MALECKI LAW

ABOUTSECURITIESLAW.COM

11 BROADWAY, SUITE 715
NEW YORK, NEW YORK 10004
(212) 943-1233 TELEPHONE
(212) 943-1238 FACSIMILE

February 14, 2022

Marcia E. Asquith
Executive Vice President, Board and External Relations
1735 K Street, NW
Washington DC 20006-1500

To Whom it May Concern,

Malecki Law files this comment in response to the Financial Industry Regulatory Authority's ("FINRA") Regulatory Notice 21-43 and proposed amendments to FINRA Rule 3240 regarding the effectiveness and efficiency of FINRA's proposal to adopt a new and modified rule that addresses borrowing and lending arrangements between registered persons and customers.

Although the proposed amendments will better define the prohibitions to the exception, we suggest that borrowing and lending with brokerage customers should be eliminated. We believe that the exceptions proposed by FINRA should be more limited, and that these exceptions be supervised on an ongoing basis, just like outside business activities and private securities transactions under FINRA Rules 3270 and 3280, respectively.

The first exception we want to address is the immediate family exception. This articulates who qualifies as an immediate family member and provides that immediate family members will always be an exception. It is too broad.

Debt situations can easily cause serious friction within family and friends, as well as business associates. In my over thirty years of practice in the securities field, I have seen many cases where multiple siblings or partners within a business will question any borrowing, lending, and brokering transactions amongst one another. The friction only increases when the broker is involved and is also managing related assets. This is neither good for public investors or for the brokerage and advisor communities.

As the last Federal Reserve survey details, income and planning for repaying debt often involve financial forecasting in income and assets – income and assets that are often managed by the broker or advisor in the debt relationship with the customer:

> Debt Burden
>
> The ability of individual families to service their loans is a function of many factors, including the level of their loan payments and the income and assets they have available to meet those payments. In planning their borrowing, families make assumptions about their future ability to repay their loans. Problems may occur when events turn out to be contrary to those assumptions. If economic shocks are sufficiently large and prevalent, a broad pattern of default, restraint in spending, and financial distress in the wider economy might ensue.

https://www.federalreserve.gov/publications/2020-bulletin-changes-in-us-family-finances-from-2016-to-2019.htm. The Federal Reserve indicates that friends and family debt accounts for $89 billion annually, according to the most recent Federal Reserve Board Survey of Consumer Finances. https://www.federalreserve.gov/econres/scfindex.htm.

Certainly educational debt for children should be permitted at the same time a parent broker or advisor may manage their children's accounts (which in large part they typically fund). However, other scenarios are problematic, as we see in countless advisory pieces from regulators around the country. As FINRA has itself observed in the senior investor context:

> "a number of recent studies indicate that the vast majority of elder financial exploitation is perpetrated by strangers, **family members** and caregivers, rather than by brokerdealers or other financial services organizations. See, e.g., Consumer Financial Protection Bureau's Office of Financial Protection for Older Americans, Suspicious Activity Reports on Elder Financial Exploitation: Issues and Trends, at 18 (Feb. 2019); Statistics and Data on Elder Abuse, The National Center for Elder Abuse, Who are the Perpetrators?."

See FINRA Regulatory Notice 19-27, https://www.finra.org/rules-guidance/notices/19-27. (Emphasis added).

Lending and borrowing with a customer, even a family member, present potential problems when there are payment deficiencies. For example, just one area of conflict raises questions about whether what is happening in the investment account is best for the customer or best for repayment of the loan. As a result, ongoing monitoring of any lending, with the exception of a child's educational lending, would need to be closely supervised to insure that the "tail does not wag the dog." There is no justification for including supervision of loans in FINRA Rule 3270, only to then omit it from 3240. It is incongruous and confusing – although the purpose of supervision on both would be the same, i.e., to make sure the customer is protected.

FINRA's own website also details that supervision and oversight is critical with respect to FINRA Rule 3270:

> "Monitoring significant changes in or other red flags relating to registered representatives' or associated persons' performance, production levels, or lifestyle that may indicate involvement in undisclosed or prohibited OBAs and PSTs (**or other business or financial arrangements with their customers, such as borrowing or lending), including conducting regular, periodic background checks and reviews of**:
>
> - correspondence (including social media);
> - fund movements;
> - marketing materials;
> - online activities;
> - customer complaints; and
> - financial records (including bank statements and tax returns).

FINRA explanation of Rule 3270 https://www.finra.org/rules-guidance/guidance/reports/2021-finras-examination-and-risk-monitoring-program/obas-and-psts (emphasis added).

There are thousands of brokers and advisors in America. If a public investor or broker/advisor needs a loan or gives a loan to a family member, there are plenty of other brokers/advisors available to take over the debtor or lender's investment account until the loan is repaid.

The fourth and fifth exceptions are the most problematic and arguably give the most leeway to open borrowing/lending arrangements to any customer and registered members. Under the fourth exception, lending arrangements can be permitted when such an 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 registered person did not maintain a relationship outside of the broker customer relationship."

This exception essentially states that anyone with a personal relationship outside the broker and customer context could meet the exception. This exception specifically is a very slippery slope. In theory and in practice, this exception could apply to virtually anyone because it would be easy to say that a broker and a customer have a personal relationship outside of the broker-customer context and allows virtually anyone to use that in an effort to get around the general prohibition. The same could be said of exception e.

With the exception of educational debt, all loans (including modifications and extensions) should be required to go through the approval and notification requirement, as well as ongoing monitoring and supervision. Without ongoing monitoring, the rule is "form over substance." The client is in a compromised and vulnerable position when the client has multiple financial relationships with the broker, inside and outside the firm.

When brokers engage in outside business activity, that activity must be monitored. In the same vein, loans between clients and brokers should be similarly monitored to ensure that loans do not cause unwanted speculation to get ahead of loan debt.

Sincerely,

Jenice L. Malecki

Jenice L. Malecki