

**Faculty Supervisors**

ADELE BERNHARD  
RICHARD DANNENBERG  
DONALD L. DOERNBERG  
M. CHRIS FABIRCANT  
MARGARET M. FLINT  
JILL GROSS  
VANESSA MERTON

**JOHN JAY LEGAL SERVICES, INC.**

PACE UNIVERSITY SCHOOL OF LAW  
80 NORTH BROADWAY  
WHITE PLAINS, N.Y. 10603

\*\*\*\*\*

TEL. 914-422-4333  
FAX 914-422-4391  
[WWW.LAW.PACE.EDU](http://WWW.LAW.PACE.EDU)

**Executive Director**

MARGARET M. FLINT

**Clinic Administrator**

FLORIE FRIEDMAN

**Staff**

IRIS MERCADO  
ROBERT WALKER  
LOUIS MACCARIELLO

September 8, 2009

Elizabeth M. Murphy, Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

Re: Release No. 34-60475; File No. SR-FINRA-2009-047, Proposed Rule Change to Adopt FINRA Rule 3160 (Networking Arrangements Between Members and Financial Institutions) in the Consolidated FINRA Rulebook

Dear Ms. Murphy:

The Investor Rights Clinic at Pace University School of Law, operating through John Jay Legal Services, Inc. (“PIRC”),<sup>1</sup> welcomes the opportunity to comment on FINRA’s proposed rule change to adopt NASD Rule 2350, also known as the “bank broker-dealer rule,” as FINRA Rule 3160 within its Consolidated Rulebook (the “proposed rule change”). Proposed FINRA Rule 3160 is designed to prevent member firms who conduct broker-dealer services through a networking arrangement with a financial institution from confusing the financial institution’s customers by ensuring that those customers understand the difference between the financial institution’s services and those services provided by a broker-dealer.

PIRC supports the proposed rule change to the extent that it expands the protection of investors who utilize broker-dealer services resulting from networking arrangements between financial institutions and broker-dealers, even if those services are conducted off the premises of the institution. PIRC also supports the proposed rule change to the extent that it requires additional and more detailed disclosures by members to investors to enhance investors’ understandings of the relationship between and the respective roles of the broker-dealer and the financial institution.

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<sup>1</sup> PIRC, which opened in 1997, is the nation’s first law school clinic in which J.D. students, for academic credit and under close faculty supervision, provide *pro bono* representation to individual investors of modest means in arbitrable securities disputes. See Barbara Black, *Establishing A Securities Arbitration Clinic: The Experience at Pace*, 50 J. LEGAL EDUC. 35 (2000); see also Press Release, Securities Exchange Commission, *SEC Announces Pilot Securities Arbitration Clinic To Help Small Investors - Levitt Responds To Concerns Voiced At Town Meetings* (Nov. 12, 1997), available at <http://www.sec.gov/news/press/pressarchive/1997/97-101.txt> (last visited Sept. 4, 2009).

However, for the reasons discussed below, PIRC strongly opposes the proposed rule change to the extent that it does not rectify members' current sales practices conducted on the premises of retail banks that confuse and even mislead individual investors of modest means who seek safe and insured *savings* products by luring them into purchasing more risky, uninsured *investment* products. Moreover, the proposed rule change adds no additional inspection, enforcement or punitive mechanism to redress these insidious practices. Additionally, PIRC does not support other aspects of the proposed rule change, including its: (1) elimination of the requirement in NASD Rule 2350(c)(3)(B) that broker-dealers make reasonable efforts to obtain a written acknowledgement from investors of the mandated disclosures; (2) dilution of the requirements in proposed FINRA 3160(a)(1)(c) such that they apply only "to the extent practicable"; and (3) insufficient and vague setting regulations in proposed FINRA 3160(a)(1) which fail, *inter alia*, to clearly regulate the off-premises activities of broker-dealers affiliated with financial institutions, including online and other electronic activities. In short, PIRC believes that these aspects of the proposed rule change are sorely inadequate to protect investors and market integrity.

*Customer confusion and investor illiteracy – then and now*

Over the past twelve years, PIRC has learned that many investors are confused regarding the role of the financial institution –as that term is defined within the proposed rule change – with respect to the securities activities of affiliated broker-dealers through what have become known as "network arrangements." Specifically, PIRC and several of the other securities arbitration clinics have interviewed investors who tell similar stories: as an unsuspecting and trusting banking customer, they are lured into purchasing high- risk non-depository investment products within the seemingly "safe and sound" confines of their trusted financial institution.<sup>2</sup> The proposed rule change, in its present form, does not adequately protect investors or market integrity.

