SUTHERLAND

Grace Building
1114 Avenue of the Americas, 40th Floor
New York, NY 10036-7703
212.389.5000 Fax 212.389.5099
www.sutherland.com

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September 14, 2012

Ronald W. Smith, Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: Notice 2012-40 – Request for Comment on Draft Proposal to Collect 529 College Savings Plan Data

Dear Mr. Smith:

We are submitting this comment letter, which responds to MSRB Notice 2012-40, *Request for Comment on Draft Proposal to Collect 529 College Savings Plan Data* (the "***Notice***"), because of our firm's representation of a number of primary distributors of state-sponsored 529 college savings plans ("***529 Plans***"). We appreciate the Municipal Securities Rulemaking Board's (the "***MSRB***") continuing efforts to improve the regulatory scheme governing broker-dealers distributing 529 Plans and believe that the MSRB's efforts have enabled it to effectively and efficiently regulate the brokerage industry's distribution of 529 Plans. However, as discussed below, we strongly question the value of using the MSRB's Electronic Municipal Market Access ("***EMMA***") system to collect the proposed data regarding 529 Plans.

I. GENERAL COMMENTS

As you know, 529 Plans are an outgrowth of Section 529 of the Internal Revenue Code, which authorized the States, their agencies or their instrumentalities to sponsor and offer the plans. The States generally establish these tuition savings plans as state trusts, either directly through legislation or by granting authority to establish such trusts to the state agency that administers 529 Plans. Section 529 and the rules promulgated by the Internal Revenue Service establish the permissible parameters and required elements of 529 Plans, including eligibility, maximum contributions, control over investments, permissible uses of contributions and tax treatment of earnings on contributions.

The State trusts through which these plans are offered to the public are instrumentalities of the states that establish them. As a result, the securities issued by the State trusts are municipal securities. The Investment Company Act of 1940 and the Investment Advisers Act of 1940 expressly do not apply to agencies, authorities, or instrumentalities of states. The offer and sale of 529 Plan interests, as municipal securities, are also exempt from the registration requirements of the Securities Act of 1933 (the "***Securities Act***"). In addition, the interests, as well as the State issuers, are not subject to the registration and reporting provisions of the Securities Exchange Act of 1934 ("***Exchange Act***"),

although to the extent interests are sold through broker-dealers, such firms are subject to regulation by the MSRB.

A. Unsupported Assertions of Value of Requested Information

The MSRB's draft proposal would require brokers, dealers, and municipal securities dealers ("***broker-dealers***"), acting in the capacity of underwriters ("***primary distributors***") of 529 Plans, to submit to the MSRB on a quarterly basis certain market information about the 529 Plans they distribute. The information would include: basic identifying information about each 529 plan; total plan assets; total plan contributions; percentage of contributions derived from automatic contributions; total plan distributions; types of strategies and total assets in each strategy; types of underlying portfolios and total assets in each portfolio; fees and expenses for the plan and for each underlying strategy; and performance data for each strategy and underlying portfolio (collectively, the "***Requested Information***"). The Requested Information would be collected quarterly pursuant to new MSRB Rule G-45 via new Form G-45. The MSRB writes in the Notice that:

> [T]he following information will assist the MSRB in better understanding the 529 plan market, including popular investment strategies and portfolios, thereby enabling the MSRB to focus its rulemaking on the strategies and portfolios with the highest risk and impact on the market. Over time, this information would also assist the Financial Industry Regulatory Authority ("FINRA"), which conducts examinations of 529 plan dealers, and other regulators in their examination and enforcement activities.

The foregoing statement is the most specific explanation afforded in the Notice as to why the MSRB believes it is necessary for it to obtain the Requested Information. Yet, it fails to provide a compelling rationale as to why such information would be useful to the MSRB given its limited regulatory authority and the comprehensive regulatory system the MSRB has implemented for broker-dealers selling 529 Plans. The Notice contains a number of vague assertions (*e.g.*, "Such information may better inform the MSRB with regard to disclosure guidance or other rulemaking") that do not detail why the MSRB wants such information or the value it would provide. Over the past 13 years, the MSRB, we believe, has designed and implemented a comprehensive and extremely effective regulatory regime governing the offer, distribution and sale of 529 Plan securities by broker-dealers. And it did this without any of the data it is now seeking. Having already implemented a comprehensive system governing the offer and sale by broker-dealers of 529 Plans that has proven to be highly effective, it is difficult for our clients to understand why the MSRB now believes the Requested Information is needed.

