



University of
Pittsburgh

School of Law

Hickton Center for Community Legal
Services and Clinical Legal Education

Barco Law Building
3900 Forbes Avenue
Suite 420
Pittsburgh, PA 15260
(P) 412-648-1300
(F) 412-648-1947

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Mailing Address
P.O. Box 7226
Pittsburgh, PA 15213

via email to pubcom@finra.org
Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

**RE: Regulatory Notice 21-43: Proposed Amendments to FINRA Rule 3240
and Retrospective Rule Review Report**

Dear Ms. Mitchell:

The University of Pittsburgh Securities Arbitration Clinic (the “Clinic”) appreciates the opportunity to comment on the Financial Industry Regulatory Authority’s (“FINRA”) retrospective rule review on issues relating to the proposed amendments to FINRA Rule 3240. The Clinic, a University of Pittsburgh curricular offering, provides legal representation to investors with limited resources, often advocating for people whose claims represent much of their life savings. The Clinic offers the following commentary on the proposed amendments to Rule 3240.

General Effectiveness and Challenges of the Current Rule 3240 and the Benefits of Amendment

FINRA has drafted Rule 3240 to prohibit borrowing and lending arrangements between registered persons and their customers to decrease the chance that registered persons will solicit customers for abusive loan arrangements. The current rule has instances of language that leave the potential for misuse.

The importance of regulations that protect consumers from predatory lending actions has been evident since adopting the 1968 Truth in Lending Act.¹ The Truth in Lending Act “was the first federal consumer protection law and is considered a leading consumer protection statute” and features regulations requiring the use of standard terminology and uniform disclosure requirements.² While the Truth in Lending Act pertains to the regulation of credit loans, its purpose of protecting customers from predatory lending behaviors highlights the importance of tightening the language of Rule 3240 to ensure that customers are protected.

¹ 15 U.S.C. §§1601, *et seq.*

² Daniel Rothstein, Comment, *Truth in Lending: The Right to Rescind and the Statute of Limitations*, 14 Pace L. Rev. 633, 634 (1994).

Member firms have long recognized that registered persons accepting loans from customers is problematic.³ FINRA has also recognized several instances where registered persons formed abusive lending arrangements with elderly investors in Regulatory Notice 19-27,⁴ where FINRA initially asked for comment on Rule 3240. Additionally, there have been several other instances where registered persons formed such arrangements with senior customers within the past year.⁵ Furthermore, in Regulatory Notice 19-27, FINRA also recognized attempts by registered persons to work around the rule “by having another registered person handle the account or by listing a spouse on loan documents.”

We believe that the proposed amendments to Rule 3240 tighten the language and serve further to ensure the protection of consumers from predatory lending arrangements and thus that the proposed changes are beneficial, especially for elderly investors.

Financial Exploitation of Elderly Populations Is Prevalent

FINRA and the University of Pittsburgh School of Law’s Securities Arbitration Clinic maintain a shared goal to protect elderly investors from financial exploitation. Despite rules such as 3240 being in place, financial exploitation of elders remains prevalent. Further tightening of Rule 3240 would help close loopholes that leave elders vulnerable to financial abuse.

In 2021, the Consumer Financial Protection Bureau released a report detailing the prevailing issue of elder financial exploitation in the United States.⁶ Financial institutions filed over 62,000 elder financial exploitation suspicious activity reports in 2020, such reports implicating over \$3.4 billion.⁷ The 2021 report notes a steady increase in these suspicious activity reports and the amount of money implicated, up from 21,656 reports, totaling an estimated amount of \$900 million in 2014.⁸ Moreover, most of these reports are flagged and filed by financial institutions rather than the elderly customers themselves, showing their vulnerability and lower propensity to note these financial abuses themselves without these external protections.⁹

Reported elderly financial abuse will likely continue to grow as the elderly population increases in the United States. The National Center on Elder Abuse reports that as of 2018, there

³ See, e.g., *McNabb v. SEC*, 298 F.3d 1126, 1129 (9th Cir. 2002) (where a broker-dealer was terminated from his member firm “in part on the grounds that he had violated the firm’s policy against accepting loans from customers.”).