Through "the culmination of a \$300 million lobbying effort by the banking and financial-services industries,"<sup>3</sup> and the resulting passage of the Gramm-Leach-Bliley Act of 1999 ("GLB"),<sup>4</sup> Congress repealed key provisions of the Glass-Steagall Act of 1933, eliminating the

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<sup>2</sup> See, e.g., Richard E. Horn, Vice-President, Bank of Boston Investor Services, Inc., June 6, 1997 regulatory correspondence, available at <http://www.sec.gov/rules/proposed/s71097/horn1.txt> (last visited Sept. 4, 2009), citing Gordon J. Alexander, Ph.D., et al., *Mutual Fund Shareholders: Characteristics, Investor Knowledge, and Sources of Information* (June 24, 1996), available at <http://comptrollerofthecurrency.gov/ftp/workpaper/wp97-13.pdf> (last visited Sept. 4, 2009); see also Frederick T. Furlong and Simon H. Kwan, Federal Reserve Bank of San Francisco, *Safe & Sound Banking, 20 Years Later: What was proposed and what has been adopted* (2006), available at [http://www.frbsf.org/economics/conferences/0608/kwan\\_furlong.pdf](http://www.frbsf.org/economics/conferences/0608/kwan_furlong.pdf) (last visited Sept. 4, 2009).

<sup>3</sup> *Securities Industry Ass'n v. Board of Governors of Federal Reserve System*, 839 F.2d 47, 57 (2d Cir. 1988).

<sup>4</sup> The Gramm-Leach-Bliley Financial Modernization Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338 (codified in scattered sections of 12 and 15 U.S.C.); see also Daniel Gross, *Shattering Glass-Steagall: Lehman's failure marks the end of an era*, NEWSWEEK, Sept. 15, 2008, available at <http://www.newsweek.com/id/159092> (last visited Sept. 4, 2009). Columbia University economics professor and 2001 recipient of the Nobel Memorial Prize in Economic

long-standing separation of insurance, banking and securities businesses. GLB did nothing to enhance investor knowledge or awareness, yet it permitted, and even fostered, the forging of seemingly secure savings institutions with the risk-taking culture of investment banks. Unsophisticated depository customers were quickly exposed to new offerings from large financial services entities, such as Citigroup, which, according to at least one observer, “were given the right to merge into behemoths, but regulators remained scattered and focused on a world that had ceased to exist.”<sup>5</sup>

Investor illiteracy research conducted prior to the passage of GLB by the Securities and Exchange Commission, in conjunction with the Office of the Comptroller of the Currency, revealed pervasive customer confusion that extended across what are referred to as financial product “distribution channels.”<sup>6</sup> For example: more than one of every eight (13.3%) mutual fund investors who participated in that study, and who made those investments through the so-called “bank broker/dealer” distribution channel, incorrectly believed they could not suffer a loss of principal in a bond fund investment; one of every five (20.1%) such investors inaccurately concluded they could not lose money in a money market fund; and more than one-third (36.4%) of all such participating investors made investment decisions under the misapprehension that money market funds are insured. Another investor illiteracy study from that era made the startling determination that “fewer than one-fifth of all individual investors (in stocks, bonds, funds, or other securities) could be considered to be ‘financially literate.’”<sup>7</sup>

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Sciences, Joseph E. Stiglitz, Ph.D., attributes the 2008 economic collapse in large part to the repeal of the Glass-Steagall Act:

The most important consequence of the repeal of Glass-Steagall was indirect—it lay in the way repeal changed an entire culture. Commercial banks are not supposed to be high-risk ventures; they are supposed to manage other people’s money very conservatively. It is with this understanding that the government agrees to pick up the tab should they fail. Investment banks, on the other hand, have traditionally managed rich people’s money—people who can take bigger risks in order to get bigger returns. When repeal of Glass-Steagall brought investment and commercial banks together, the investment-bank culture came out on top. There was a demand for the kind of high returns that could be obtained only through high leverage and big risktaking.