In both the Notice and its predecessor,[1] the MSRB notes that it does not collect and disseminate 529 Plan market or program-specific data as it does for the municipal bond market. In pointing to the difference in the current collection and dissemination of market data between municipal bonds and 529 Plans, the MSRB overlooks a fundamental and crucial difference between the two: the prices of municipal bonds are set by the market, which means the MSRB's regulatory mission is served from increased access to real time market data. Such access allows the MSRB to monitor the municipal bond

[1] MSRB Notice 2011-33 (July 19, 2011), *Request for Comment on Plan to Collect Information on 529 College Savings Plans* (the "2011 Notice").

market. In contrast, the prices of 529 Plans are based, in the case of Portfolios (as defined below[2]) that invest in mutual funds, on the net asset value of the mutual funds in which Portfolios invest. In other words, the value of the 529 Plan Portfolio is in large part dependent upon the performance of the underlying mutual funds. For 529 Plans, there simply is no market data that is comparable to the market data that exists for municipal bonds.

None of the data points proposed to be filed with and reviewed by the MSRB under the proposal can ever impact the value of mutual funds or any other instrument in which a Portfolio invests. Thus, the data sought by the MSRB has limited value as a regulatory tool. In addition, the data that would be filed with the MSRB would not be able, by itself, to indicate anything of value. Without a substantive context in which to analyze the data, it would be reckless, and potentially dangerous, to reach conclusions merely by reviewing the data itself. Our clients therefore question the value of the data when it is completely divorced from the terms and characteristics of 529 Plans and merely reflects movement of funds. Given the MSRB's limited authority to adopt rules and the fact that it has already instituted a comprehensive system regulating the offer, sale and distribution of 529 Plans by broker-dealers, our clients believe that the proposal in the Notice lacks a compelling justification.

As but one example, the MSRB states in the Notice that:

> the following information will assist the MSRB in better understanding the 529 plan market, including popular investment strategies and portfolios, thereby enabling the MSRB to focus its rulemaking on the strategies and portfolios with the highest risk and impact on the market.

It is not at all clear from the proposal how knowing which strategies and portfolios are "popular" helps the MSRB focus on those "with the highest risk." How is the MSRB measuring "risk" in this context? Does the quoted language indicate that the MSRB believes that more popular strategies and portfolios entail more risks to investors simply because they are more popular? The possibility of the MSRB (and potentially other regulators) drawing substantive conclusions solely from data flows, without any context associated with such flows, is troubling. This concern is heightened in situations where such conclusions are based on inaccurate or unsupported assumptions, as exemplified by the above quoted language.

B. Contractual Arrangements Often Result in Requested Information Not Being Within the Possession, Custody or Control of the Primary Distributor

The MSRB states in the Notice that:

> After discussing the reporting cycle with various market participants, including primary distributors, the MSRB believes there is more value in receiving the information quarterly and that the information sought by the MSRB is readily available. Primary distributors, in

[2] To differentiate between the MSRB's proposed definition of "portfolio" on one hand and the historical regulatory use of such term by the Securities and Exchange Commission ("SEC") (and the predominant use of such term in the industry in our experience) on the other hand, all lower-case uses of the term "portfolio" herein refer to the MSRB's proposed use of such term and capitalized uses of the term "Portfolio" refer to the definition as set forth in this comment letter.

conjunction with program managers, regularly produce reports for internal use and for distribution to their state clients, vendors, and trade groups.... Primary distributors that spoke with the MSRB provided examples of daily, weekly and quarterly reports, some of which were prepared for state 529 plan boards or State Treasurers....

As for the burdens and benefits, the MSRB mentioned above that it conducted a series of meetings with market participants, including trade groups, vendors, primary distributors and issuers and determined that much of the information described below is readily available ....

Based on its further review, after receiving comments to the 2011 Notice, the MSRB believes primary distributors have ready access to basic information regarding the 529 plans they distribute and that much, if not all of such information is already gathered and produced regularly to their issuer clients....