⁴ See, e.g., *Michael Mendenhall*, OHO Decision, Case ID 2009020489901 (July 25, 2012); *Katherine Ann White*, OHO Decision, Case ID 2015045601401 (April 7, 2017).

⁵ See, e.g., *Alan Price*, FINRA Disciplinary Proceeding, Case ID 2020066136801 (January 25, 2022); *Steven Patrick Melen*, FINRA Letter of Acceptance, Waiver, and Consent, Case ID 2019062323801 (April 15, 2021); *Cynthia Kay Whitman*, FINRA Letter of Acceptance, Waiver, and Consent, Case ID 2020065709801 (April 26, 2021).

⁶ Consumer Financial Protection Bureau, *Suspicious Activity Reports on Elder Financial Exploitation* (2020). <https://www.consumerfinance.gov/consumer-tools/educator-tools/resources-for-older-adults/data-spotlight-suspicious-activity-reports-on-elder-financial-exploitation/> (Last accessed February 12, 2022).

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

were 52.4 million adults aged 65 and over in the United States.¹⁰ The organization estimates that by 2040, that number will have grown to 80 million, comprising almost 21% of the population.¹¹ Additionally, as of 2016, the population aged 85 was estimated to have nearly tripled, rising to 19 million from the reported 6.7 million.¹² The number of individuals left vulnerable to financial abuse, and the ever-growing economic impact of that abuse, provide a sufficient basis to further narrow rules, such as Rule 3240, which provide critical protections to vulnerable elderly investors.

The Center reported that financial abuse is the most prevalent among the various forms of elder abuse.¹³ The Pennsylvania Department of Aging released a report in September 2020 detailing a case study of financial exploitation of older adults in Pennsylvania.¹⁴ The report noted that 15% of the perpetrators were outside the family, friend, or caregiver categories.¹⁵ Scams and loans made up 36% of the fraud reported, totaling an estimated loss of over \$4 million.¹⁶ Of those studied, only 4% of all losses were recovered.¹⁷ A similar study in New York reflected a similar recovery percentage, with only 5% of those studied recovering their losses partially or fully.¹⁸ Given the economic implications, the category of individuals outside of family and friends who commit the financial abuse, that scams and loans are two of the top three categories of abuse, and the low recovery rates, we agree that FINRA should narrow Rule 3240 to the greatest extent possible to prevent vulnerable elderly investors from prevalent and ever-growing financial abuse through loans.

Moreover, registered persons are vulnerable to growing punishments for financial abuse. Pennsylvania recently amended their criminal code to add financial exploitation of an older adult or care-dependent person by a person in a position of trust as a criminally punishable offense.¹⁹ This creates a felony offense for financial exploitation that leads to a loss of property in the specified amounts.²⁰ The statute describes a person in a “position of trust” as “[a] person [who] has a fiduciary obligation to an older adult or care-dependent person, including through the power of attorney, guardianship, custodianship or conservatorship or as a trustee or personal representative.”²¹ Investment advisers could presumably be held criminally liable for offenses under this definition. Given the grave consequences of the statute, it is clear that the narrowing of exceptions of Rule 3240 is in line with a growing trend to protect against financial exploitation of elder adults.

For the preceding reasons, we make the following agreements or recommendations to the proposed amendments to Rule 3240.

¹⁰ National Center on Elder Abuse, Research, Statistics, and Data, (2020).
<https://www.consumerfinance.gov/consumer-tools/educator-tools/resources-for-older-adults/data-spotlight-suspicious-activity-reports-on-elder-financial-exploitation/> (Last accessed February 12, 2022).

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ Pennsylvania Department of Aging, Financial Exploitation of Older Adults: Study Report (September 2020).

¹⁵ *Id.*, at 23.

¹⁶ *Id.*, at 25.