Joseph E. Stiglitz, Ph.D., *The Economic Crisis - Capitalist Fools*, VANITY FAIR, Jan. 2009, available at <http://www.vanityfair.com/magazine/2009/01/stiglitz200901> (last visited Sept. 4, 2009).

<sup>5</sup> Chris Suellentrop, *Sandy Weill - How Citigroup’s CEO rewrote the rules so he could live richly*, SLATE.COM, Nov. 20, 2002, available at <http://www.slate.com/id/2074372/> (last visited Sept. 7, 2009).

<sup>6</sup> See Alexander, *et al.*, *supra* note 2, at abstract (The study consisted of a “nationwide telephone survey of 2,000 randomly selected mutual fund investors who purchased shares using the services of six different intermediaries, referred to as distribution channels – brokers, banks, mutual fund companies, insurance companies, employer-sponsored pension plans, and “other” (e.g., financial planners)”).

<sup>7</sup> *Id.* at n.17, p.4, citing Princeton Survey Research Assocs., *The Investor Knowledge Survey: A Report of the Findings* (1996). One of the predecessor organizations to FINRA, the National Association of Securities Dealers (“NASD”), subsequently defined “investor literacy” in 2003 as being “the understanding ordinary investors have of market principles, instruments, organizations and regulations.” Applied Research & Consulting, LLC, *NASD Investor Literacy Research* (2003), available at

A 2003 NASD study of “a wide range of investors across income, gender, size of investment portfolio and types of investments” produced similar results of investor illiteracy, despite the fact that almost seventy percent of responding investors “described themselves as being ‘somewhat knowledgeable’ about investing.”<sup>8</sup> For example, just slightly more than one-third (35%) of the NASD study’s respondents were able to “answer[ ] seven out of the ten of NASD’s Basic Market Knowledge questions correctly.” Meanwhile, almost two-thirds (62%) of respondent-investors either did not know or believed they were insured against stock market losses, and one-fifth of all respondents believed that such insurance was actually provided by either the SEC (16%) or the NASD (4%). Of course, the hallmark of the financial institution is “the presence of full faith and credit [of the United States] behind deposit insurance,” unlike the uninsured non-deposit investment products found in the typical brokerage account.<sup>9</sup>

A 2006 FINRA Investor Education Foundation study of senior investor illiteracy found that “55% of respondents lost money on an investment” and of those who did lose investment principal, almost one in five “attribute[d] the loss to being misled or defrauded and 78% of those misled or defrauded did not report it.”<sup>10</sup> These troubling findings translate into approximately ten percent of all senior citizen investors being defrauded at some point, and, of that population, four out of five defrauded seniors will not report being victimized. This study also concluded that many “victims of fraud are relatively knowledgeable and active investors.”<sup>11</sup> The SEC maintained in 2007 that the prevention of fraud targeting senior investors was a top priority, yet the experiences of PIRC and many of its peer clinics suggest that this trend has not abated.<sup>12</sup>

Finally, a 2007 FINRA Investor Education Foundation study determined, not surprisingly, that “personal relationships factor into senior investor decision making.”<sup>13</sup> According to the Electronic Financial Services Council, “[i]nvestors are most vulnerable to high

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<http://www.finra.org/web/groups/Investors/@inv/@protect/documents/Investors/P011459.pdf> (last visited Sept. 4, 2009).

<sup>8</sup> *NASD Investor Literacy Research*, *supra*, note 7.

<sup>9</sup> Carl Felsenfeld, *BANKING REGULATION IN THE UNITED STATES*, p. 76, Juris Publishing (2004).

<sup>10</sup> *NASD Senior Investor Literacy and Fraud Susceptibility Survey Executive Summary* (2006), available at [http://www.finrafoundation.org/web/groups/sai/@sai/documents/sai\\_original\\_content/p036699.pdf](http://www.finrafoundation.org/web/groups/sai/@sai/documents/sai_original_content/p036699.pdf) (last visited Sept. 4, 2009).

<sup>11</sup> FINRA Investor Education Foundation *Senior Investor Literacy and Fraud Susceptibility Survey Key Findings* (2007), available at <http://www.finra.org/web/groups/investors/@inv/@smart/documents/investors/p036810.pdf> (last visited Sept. 4, 2009).