Primary distributors of many 529 Plans do not maintain or have access to the information sought to be obtained by the MSRB. In such instances, this information often is maintained by the 529 Plan recordkeeper. It appears to us that the factor that most determines whether such information is maintained by or accessible by the primary distributor is the nature of the contractual arrangements and role(s) played by the primary distributor vis-à-vis the States. In a fair number of 529 Plans, the primary distributor also serves as the program manager and has access to the type of information described by the MSRB above. However, in many 529 Plans the primary distributor does not serve as the program manager and typically does not possess or have access to the information described in the Notice. In such cases, the recordkeeper or program manager (after obtaining the data from the recordkeeper) reports some or all of the data subject to the Notice to the State instrumentality issuing the 529 Plan.

It is important to recognize that much of the Requested Information is divorced from the sales process and the activities of a primary distributor. For instance, total aggregate assets held in 529 Plans is impacted by performance, "add-on" contributions, and withdrawals, the latter two of which often are processed through the recordkeeper and/or selling broker-dealer, and not through the primary distributor. The same is true with respect to the information about total assets held in each 529 Plan and the total assets invested in each portfolio.

In cases where the primary distributor is not the Program Manager, many primary distributors do not have possession of or access to the Requested Information and have no authority to obtain such information from the 529 Plan recordkeeper. Such recordkeepers are under no obligation to provide such information, and in fact, may well violate their contractual agreements if they were to provide such information to the primary distributor. We seek confirmation from the MSRB that in such situations the Requested Information is deemed to be outside the possession, custody or control of the primary distributor. We also note that the primary distributor may be contractually prohibited from sharing the type of information sought to be filed with the MSRB without the prior written consent of the State. We likewise request confirmation from the MSRB that in such situations the Requested Information is deemed to be outside the possession, custody or control of the primary distributor.

As discussed, the above quoted language from the Notice reflects the reality of certain primary distributors but not others. Such language fails to recognize that whether primary distributors have possession, custody or control is a facts and circumstances analysis that is largely driven by their role

and contractual relationship vis-à-vis the State instrumentality issuing the 529 Plan and/or the recordkeeper. Unfortunately, it appears from the Notice that the MSRB has reached conclusions based on discussions with primary distributors who may have a specific type of arrangement and are thus who may be able to provide the Requested Information relatively easily. However, the MSRB is seeking information from primary distributors that they may or may not be able to provide. The MSRB, therefore, and FINRA (and other regulators as well) should not be surprised that many primary distributors will not be able to provide the Requested Information, thus reducing the value of the Requested Information. We therefore question the public policy rationale for the Notice when the ability to provide the Requested Information largely hinges on the specific contractual arrangements and structures of 529 Plans. We also reiterate a point made by others that the rationale for the Notice is largely undercut by the reality that much of the information sought to be obtained is readily available today in the public domain.

C. The MSRB's Proposal Will Result in Incomplete Data

Even if the MSRB's proposal is implemented, the value of the information obtained will, we believe, be of limited value for another reason. Unlike the municipal bond market, many 529 Plans are not offered and sold through broker-dealers, and are therefore not subject to the jurisdiction of the MSRB. This difference is very important in the context of the data sought to be collected and disseminated by the MSRB in the Notice. Because the data filed with the MSRB will not include data on direct-sold 529 Plans, the data will be substantially incomplete. In fact, as of the end of the first quarter of 2011, only 51% of 529 Plan assets were held in broker-sold 529 Plan accounts, according to Financial Research Corp., and this percentage has been decreasing in recent years.[3] Accordingly, the data obtained by the MSRB would, at best, only represent approximately half of the assets in the 529 Plan industry. The Notice acknowledges this by noting that the Requested Information " . . . would be required to be submitted by rule, at least as to those market participants subject to MSRB jurisdiction." It also notes that the MSRB "will use this information to aggregate asset data for all reporting plans and estimate the size of the entire market." Thus, it appears the MSRB will be making estimates, and presumably drawing conclusions from such estimates, without seeing data for roughly half the industry. We question the wisdom of following through on the MSRB's proposal when the data to be obtained from the initiative will be so incomplete. We also note that some of the data already available in the public domain covers direct-sold 529 Plans, which means this data is, in some ways, more comprehensive than the data that the MSRB seeks. These considerations suggest that the proposal under the Notice would only offer marginal benefits to the MSRB.