¹⁷ *Id.*, at 27.

¹⁸ *Id.*

¹⁹ Financial Exploitation of An Older Adult or Care-Dependent Person, 18 PA. C.S., § 3922.1 (2021).

²⁰ *Id.*

²¹ 18 PA. C.S., §3922.1(f)(2)(3).

General Approval of Proposed Amendments:

Amendments that Strengthen the General Prohibition against Borrowing and Lending Arrangements

1. **Proposed change to the title of rule: “Borrowing from or Lending to Customers” → “Prohibition on Borrowing From or Lending to Customers”; Title of Rule 3240(a): “Permissible Lending Arrangements; Conditions” → “General Prohibition; Permissible Borrowing or Lending Arrangements; Conditions.”**

We agree with these proposed changes to the titles of the rules as it increases clarity on the fact that forming borrowing or lending arrangements with customers is generally prohibited, with the exceptions stated in Rule 3240(a)(2)(A), (B), (C), (D), and (E).

2. **Proposed broadening of Rule 3240(a)’s “general requirements for borrowing and lending arrangements to apply to arrangements that pre-exist a new broker-customer relationship”; Proposed Supplementary Material 3240.02 that “would define “customer” to include . . . any customer that has, or in the previous six months had, a securities account assigned to the registered person at any member.”; Proposed Supplementary Material 3240.05 extended the rule’s requirements to “Arrangements with Persons Related to Either the Registered Person or the Customer.”**

We agree with broadening the group as to whom this rule would apply. We believe that these changes would provide an adequate safeguard against the potential exploitation of customers by registered persons. If a registered person were allowed to form borrowing or lending arrangements immediately prior to the formation of a broker-customer relationship, a registered person who is not working in good faith might attempt to create an exploitative borrowing or lending arrangement prior to the formation of a broker-customer relationship to avoid the wording of the rules.

Likewise, proposed Supplementary Material 3240.02’s expanded definition of “customer” to include any customer that has had a securities account assigned to the registered person within the past six months decreases the chance that a registered person acting in bad faith would terminate a broker-customer relationship specifically to form an exploitative borrowing or lending arrangement.

Proposed Supplementary Material 3240.05 also decreases the risk of exploitative borrowing or lending arrangements being formed by extending the rule’s requirements so that registered persons or customers cannot include borrowing or lending arrangements with persons related to the other.

These proposed changes reduce the risk of a registered person succeeding in exploitative behavior and increase security in the member’s handling of their customers.

3. Proposed Supplementary Material 3240.03 that would state “borrowing and lending arrangements include owner-financing arrangements that do not involve borrowing or lending of money.”

We approve of this proposed amendment as it codifies a pre-existing interpretation of Rule 3240 and will simplify the interpretation process.

Amendments of the Definitions of “Immediate Family,” “Personal Relationship,” and “Business Relationship”

1. Proposed modernization of Rule 3240(c)’s “Immediate Family” definition; Addition of “step and adoptive relationships”

We approve of the modernization of the “Immediate Family” definition in the proposed change of “husband or wife” to “spouse or domestic partner” and the addition of step and adoptive relationships. These additions properly account for the changes in the modern social definition of “immediate family,” mirroring the definition of “immediate family” as now defined in Rule 3241.

2. Proposed narrowing of Rule 3240(a)(2)(D)’s “Personal Relationship” exception to require it to be a “close personal relationship between the registered person and the customer maintained outside of, and formed prior to, the broker-customer relationship”

We agree with the proposed amendment to Rule 3240(a)(2)(D) and proposed Supplementary Material 3240.04, as it would serve to prevent relationships from being formed under false pretenses to take advantage of a customer. By requiring personal relationships to be “close” relationships formed prior to and maintained outside of the broker-customer relationship, the risk of a registered person successfully creating a close personal relationship in bad faith solely to exploit their customer is decreased. This narrows the rule's language so that it is not as open to such risks.

