writing protocol.

(2) With respect to the borrowing or lending arrangements described in paragraph (a)(2)(A) above, a member's written procedures may indicate that registered persons are not required to notify the member or receive member approval either prior to or subsequent to entering into such borrowing or lending arrangements.

**Bill Singer's Comment:** If you look back up to the top of the Rule, you will see the provision that would permit lending to or borrowing from customers who are also immediate family members (which still isn't formally defined, as yet, at this point of the Rule). Nonetheless, you may not need to notify your firm or get its prior approval if your customer is an immediate family member provided that your member has a specific written procedure waiving said notice and/or approval.

(3) With respect to the borrowing or lending arrangements described in paragraph (a)(2)(B) above, a member's written procedures may indicate that registered persons are not required to notify the member or receive member approval either prior to or subsequent to entering into such borrowing or lending arrangements, 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. For purposes of this subparagraph, the member may rely on the registered person's representation that the terms of the loan meet the above-described standards.

**Bill Singer's Comment:** As to arrangements involving financial institutions (or credit providing companies/individuals), there is an exemption from the need to give notice or obtain approval provided that the loan will be made on commercial terms generally available to the similarly situated general public (taking into account need, purpose, and creditworthiness). FINRA does not necessarily require you to document those preconditions to your member and your representation may be deemed satisfactory. The issue here is that you better not be getting a so-called "sweetheart deal." Bottom line, the arrangement better pass the sniff test.

### (c) Definition of Immediate Family

The term "immediate family" means 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.

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**Bill Singer's Comment:** Finally -- here it is, the critical definition. Make sure to check the list and note that it also covers folks to whom you provide *material* support on a direct or indirect basis; as such, "any other person" could include non-relatives under the term "immediate family."

### **Supplementary Material:**

**.01 Record Retention.** For purposes of paragraph (b)(1) of this Rule, members shall preserve the written pre-approval for at least three years after the date that the borrowing or lending arrangement has terminated or for at least three years after the registered person's association with the member has terminated.

**Bill Singer's Comment:** This language requires your member firm to preserve the written approvals for at least three years from the date the arrangement terminated or at least three years after the registered person's association has terminated with the member. Be careful not to misinterpret this record retention provision: *You must retain the pre-approval for three years from the date of:*

- *the loan's termination, or*
- *the registered person's termination from the subject member.*

## FINRA Regulatory Sanctions

In **FINRA Regulatory Notice 17-13: Sanction Guidelines / FINRA's NAC Revises the Sanction Guidelines** (April 2017),

<http://www.finra.org/sites/default/files/Regulatory-Notice-17-13.pdf>, the self-regulatory organization notes in pertinent part:

**4. Borrowing From or Lending to Customers.** There are large numbers of litigated and settled cases involving borrowing and lending arrangements between registered representatives and customers, but the current iteration of the *Sanction Guidelines* has no guideline related to these types of violations. The introduction of a guideline related to borrowing and lending arrangements between representatives and customers provides adjudicators with guidance on the assessment of sanctions in these cases.

As is now set forth in the **FINRA Sanction Guidelines** (April 2017) on page 77:

[http://www.finra.org/sites/default/files/Sanctions\\_Guidelines.pdf](http://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf)

### **Borrowing From or Lending to Customers – Failure to Comply With Rule Requirements**

#### **FINRA Rules 2010 and 3240**

#### **Principal Considerations in Determining Sanctions**

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### **See Principal Considerations in Introductory Section**

1. The purpose of the loan.
2. The number of loans at issue.
3. The number of customers involved in the respondent's borrowing or lending arrangements.
4. Whether the loan was documented through a loan agreement or other written instrument.
5. The dollar amount, duration, interest rate, repayment schedule, and other terms of the loan and whether they are reasonable.
6. Whether the respondent made payments in conformance with the loan agreement and has repaid, or attempted to repay, the loan.
7. The age, financial condition, and financial sophistication of the customer.
8. Whether the respondent made any misrepresentations to the customer.
9. Whether the respondent misled his or her employer member firm about the existence of the loan or otherwise concealed the activity from the firm.

### **Monetary Sanction**

Fine of \$2,500 to \$73,000

### **Suspension, Bar or Other Sanctions**

Consider suspending the respondent for a period of 10 business days to three months.

Where aggravating factors predominate, consider a longer suspension (of up to two years) or a bar.