D. Costs vs. Benefits

Subject to the anti-fraud provisions of the federal securities laws, the requirements for official statements generally are determined at the State level. Accordingly, each 529 Plan treats its portfolio level data differently. The Notice acknowledges that systems modifications would be required to provide the Requested Information in a uniform manner. Unfortunately, the MSRB determined not to collect or provide any data supportive of the notion that the benefits of the proposal will outweigh the

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[3] Jackie Noblett, *American Funds Cracks 529 Recordkeeping Puzzle*, Ignites, July 8, 2011, http://ignites.com/c/218882/27272referrer_module=searchResults&module_order=1&q=recordkeeping+puzzle&sort_by=date.

systems collection and dissemination costs that will be incurred by primary distributors of 529 Plans. Instead, the Notice merely states as follows:

> Based on the MSRB's need for reliable information in furtherance of its regulatory responsibilities and transparency goals and the modest burden that market participants have described as likely to result for primary distributors from the draft proposed rule, the MSRB currently believes the benefits of the proposal, including the anticipated use of the information by the MSRB and other regulators for the protection of investors, outweigh the burden that would be imposed on primary distributors.

In short, the MSRB concludes the benefits of its proposal will outweigh the costs without ever seeking to quantify either the benefits or the costs. Notwithstanding the fact that the MSRB reached this conclusion without any supportive data whatsoever and after speaking to an undisclosed number of market participants, the MSRB adds that:

> [t]o the extent that any commenters believe any such additional burdens are material, they should provide information describing, with particularity, the nature of such additional burden, an estimate of any additional cost they would incur to meet such requirement, and any other viable alternatives to meeting the objectives of the draft proposed rule in light of the discussion included in this request for comment regarding such alternatives.

In other words, after having already reached a conclusion and deciding not to conduct a cost-benefit analysis, the MSRB asks commenters to provide an estimate of the costs involved. One wonders what effect such data would have given the fact that the MSRB already has reached its conclusion. We believe that the MSRB should hold itself to the same standard it is asking of commenters and conduct a meaningful cost-benefit analysis "with particularity."[4]

It appears that a significant component of the justification for the proposal in the Notice rests on the MSRB's assertion of benefits that will flow to regulators other than the MSRB. We believe that the industry needs to better understand the proposed use of the data by regulators other than the MSRB and what protections primary distributors will have in connection with the sharing of such information. We seek an explanation of the protocols, standards and protections that will be implemented in connection with the sharing of the Requested Information. We also seek an understanding of which regulators the Requested Information would be shared with and the conditions under which such information will be shared.

[4] We also are concerned that while the MSRB states that it does not intend at this time to disseminate any of the Requested Information to the public via EMMA, it seeks to justify obtaining certain data based on the benefit that public dissemination of the information would provide to investors. Thus, while the MSRB explicitly acknowledges problems and challenges with publicly disseminating the Requested Information on EMMA and says the Requested Information will not be publicly disclosed at this time, throughout the Notice it relies on assertions of benefits to come from public disclosure of the Requested Information to justify its proposal and to respond to comments in the 2011 Notice.

II. COMMENTS ON THE PROPOSED DEFINED TERMS

A. The Proposed Definition of "Portfolio"

In the Notice the MSRB correctly notes that terminology used in the industry is not consistent. However, the Notice would exacerbate this problem in a number of profound ways. 529 Plans generally operate through statutory trusts created pursuant to statute, through which investors' contributions to a 529 Plan become assets of the 529 Plan that then invests in underlying investment vehicles ("***Underlying Investments***"). States usually offer more than one 529 Plan under the qualified tuition program through the statutory trust. In these cases, each 529 Plan is typically managed by a different private service provider, often invests in a distinct set of Underlying Investments and is offered through separate distribution channels. Each 529 Plan permits investors to invest contributions in one or more of the trust portfolios ("***Portfolios***") offered in the 529 Plan. The Portfolios, in turn, purchase shares of the Underlying Investments, which typically are mutual funds, although other types of securities and investments have been increasingly available as Underlying Investments in recent years.

The Notice would define "portfolio" to mean the most basic legal entity into which account owner funds are deposited, such as a registered investment company. This definition is inappropriate for two important reasons. While we grant that there are differences in how various 529 Plans have defined and used the word "portfolio," the far better approach would be to follow the SEC's seminal description of 529 Plans in a 2004 letter to Congress (the "***SEC Letter***").[5] In describing 529 Plans, the SEC Letter notes that investors' contributions, "which are held in separate accounts in the state trust fund, are generally invested by the trust fund in state-managed portfolios that, in turn, usually invest their assets in several mutual funds or other pooled investment vehicles." Similarly, the 2004 SEC Letter discusses "discrepancies between the returns on underlying investments and the reported returns of plan portfolios" and notes that "[i]n the case of direct-sold 529 plans, plan documents typically offer prospective investors a choice of several managed portfolios that invest in investment companies or other pooled investment vehicles, and provide generalized disclosure about the underlying investments."