3. Proposed Supplementary Material 3240.04’s “factors for evaluating whether a borrowing or lending arrangement is based on a ‘close personal relationship’ or a ‘business relationship,” and examples of a close personal relationship

We agree with the need to define and narrow “close personal relationship” and “business relationship” to prevent exploitation of these exceptions. Overall, the amendments provided specifically define “close personal relationship,” leaving uncertainty around what types of business relationships qualify and what factors to consider when analyzing if a business relationship meets the exception's threshold. Additionally, the examples provided are tailored to “close personal relationships.” We would request examples of qualifying “business relationships” be provided, as well as a narrower definition of the term.

First, we will analyze the amendments affecting the “close personal relationship” exception. We consider these amendments in light of the rule’s stated aim: to guarantee 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.” We agree that narrowing the “close personal relationship” definition aligns with FINRA’s aim to protect customers. Restricting qualifying relationships to those formed prior to, and maintained outside of, the broker-customer relationship would prevent bad actors with exploitative intentions from forming personal relationships with customers outside of the broker-customer relationship to take advantage of the exception.

Moreover, each of the factors for analyzing if a relationship is a qualifying “close personal relationship” or “business relationship” for the purposes of the exception are necessary to analyze the relationship properly. While the factors are necessary to evaluate a “close personal relationship” or a “business relationship” for purposes of Rule 3240, we believe additional factors should be considered when analyzing if a business relationship qualifies under this exception.

The first factor, when the relationship began, is crucial. If the exception only bars relationships formed within the six months before a broker-customer relationship began and the relationship in question began seven months prior to the broker-customer relationship, there should be room for caution. The final factor, facts that indicate the relationship may not be a bona fide relationship under the exception, is perhaps the most important. Any indication that a relationship may have been formed to circumvent Rule 3240 should be investigated.

As stated above, we would request more information on defining “business relationship” and the factors for analyzing if a business relationship qualifies for the exception. Some factors that may be useful to consider would be: (1) what are the financial risks for the parties in this business relationship? (Ex.: is it nominal or is there already significant trust established between the parties based on the value of their business dealings); (2) what industry does the business relationship concern? (Ex.: is this a field unrelated to securities or a finance-based business); (3) any other factor that may help determine both the trust established between the parties and the comparative risks of their past business practices and their potential borrower-lender agreements.

We found one definition of “business relationship” on FINRA’s website, in FINRA’s Notice to Members 04-15²². This definition listed three specific ways a “business relationship” could be formed in the context of the Do-Not-Call Registry.²³ The “business relationship” defined seems to be narrowly tailored to the industry. Conversely, 15 U.S.C. § 1681s-3(d)(1) defined “business relationship” in a broad sense.²⁴ While this statute is not related to the FINRA rule at issue, it shows the potential for “business relationship” to be defined broadly.

We would ask FINRA to provide a narrow definition of “business relationship.” Specifically, the most appropriate business relationships for this exception would be those in the financial industry. While perhaps proof of a relationship outside of the broker-customer

²² FINRA, Notice to Members 04-15, SEC Approves Amendments to NASD Rules Concerning Member Participation in the National Do-Not-Call Registry. <https://www.finra.org/rules-guidance/notices/04-15> (Last accessed February 6, 2022).

²³ *Id.*

²⁴ 15 U.S.C. § 1681s-3(d)(1). https://www.law.cornell.edu/definitions/uscode.php?width=840&height=800&iframe=true&def_id=15-USC-1202457133-371528456&term_occur=1&term_src=title:15:chapter:41:subchapter:III:section:1681s%E2%80%9333 (Last accessed February 6, 2022).

relationship, other business relationships may not provide the requisite knowledge or intimacy to prevent the exploitation of a vulnerable customer. Individuals may start a low-risk, nominal business relationship to take advantage of this exception. We imagine a scenario in which a broker finds a hairstylist and sees them every six weeks for a haircut and deems this a qualifying business relationship to meet the threshold of the exception. A narrower definition of “business relationship” and factors that help analyze the quality of a business relationship would help further Rule 3240’s aim to prevent exploitation of customers by brokers.