<sup>12</sup> See, e.g., Christopher Cox, *Speech by SEC Chairman: Address to the Senior Investor Protection Symposium*, (May 18, 2007), available at <http://www.sec.gov/news/speech/2007/spch051807cc.htm> (last visited Sept. 4, 2009); see also *For Seniors*, available at <http://www.sec.gov/investor/seniors.shtml> (last visited Sept. 4, 2009).

<sup>13</sup> FINRA Investor Education Foundation *Senior Fraud Risk Survey*, Applied Research & Consulting LLC (2007), available at <http://www.finra.org/web/groups/investors/@inv/@smart/documents/investors/p036813.pdf> (last visited Sept. 4, 2009).

pressure sales tactics when they are interacting personally with a salesperson in whom they have placed their trust and confidence.”<sup>14</sup> Two of every five senior investors who participated in the 2007 FINRA study “have hired a broker recommended by a friend, relative, co-worker or neighbor.” Nearly three of every five (58%) senior investors who have been defrauded previously have entrusted their investing activity to a broker based on a personal recommendation. At least one observer has opined recently that the presence of a “‘truth bias’ caus[es] [seniors] to believe what they’re told by someone who appears to be authoritative.”<sup>15</sup>

These studies make clear that the traditional financial institution setting creates a false impression of safety and security for customers who are ill-equipped to sense they are being aggressively solicited for their savings. Representatives from a number of peer *pro bono* securities arbitration clinics report increasing frequency of senior citizen bank customers being especially vulnerable to bank employee persuasion that is designed to steer conservative savings to affiliated broker-dealers based on recommendations by someone familiar to them, such as a seemingly helpful and friendly bank teller. Additionally, anecdotal evidence suggests instances of bank employees utilizing bank customer account records in order to apply relationship-based sales tactics when potentially investable funds become available, such as on or near the maturity date of a certificate of deposit. Similarly, bank customers are unlikely to know that the bank employee who recommends the customer to an affiliated broker-dealer may well be motivated by the bank-friendly compensation limits of Regulation R, in exchange for steering long-time customers toward so-called non-depository products (*e.g.*, securities).<sup>16</sup>

These misleading activities have taken place despite the regime established by NASD Rule 2350, strongly suggesting that the current rule does not adequately protect unsophisticated investors from the confusion it was designed to eliminate. Because it appears designed to maintain this status quo, PIRC opposes proposed FINRA Rule 3160.

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<sup>14</sup> *Promoting Efficient Arrangements Between Portals and Online Brokers* (2000), submitted to the SEC by Intuit, Inc. and the Electronic Financial Services Council, available at <http://www.sec.gov/pdf/intuifscpaper.pdf> (last visited Sept. 4, 2009).

<sup>15</sup> See Jayne W. Barnard, *Deception, Decisions, and Investor Education*, 7 ELDER L. J. (2009), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1291843](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1291843).

<sup>16</sup> See Regulation R, 12 CFR § 218 and 17 CFR § 247. According to former SEC Commissioner and Acting Chair, Laura S. Unger, “[t]he Commission [r]eceived [s]ubstantial [i]nput from the [b]anking [c]ommunity and the Rules [r]eflect [t]his [i]nput . . . [and] [p]rovide [f]lexibility to [b]anks to [c]ompensate [e]mployees.” *Testimony Concerning Functional Regulation Provisions of the Gramm-Leach-Bliley Act, Before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises and the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services U.S. House of Representatives* (Aug. 2, 2001), available at <http://www.sec.gov/news/testimony/080201tslu.htm> (last visited Sept. 4, 2009); see also Securities Exchange Act of 1934, § 3(a)(4)(B)(i), 15 U.S.C. § 77c(a)(4)(B)(i).

*Inadequate enforcement and sanctions*

Bank customers have reported to PIRC and peer clinics confusing financial institution settings where the absence of appropriate on-premises signage is commonplace,<sup>17</sup> vague customer communications and inadequate disclosure are standard, and securities activities transpiring in close proximity to retail deposit-taking areas, without appropriate segregation, is a regular occurrence. Clearly, FINRA must bolster its inspection and enforcement activities with respect to the bank-broker dealer rule, as prior efforts were insufficient to protect these investors.