Even before the SEC Letter but particularly thereafter, the term "Portfolio" predominately has been used to refer to a component of the state trust, and not to the Underlying Investments into which the 529 Plan invests. The MSRB's proposed definition runs counter to the SEC's description and what we have found to be the predominant long-standing practice in the industry. Accordingly, the definition is regressive and will increase confusion in the industry.

Ever more important, however, is the fact that the MSRB's proposed definition is inaccurate as a matter of law because it would define the term "portfolio" to mean the most basic legal entity into which account owner funds are deposited, such as a registered investment company. This is not accurate. Account owner funds are solely invested in the 529 Plan. They are not invested in anything else. The 529 Plan trust is the SOLE legal **and** beneficial owner of the Underlying Investments. We note, in particular, the following from the SEC Letter:

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[5] *See* Letter from William H. Donaldson, Chairman, SEC, to the Honorable Michael G. Oxley, Chairman, Committee on Financial Services, U.S. House of Representatives (Mar. 12, 2004) (containing Letter from Annette L. Nazareth, Director, Division of Market Regulation, SEC, to William H. Donaldson, Chairman, SEC (Mar. 2, 2004)).

> Investors in 529 tuition savings plans, however, hold interests in a municipal issuer-the state trust fund-that is exempt from the bulk of the federal securities laws. Thus, many of the substantive aspects of the Investment Company Act and the other federal securities laws do not operate to the direct benefit of 529 plan investors.... Because 529 plan investors are not considered to be beneficial owners of the investment companies that serve as the underlying investments in their 529 plan accounts, the federal securities laws do not require delivery of disclosure documents such as annual reports, semi-annual reports, and proxy statements. These documents must generally be delivered directly to beneficial owners of investment company shares. Similarly, 529 plan investors do not have voting rights in the registered investment companies held in their accounts. (Emphasis added).

Thus, it is legally and factually incorrect to talk of 529 Plan investors' funds being deposited into the Underlying Investments. As an example of the problems created by the language in the Notice, we note that the Notice contains the following paragraph:

> Under the draft proposal, MSRB-registered primary distributors, or those plans electing to make voluntary submissions, would deliver electronically to the MSRB information regarding types of underlying portfolios and total assets in each underlying portfolio of the plan for the calendar quarter. The information would include total assets in each underlying portfolio in the plan, as of the last day of the calendar quarter, but would not include portfolio assets held outside of the plan, by, for example, mutual fund investors. For example, if one underlying portfolio was a small cap growth fund in which investors can invest either through a 529 plan or directly as a mutual fund investment, the primary distributor would report the 529 plan assets in the small cap growth fund but not other assets in the fund owned by mutual fund investors.

This paragraph reflects many of the ills described above. In most locations in the Notice the word "portfolios" refers to the Underlying Investments. However, in a few locations, the language refers to "portfolios of the plan," or a similar phrase, thus shifting up to the trust level. It also inaccurately refers to an investor investing in a small cap growth fund. In addition, as the SEC noted in 2004, such a description is legally inaccurate; investors solely purchase a municipal security. They do not purchase anything else. They do not invest in the Underlying Investments. Accordingly, if the MSRB proceeds with this rulemaking initiative, we urge the MSRB to appropriately redefine the term "portfolio."

B. The Proposed Definition of Strategy

The Notice would define "strategy" to mean "a combination of more than one portfolio through which funds of account owners are allocated to achieve a particular investment outcome (such as an age-based, conservative strategy)." The definition of "strategy" thus suffers from the same infirmities that plague the proposed definition of "portfolio" in the Notice and thus should be similarly revised.

The problems with the foregoing proposed definitions are exacerbated by the MSRB's inconsistent use of these proposed definitions in the Notice. For instance, the Notice asserts that:

> Information about the types of strategies and total assets in each strategy is needed to understand the types of strategies offered by each plan and the allocation of assets to each such strategy. While the MSRB has been informed that investors are electing to invest in age-based strategies over other strategies due to their ease of use (*e.g.*, plans rebalance to purportedly more conservative, fixed income assets as the beneficiary approaches college age without input or effort on the part of investors), the MSRB has no statistics on the investments in such strategies. Moreover, the MSRB desires information on the asset class allocation of each strategy, so it can understand and compare differences between age-based strategies in the context of the manner in which the strategies are marketed (emphasis added).

