

June 10, 2003

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: File No. SR-NASD-2003-092 - Borrowing From Or Lending To Customers

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find the above-numbered rule filing. This rule filing replaces in its entirety File No. SR-NASD-2003-90, filed with your office on June 2, 2003. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Shirley H. Weiss, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-8844; e-mail shirley.weiss@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Barbara Z. Sweeney
Senior Vice President
and Corporate Secretary

cc: Christopher J. Solgan
Theodore R. Lazo

Enclosures

File No. SR-NASD-2003-092
Consists of 15 Pages
June 10, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), the National Association of Securities Dealers, Inc. ("NASD") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to adopt NASD Rule 2370 to govern lending arrangements between registered persons and customers. Below is the text of the proposed rule change. Proposed new language is underlined.

* * * * *

2370. Borrowing From or Lending to Customers

(a) No person associated with a member in any registered capacity may borrow money from or lend money to any customer of the member unless: (1) the member has written procedures allowing the borrowing and lending of money between such registered persons and customers of the member; (2) the lending or borrowing arrangement meets one of the following conditions: (A) the customer is a member of such person's immediate family; (B) the customer 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; (C) the customer and the registered person are both registered persons of the same member firm; (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 associated person not maintained a relationship outside of the broker/customer relationship; or (E) the lending arrangement is based on a business relationship outside of the broker-customer relationship; and (3) the member has pre-approved in writing the lending or borrowing arrangement.

(b) The term immediate family shall 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 shall also include any other person whom the registered person supports, directly or indirectly, to a material extent.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Directors of NASD Regulation, Inc. at its meeting on April 23, 2003, which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Dispute Resolution have been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by NASD to its Subsidiaries. The NASD Board of Governors had an opportunity to review the proposed rule change at its meeting on April 24, 2003. No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt NASD Rules without recourse to the membership for approval. NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

(b) Questions regarding this rule filing may be directed to Shirley H. Weiss, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-8844.

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

(a) Purpose

The purpose of the proposed rule change is to prohibit registered persons from borrowing money from or lending money to a customer unless the member has written procedures allowing such lending arrangements consistent with the rule, the loan falls within one of five permissible types of lending arrangements, and the member pre-approves the loan in writing. The five types of permissible lending arrangements are: the customer is a member of the registered person's immediate family (as defined in the rule); the customer is in the business of lending money; the customer and the registered person are both registered persons of the same firm; the lending arrangement is based on a personal relationship outside of the broker-customer relationship; or the lending arrangement is based on a business relationship outside of the broker-customer relationship.

NASD believes that the solicitation of loans from customers by registered persons is an area of legitimate NASD interest because of the potential for misconduct. NASD has brought disciplinary action against registered persons who have violated just and equitable principles of trade by taking unfair advantage of their customers by inducing them to lend money in disregard of the customers' best interests, or by borrowing funds from, but not repaying, customers. The potential for misconduct also exists when a registered person lends money to a customer.

The proposed rule change establishes a regulatory framework that will give members greater control over, and more specific supervisory responsibilities for, lending arrangements between registered persons and their customers. Members can choose to permit their registered persons to borrow from or lend to customers consistent with the requirements of the rule or prohibit the practice in whole or in part. If members choose to permit their registered persons to engage in lending arrangements with customers, the proposed rule change will require members to have written procedures in place to monitor such lending arrangements. The notice and approval requirements of the proposed change will enhance members' ability to supervise the activities of registered personnel. Members will be able to evaluate, before granting approval, whether the lending arrangement falls within one of the five types of permissible arrangements. Members will be permitted to approve loans only if the loan falls within one of the five types of permissible lending arrangements. In addition, the notice requirement will place an affirmative obligation on registered persons that could be separately charged in a disciplinary action if not followed.

The proposed rule change also will enhance NASD's ability to monitor loans between registered persons and their customers. Currently, under controlling Commission decisions, to bring a disciplinary action against a registered person who has entered into an unethical lending arrangement with a customer, NASD generally must prove that the arrangement is inconsistent with just and equitable principles of trade under Rule 2110 because the registered person has acted in bad faith or unethically. This can be difficult to prove in cases in which the customer is unable or unavailable to testify, or refuses to testify because he or she is relying on the registered person for financial advice. The proposed rule change will better enable NASD to monitor such loans, since members will be required to maintain written records of the loans as evidence of

compliance. NASD also believes that the proposed rule change will be an effective deterrent to potential misconduct because members will require their registered persons to give prior notice of the loan and get approval from the member before engaging in the transaction, and the lending arrangement must fall within one of the five types of permissible arrangements. Members that do not wish to engage in this review and approval process may prohibit the practice altogether.

It is important to note that this proposal does not change the application of Regulation T to lending activities by associated persons. Specifically, the definition of "creditor" under Regulation T extends to associated persons of broker/dealers and therefore, certain loans to customers by associated persons may require compliance with the provisions of Regulation T.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD's 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. NASD believes that the proposed rule change is designed to accomplish these ends by establishing a regulatory framework that will give members greater control over lending arrangements by permitting members to prohibit such arrangements altogether or, in the alternative, permit such arrangements only if they fall within one of five types of permissible arrangements. Members that permit such arrangements will be required to keep written procedures. Providing the member permits such loans, registered persons will be required to give their firms prior notice of the loan, and the member will be required to pre-approve the loan in writing. These procedures will enable both members and NASD to proscribe customer-broker loans and monitor those that have been approved.

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD 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, as amended.