Proposed Amendments to Notification and Approval Requirements

- 1. Proposed amendment to Rule 3240(b)(1) to require a registered person to provide notice to a member firm of arrangement or modifications *prior* to entering such arrangements or modifications; removal of language that states that a member “shall pre-approve” such arrangements or modifications.**

We believe that this change will prevent the misinterpretation of the rule by registered members and disciplinary parties, and we approve of it. There are multiple disciplinary action reports where registered persons formed borrowing or lending arrangements with elderly customers without informing or receiving the approval of their member firm.²⁵ In the scenario that some did so under the impression that the “shall pre-approve” language required their firms to approve their request mandatorily, and thus neglected their duties to seek approval, this amendment will provide further clarity that their member must receive notification and may decide to approve the request or not.

- 2. Proposed addition of Rule 3240(b)(1)(B) that would require registered persons to provide notice to and seek approval from a member firm before initiating a broker-customer relationship with a customer with whom the registered person has a pre-existing borrowing or lending arrangement.**

We agree with this proposed amendment as it would bring Rule 3240(b)(1)(B) in line with the proposed change to extend Rule 3240 to brokers that have pre-existing borrowing or lending arrangements with potential customers.

- 3. Proposed amendments to Rule 3240(b)(1) and Supplementary Material 3240.01 that would require all notices and approval to be in writing and preserved for at least three years after the termination of the borrowing or lending arrangement “or at least three years after the registered person’s association with the member has been terminated.”**

We agree with these proposed amendments which require all notices and approval to be in writing and preserved for at least three years will provide records and documents that can be referred to if a registered member suffers a complaint or is subject to disciplinary action.

²⁵ See, e.g., *Alan Price*, FINRA Disciplinary Proceeding, Case ID 2020066136801 (January 25, 2022); *Steven Patrick Melen*, FINRA Letter of Acceptance, Waiver, and Consent, Case ID 2019062323801 (April 15, 2021); *Cynthia Kay Whitman*, FINRA Letter of Acceptance, Waiver, and Consent, Case ID 2020065709801 (April 26, 2021).

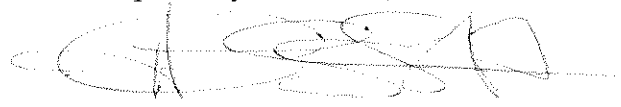
4. **Proposed amendments to Rule 3240(b)(2) and (3) that would allow for a member firm's procedures to require a registered person to notify their member firm or receive approval to form a borrowing or lending arrangement prior or subsequent to forming a broker-customer relationship with a member of their immediate family.**

We agree with these proposed amendments as they would bring Rule 3240(b)(2) and (3) in line with the proposed change to extend the rule to brokers that have pre-existing borrowing or lending arrangements with potential customers.

Conclusion

Thank you for this opportunity to comment on the proposed amendments to Rule 3240, Prohibition on Borrowing from or Lending to Customers. It is important to our clinic at the University of Pittsburgh School of Law, as our clinic provides legal representation to investors with limited resources, often advocating for people whose claims represent much of their life savings. For the aforementioned reasons, we submit our approval of the proposed amendments and the above suggestions.

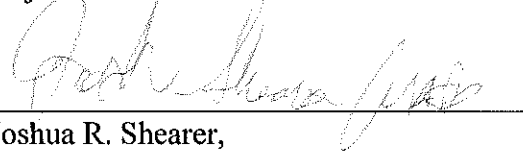
Respectfully Submitted,



Alice L. Stewart, Esquire
Director, Securities Arbitration Clinic and
Professor of Law



Rachael T. Shaw, Esquire
Adjunct Professor of Law



Joshua R. Shearer,
Certified Legal Intern
Securities Arbitration Clinic



Jacqueline M. Stalnaker,
Certified Legal Intern
Securities Arbitration Clinic

ALS/RTS/mkb