In most places in the above paragraph, the term "strategies" refers to a combination of more than one of the Underlying Investments, consistent with the MSRB's proposed definition of "strategies" in the Notice. However, in the second line of the quoted language, the MSRB discusses "strategies offered by each plan," thus changing the level that is being discussed. We also note that in two other locations in the Notice, the MSRB refers to 529 Plans and their "underlying investment options" and it is not clear how these references to "underlying investment options" differ from the MSRB's proposed definition of "portfolio." In addition, the paragraph reflects the inaccurate understanding that investors invest in the Underlying Investments.

C. The Description of Asset Allocation

The following paragraph in the Notice likewise contains a number of inaccuracies:

> As with the information regarding strategies, it is important to understand the size of investment in each underlying mutual fund or other product, as well as the asset class allocation within each portfolio. These products vary, in terms of their risk characteristics, and it is important for regulators to understand the level of risk taken by investors in 529 plans and the Underlying Investments. Such information may better inform the MSRB with regard to disclosure guidance or other rulemaking.

First, as discussed earlier, investors do <u>not</u> invest in underlying mutual funds or other products at the Underlying Investment level. Second, the asset class allocation that is referenced occurs at the 529 Plan trust Portfolio level and not at the Underlying Investment level. The asset allocation being referenced occurs at the trust Portfolio level where a Portfolio option invests in one or more Underlying Investments. The reference to asset allocation taking place at the Underlying Investment level is simply not accurate.

D. The Proposed Definition of "Benchmark"

We note that the proposed definition of "benchmark" does not reflect the way in which 529 Plans with Portfolios that invest in multiple Underlying Investments typically benchmark their performance. Such Portfolios do not generally have their performance benchmarked against a single established index or an unmanaged portfolio comprised of established indexes (we assume that the term "portfolio" in the definition of benchmark was intended to refer to the defined term "portfolio" in proposed Rule G-45(d)(viii), but this is not clear). For such Portfolios, 529 Plans typically compare the performance of the relevant Portfolio against a custom blended benchmark comprised of the indices used to benchmark

the various underlying mutual funds in which the Portfolio invests; these indices are weighted in the same proportion that the Portfolio invests in the corresponding mutual funds.

E. The Proposed Definition of Contribution

We note that the definition of "contribution" does not seem to take into account third-party contributions by persons other than the account owner. By only including contributions by account owners, the information sought to be obtained will not capture all of the contributions made into 529 Plans. We are unaware of a public policy reason why third party contributions should not be included and ask the MSRB to consider including such contributions in order to improve the accuracy of the requested data.

F. Plans vs. Programs

If the MSRB proceeds with this rulemaking initiative, we recommend that the MSRB create definitions for "plans" and "programs" since the Notice references both and it is not clear how the MSRB means to distinguish between them.

G. Definition of "Primary Distributor"

The proposal would require "primary distributors" to file certain information with the MSRB but the Notice does not contain a definition of primary distributor. We urge the MSRB to define such term and to offer the industry an opportunity to comment on the proposed definition since the definition would be central to any final Rule G-45 and Form G-45. We note that the Notice refers to "brokers, dealers, and municipal securities dealers ('dealers') that act in the capacity of underwriter (commonly known as 'primary distributor') of such plans." This language seems to suggest that the MSRB equates falling within the definition of underwriter (as defined in Rule G-45) to being a primary distributor. The Notice contains a proposed new definition of "underwriter" ("a broker, dealer or municipal securities dealer that is an underwriter as defined in Securities Exchange Act Rule 15c2-12(f)(8), including but not limited to a broker, dealer or municipal securities dealer that acts as a primary distributor of municipal fund securities that are not local government investment pools"). This definition would thus include any broker, dealer or municipal securities dealer that is an underwriter as defined in 15c2-12(f)(8) under the Exchange Act. Contrast this proposed definition with the language quoted earlier in this paragraph, which equates being an "underwriter" to being a primary distributor. Given the conflicting language, it is not clear whether the MSRB views every broker-dealer meeting the newly proposed definition of underwriter as being a primary distributor.