Instead, the proposed rule change swings in the opposite direction by reducing its compliance and disclosure mechanisms as compared to NASD Rule 2350. By eliminating the requirement in NASD Rule 2350(c)(3)(B) that broker-dealers make reasonable efforts to obtain a written acknowledgement from investors of the mandated disclosures, members have less incentive to ensure their associated persons are disclosing the mandated information; rather, the associated persons can just routinely state they make those disclosures as no investor acknowledgement would be affirmatively required. Likewise, the “to the extent practicable” language of subsection 3160(a)(1)(c) of the proposed rule change regarding the financial institution setting is particularly problematic as it invites subjective and self-serving interpretation by the bank and the broker-dealer. Thus, PIRC opposes proposed FINRA Rule 3160 because it lacks sufficient inspection, enforcement and punitive measures.

*Setting regulations are vague and insufficient to protect investors and market integrity*

While FINRA 3160 does contemplate “off-premises” broker-dealer activities generally, it explicitly carves out important electronic activities from subsection (a)(1), which governs the financial institution setting. PIRC opposes this carve-out. This provision, which addresses only “on premises” activities in the “retail deposit-taking area,” ignores that bank deposits in ever increasing numbers, such as payroll deposits, are facilitated electronically. Expansion of the setting regulation’s covered “area” should include all broker-dealer activities undertaken electronically in connection with any networking arrangement involving a financial institution.

The retail online “areas” of financial services marketing are, to date, also entirely lacking in proper monitoring, examination and inspection. According to a 2007 FINRA study, “a majority of older investors (55 and older) are interested in a variety of online resources, [although] they are less interested than younger investors: . . . [but] are more likely to visit brokerage firm web sites to research investment[s] than other web sites, such as Yahoo and

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<sup>17</sup> PIRC urges the Commission to altogether eliminate disclosure loopholes provided by what is known as “The Interagency Statement,” a scheme crafted in response to American Bankers Association lobbying efforts, allowing exempted non-disclosure in: “[i] radio broadcasts of 30 seconds or less; [ii] electronic signs [which] may include billboard-type signs that are electronic, time and temperature signs and ticker tape signs. Electronic signs would not include such media as television, on line services, or ATMs; and [iii] signs, such as banners and posters, when used only as location indicators.” Office of the Comptroller of the Currency (“OCC”), Office of Thrift Supervision (“OTS”), Federal Reserve Board (“FRB”) and Federal Deposit Insurance Corporation (“FDIC”), *Joint Interpretations of the Interagency Statement on Retail Sales of Non-deposit Investment Products*, Sept. 12, 1995, available at <http://www.occ.treas.gov/ftp/release/95-94.txt> (last visited Sept. 4, 2009).

Morningstar.”<sup>18</sup> A recent sampling by PIRC of numerous commercial banking websites revealed a disconcerting and endemic pattern of the misleading blending of securities activities with traditional banking functions on the same internet website, located at the same URL address, apparently hosted on the same computer server, and frequently utilizing the same widely-recognized bank logo, trade name and trade dress.<sup>19</sup> All too often a trade name for the broker-dealer affiliated by a “network arrangement” is utilized that is confusingly similar to that of the financial institution, with a perfunctory appendage such as “Investment Services, LLC,” added to the financial institution’s already widely recognized trade name.<sup>20</sup>

Often, the only “segregation” between the banking and non-banking products, and services marketed online, is the use of html-coded tabs, buttons or hyperlinks designed to enable a customer to seamlessly navigate between checking and savings accounts, credit cards, mortgages, HELOCs, student loans, and a host of securities-related activities involving non-depository products such as equities, mutual funds, options, commodities, forex products, futures and the like. There can be little doubt that bank holding companies are presently exploiting the absence of any meaningful regulatory oversight in this fast-growing distribution sub-channel.<sup>21</sup>

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<sup>18</sup> Applied Research & Consulting, LLC (for FINRA), *Insights on Investment Attitudes and Behaviors Comparing Older and Younger Investors* (2007), available at <http://www.finra.org/web/groups/investors/@inv/@smart/documents/investors/p036812.pdf> (last visited Sept. 4, 2009).