5. 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 for this rule proposal. Previously, in NASD Notice to Members 94-93 (December 1994), NASD requested comment on a more limited proposal regarding the adoption of a rule that would require registered persons to provide prior notification to, and obtain prior approval from, their employing member firm when personally borrowing funds or securities from customers. NASD has not included a discussion of the comments received on that proposal because the current rule proposal differs significantly in that it specifies the permissible types of lending arrangements and requires members to have written procedures that permit only those lending arrangements consistent with the rule.

6. Extension of Time Period for Commission Action

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD

BY: _____
Barbara Z. Sweeney, Senior Vice President and
Corporate Secretary

Date: June 10, 2003

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-2003-092)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Borrowing From or Lending to Customers

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on , the 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 prepared by NASD. 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

NASD is proposing to adopt NASD Rule 2370 to govern lending arrangements between registered persons and customers. Below is the text of the proposed rule change. Proposed new language is in italics.

* * * * *

2370. Borrowing From or Lending to Customers

(a) No person associated with a member in any registered capacity may borrow money from or lend money to any customer of the member unless: (1) the member has written procedures allowing the borrowing and lending of money between such registered persons and

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

customers of the member; (2) the lending or borrowing arrangement meets one of the following conditions: (A) the customer is a member of such person's immediate family; (B) the customer 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; (C) the customer and the registered person are both registered persons of the same member firm; (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 associated person not maintained a relationship outside of the broker/customer relationship; or (E) the lending arrangement is based on a business relationship outside of the broker-customer relationship; and (3) the member has pre-approved in writing the lending or borrowing arrangement.

(b) The term immediate family shall 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 shall also include any other person whom the registered person supports, directly or indirectly, to a material extent.

* * * * *

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD 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. NASD 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

(a) Purpose

The purpose of the proposed rule change is to prohibit registered persons from borrowing money from or lending money to a customer unless the member has written procedures allowing such lending arrangements consistent with the rule, the loan falls within one of five permissible types of lending arrangements, and the member pre-approves the loan in writing. The five types of permissible lending arrangements are: the customer is a member of the registered person's immediate family (as defined in the rule); the customer is in the business of lending money; the customer and the registered person are both registered persons of the same firm; the lending arrangement is based on a personal relationship outside of the broker-customer relationship; or the lending arrangement is based on a business relationship outside of the broker-customer relationship.

NASD believes that the solicitation of loans from customers by registered persons is an area of legitimate NASD interest because of the potential for misconduct. NASD has brought disciplinary action against registered persons who have violated just and equitable principles of trade by taking unfair advantage of their customers by inducing them to lend money in disregard of the customers' best interests, or by borrowing funds from, but not repaying, customers. The potential for misconduct also exists when a registered person lends money to a customer.

The proposed rule change establishes a regulatory framework that will give members greater control over, and more specific supervisory responsibilities for, lending arrangements between registered persons and their customers. Members can choose to permit their registered persons to borrow from or lend to customers consistent with the requirements of the rule or

prohibit the practice in whole or in part. If members choose to permit their registered persons to engage in lending arrangements with customers, the proposed rule change will require members to have written procedures in place to monitor such lending arrangements. The notice and approval requirements of the proposed change will enhance members' ability to supervise the activities of registered personnel. Members will be able to evaluate, before granting approval, whether the lending arrangement falls within one of the five types of permissible arrangements. Members will be permitted to approve loans only if the loan falls within one of the five types of permissible lending arrangements. In addition, the notice requirement will place an affirmative obligation on registered persons that could be separately charged in a disciplinary action if not followed.

The proposed rule change also will enhance NASD's ability to monitor loans between registered persons and their customers. Currently, under controlling Commission decisions, to bring a disciplinary action against a registered person who has entered into an unethical lending arrangement with a customer, NASD generally must prove that the arrangement is inconsistent with just and equitable principles of trade under Rule 2110 because the registered person has acted in bad faith or unethically. This can be difficult to prove in cases in which the customer is unable or unavailable to testify, or refuses to testify because he or she is relying on the registered person for financial advice. The proposed rule change will better enable NASD to monitor such loans, since members will be required to maintain written records of the loans as evidence of compliance. NASD also believes that the proposed rule change will be an effective deterrent to potential misconduct because members will require their registered persons to give prior notice of the loan and get approval from the member before engaging in the transaction, and the lending

arrangement must fall within one of the five types of permissible arrangements. Members that do not wish to engage in this review and approval process may prohibit the practice altogether.

It is important to note that this proposal does not change the application of Regulation T to lending activities by associated persons. Specifically, the definition of "creditor" under Regulation T extends to associated persons of broker/dealers and therefore, certain loans to customers by associated persons may require compliance with the provisions of Regulation T.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD's 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. NASD believes that the proposed rule change is designed to accomplish these ends by establishing a regulatory framework that will give members greater control over lending arrangements by permitting members to prohibit such arrangements altogether or, in the alternative, permit such arrangements only if they fall within one of five types of permissible arrangements. Members that permit such arrangements will be required to keep written procedures. Providing the member permits such loans, registered persons will be required to give their firms prior notice of the loan, and the member will be required to pre-approve the loan in writing. These procedures will enable both members and NASD to proscribe customer-broker loans and monitor those that have been approved.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD 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, as amended.

(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 for this rule proposal. Previously, in NASD Notice to Members 94-93 (December 1994), NASD requested comment on a more limited proposal regarding the adoption of a rule that would require registered persons to provide prior notification to, and obtain prior approval from, their employing member firm when personally borrowing funds or securities from customers. NASD has not included a discussion of the comments received on that proposal because the current rule proposal differs significantly in that it specifies the permissible types of lending arrangements and requires members to have written procedures that permit only those lending arrangements consistent with the rule.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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. Copies of such filing will also be available for inspection and copying at the principal office of NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Margaret H. McFarland
Deputy Secretary