The language in Rule G-45(a) adds to this confusion. Rule G-45(a) states that "[e]ach underwriter of a primary offering of municipal fund securities that are not interests in local government investment pools shall report to the MSRB the information relating to such offering required by Form G-45 . . . ." This language indicates that there can be multiple primary distributors under the rule. However, Rule G-45(b)(ii) states that "Form G-45 shall be submitted by the underwriter or by any submission agent designated by the underwriter pursuant to the procedures set forth in the Form G-45 Manual," (emphasis added) indicating that there can only be one primary distributor. We again ask the MSRB to propose a definition of primary

distributor in order to clarify its meaning and to provide the industry the opportunity to comment on the proposed definition.

We note that the definition of underwriter in Rule 15c2-12 was based on, and is substantially similar to the definition of "underwriter" in Section 2(a)(11) of the Securities Act, which was designed to connote the notion of a "statutory underwriter" for purposes of the anti-fraud provisions of the Securities Act. The definition of "underwriter," as carried through to Rule 15c2-12, is thus broader than what the term "primary distributor" connotes, in that the term "underwriter" covers entities that do not serve as and/or do not need to be registered as broker-dealers (either because such entities rely on an exclusion or exemption from broker-dealer registration or are deemed not to be "brokers" or "dealers"). In addition, not every firm that meets the definition of underwriter in Rule 15c2-12 (or newly proposed Rule G-45 for that matter) is, in reality, serving as the primary distributor of a 529 Plan. In other words, falling within the definition of underwriter does not mean an entity is serving as the primary distributor.

In this respect, it is important to recognize that primary distributors of 529 Plans do not 'underwrite' securities in the traditional *economic* sense of the term. That is to say, primary distributors of 529 Plans do not, as principal, buy 529 Plan securities from issuers and thereby take on the economic risk of a distribution common to firm commitment underwritings. All 529 Plan sales by broker-dealers are conducted on an agency basis, as the MSRB itself has recognized,[6] due to the practical restrictions and limitations imposed on such securities by Section 529 under the Internal Revenue Code.

III. COMMENTS ON THE REQUESTED INFORMATION

A. Requested Information About Underlying Investments

We believe that it is inappropriate to request information about the Underlying Investments (*i.e.*, what the Notice refers to as "portfolios"). As the SEC observed in 2004, the Underlying Investments are not part of what investors purchase and are not municipal securities. The MSRB itself acknowledged this in the process of adopting MSRB Rule G-21(e)(ii)(F), which is entitled "applicability with respect to underlying assets" and which states, in relevant part, that "subsection (e)(ii) shall apply solely to the calculation of performance relating to municipal fund securities and does not apply to . . . the calculation of performance for any security held as an underlying asset of the municipal fund securities." In proposing this provision, the MSRB stated the following:

> **Underlying Registered Securities.** New paragraph (vi) requires that, if an advertisement for a municipal fund security provides specific details of a security held as an underlying asset of the municipal fund security, the details included in the advertisement relating to such underlying security be presented in a manner that would be in compliance with any SEC or NASD advertising rules that would be applicable if the advertisement related solely to such underlying security. Details of the underlying security included in the advertisement must be accompanied

[6] "The MSRB understands that sales of municipal fund securities currently are made primarily, if not exclusively, on an agency basis." MSRB Notice, Municipal Fund Securities—Qualification of Municipal Securities Principals and Application of MSRB Rules to Fees, Disclosure and Other Market Practices (July 5, 2001); *See also* Interpretive Notice on Commissions and Other Charges, Advertisements and Official Statements (Dec. 19, 2001).

by any further statements necessary to ensure that the inclusion of such details does not cause the advertisement to be false or misleading with respect to the municipal fund securities advertised. This provision does not limit the applicability of any rule of the SEC, NASD or any other regulatory body relating to advertisements of securities other than municipal fund securities, including advertisements that contain information about such other securities together with information about municipal fund securities.[7]

Similarly, the MSRB has stated that "the draft language confirms that these provisions of Rule G-21 would apply solely to the calculation of performance relating to municipal fund securities and not to the calculation of performance for any security (such as a mutual fund) held as an underlying asset of the municipal fund securities."[8] Thus, the MSRB previously has recognized that securities in which the 529 Plan Portfolios invest, such as mutual funds, are not subject to MSRB rules because they are not part of the municipal fund securities. We question the authority of the MSRB to mandate the filing of information regarding mutual funds and other securities and financial instruments that are not municipal securities. Accordingly, we request that should the MSRB proceed with its proposal that it eliminate from Form G-45 all information regarding the Underlying Investments (as defined herein).