<sup>19</sup> Websites sampled include: Bank of America, <https://www.baisidirect.com/live/login.jspv>; CitiBank, <https://online.citibank.com/US/JRS/pands/detail.do?ID=InvestingOverview>; Chase, [https://www.chase.com/ccp/index.jsp?pg\\_name=ccpmapp/individuals/investments/page/plan\\_brkg](https://www.chase.com/ccp/index.jsp?pg_name=ccpmapp/individuals/investments/page/plan_brkg); Wells Fargo, <https://www.wellsfargo.com/investing/styles/comparison>; Key, <https://www.key.com/html/ira-investments-retirement.html>; PNC, <https://www.pnc.com/webapp/unsec/ProductsAndService.do?siteArea=/pnccorp/Regions>, [http://www.regions.com/personal\\_banking/morgan\\_keegan.rf](http://www.regions.com/personal_banking/morgan_keegan.rf); and BB&T, <http://www.bbt.com/personal/products/investments/default.html> (all websites last visited Sept. 8, 2009).

<sup>20</sup> See *Rescuecom Corp. v. Google Inc.*, 562 F.3d 123, 130 (2d Cir. 2009), citing 15 U.S.C. § 1125(a); *Estee Lauder Inc. v. The Gap, Inc.*, 108 F.3d 1503, 1508-09 (2d Cir.1997) (discussing the likelihood of consumer confusion standard within the Lanham Act context); see also Securities Industry Association, regulatory correspondence to the Texas Securities Board regarding *Proposed Rules for Sales of Securities at Financial Institutions*, Apr. 16, 1997, available at [http://www.sifma.org/regulatory/comment\\_letters/comment\\_letter\\_archives/31224607.pdf](http://www.sifma.org/regulatory/comment_letters/comment_letter_archives/31224607.pdf) (last visited Sept. 4, 2009) (“A non-deposit investment product must not have a name that is identical to the name of the financial institution”).

<sup>21</sup> See, e.g., John Adams, *Small Banks Seen Flocking to Online Account Products*, AMERICAN BANKER, May 29, 2009 (“Online account-opening applications offer a low-cost way to increase deposits, according to community and regional bankers”), available at [http://www.americanbanker.com/issues/174\\_106/-379234-1.html](http://www.americanbanker.com/issues/174_106/-379234-1.html) (last visited Sept. 4, 2009); see also Press Release, *Bank of America Corp. - 1st Quarter Results*, April 20, 2009, PR NEWSWIRE EUROPE (Bank of America maintains a total of “approximately 55 million consumer and small business relationships . . . [and] online banking with nearly 30 million active users”); Bill Stoneman, *Rationale for Online Banking Starts to Shift*, AMERICAN BANKER (USA), Mar. 12, 2001, 2001 WLNR 2793600 (emphasis added).

But just as with the ATM and automated phone systems of a generation earlier, Internet banking didn't cause a mass migration of transactions from high- to low-cost channels. Instead, bankers say, *it has spurred more transactions than ever*. . . . Wendy Grover, a spokeswoman for Wells Fargo & Co.'s Internet services group, said the San Francisco banking company has seen the same benefits that Mr. Andrews described and more. The company is no longer worrying about the kind

### Conclusion

The proposed rule change's language is insufficient to prevent fraudulent and manipulative acts and practices, and, in general, to protect investors and the public interest. It also lacks sufficient enforcement measures and sanctions for non-compliance. The statutory purpose of "ensur[ing] that communications with customers clearly identify that the broker-dealer services are provided by the member"<sup>22</sup> is offended by the false sense of security created within the financial institution setting. This is true whether one considers the on-premises "bricks," or the off-premises "clicks," particularly when coupled with relationship sales tactics by compensated bank employees whose mission it is to steer customers to affiliated broker-dealers who utilize confusingly similar trade names and feature the same, or confusingly similar, logos and trade dress, inadequate signage and vague or non-existent disclosure.

The level of documented investor illiteracy demonstrates a pressing need for thorough investor protection, yet profound regulatory gaps exist with regard to the industry's present use of networking agreements between financial institutions and affiliated broker-dealers, as outlined within the proposed rule change and in this letter. PIRC urges the Commission to require FINRA to substantially enhance the provisions of the proposed rule change which are directed towards customer communication and disclosure, inspection and examination, enforcement and sanctions, so as to protect individual investors.

Respectfully submitted,

Jill I. Gross  
Director, PIRC

Ed Pekarek,  
Clinical Law Fellow, PIRC

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of benefits it initially expected from online banking, she said, and instead enjoys customer retention, *cross-selling*, and balance growth rewards.

<sup>22</sup> 74 Fed. Reg. 41774, § II(A)(1)(4).