B. Proposed Form G-45(i)(F)

Proposed Form G-45(i)(F) would require primary distributors to disclose the manner of distribution, which is defined as "the manner by which municipal fund securities are sold to the public, such as through a broker, dealer or municipal securities dealer that has a selling agreement with a primary distributor (commonly known as "advisor-sold") or through a website or toll-free telephone number (commonly known as "direct-sold")." We see no value in asking for a description of the manner of distribution since under the proposal *only* primary distributors could be required to provide the requested information. By definition, "direct-sold" plans do not involve a broker-dealer offering the securities.[9] A form designed to be used by primary distributors should not require disclosure of information in situations where no broker-dealer is involved (*i.e.*, the form should not contemplate and ask for information that would be relevant only to voluntary filings by non-broker-dealers).

C. Proposed Form G-45(ii) and (iii)

Our clients believe that the MSRB has failed to justify its need for each of the various pieces of information under these subsections (such as "Inception date of strategy," "Asset classes in strategy" and "Asset class allocation as of the end of the most recent quarter" as well as much of the information in (iii) and (iv)) and note that much of the requested information already is filed on EMMA and appears in 529 Plan official statements or is on the official 529 Plan websites maintained by the States or other public websites.

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[7] MSRB Notice 2004-42 (Dec. 16, 2004) Notice of Filing of Amendments Relating to Advertisements of Municipal Fund Securities.

[8] MSRB Notice 2004-16 (June 10, 2004) Request for Comments on Draft Amendments Relating to Advertisements of Municipal Fund Securities and Draft Interpretive Guidance on Disclosures in Connection with Out-of-State Sales of College Savings Plan Shares.

[9] See the SEC Letter (describing direct-sold plans as those "in which investors acquire interests in the state trust directly from the state trust or a state agency on behalf of the trust, and do not involve a sales intermediary").

D. Use of the Term "Strategy"

The Notice states the following regarding "strategies":

> Under the draft proposal, MSRB-registered primary distributors, or those plans electing to make voluntary submissions, would deliver electronically to the MSRB information regarding types of strategies and total assets in each strategy of the plan for the calendar quarter. The information would include total assets in each strategy as of the last day of the calendar quarter.
>
> Information about the types of strategies and total assets in each strategy is needed to understand the types of strategies offered by each plan and the allocation of assets to each such strategy. . . . (Emphasis added.)

The language used is problematic in that 529 Plans do not have "strategies" as part "of the plan" or "offer" "strategies." The language in the Notice incorrectly implies that 529 Plans offer packaged guidance or advice, in the form of "strategies." Such language is disconcerting to primary distributors because of the implications that arise under the federal securities laws if one offers or provides investment advice. In addition, the language quoted above simply does not reflect reality – 529 Plans do not offer any kind of strategies. An investor may choose to invest in a 529 Plan and allocate their funds to one or more of the 529 Plan Portfolios in order to achieve a strategy that is personal to the investor but it is inaccurate and misleading to suggest that 529 Plans themselves "offer," "contain," "have" or otherwise involve strategies that are made available to the public. Rather, they merely contain Portfolios that invest in Underlying Investments. It is up to investors and their financial advisors, to the extent investors utilize the services of a financial advisor, to decide in which Portfolios to invest and whether any such Portfolios can be used to further the investors' own strategies and meet their goals and objectives.

IV. CONCLUSION

Although we appreciate the MSRB's desire to learn more about the 529 Plan marketplace, there is an unsubstantiated assumption in the Notice that possessing the requested data would improve the MSRB's regulatory efforts. We believe that the MSRB should, before requiring the filing of any data, first support the notion that the requested information will in fact aid it in regulating primary distributors of 529 Plans, particularly since the data will provide such a limited, and perhaps skewed, snapshot of the industry. Until the MSRB satisfies this burden, we believe it would be premature for it to impose a substantial burden on the industry to obtain, review, and report the Requested Information.

I would be pleased to provide additional information or discuss these comments at your convenience.

Very truly yours,

Michael Koffler

Michael Koffler