OMB APPROVAL	
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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - 2006 - 03
Amendment No.

Proposed Rule Change by Municipal Securities Rulemaking Board

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

Initial	Amendment	Withdrawal	Section 19(b)(2)	Section 19(b)(3)(A)	Section 19(b)(3)(B)
☑	☐	☐	☑	☐	☐

Pilot ☐

Extension of Time Period for Commission Action ☐

Date Expires

Rule

☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☐ 19b-4(f)(6)

Exhibit 2 Sent As Paper Document ☑

Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the proposed rule change (limit 250 characters).

A proposed rule change consisting of interpretive guidance on customer protection obligations of brokers, dealers and municipal securities dealers relating to the marketing of 529 college savings plans

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name: Ernesto Last Name: Lanza
Title: Senior Associate General Counsel
E-mail: elanza@msrb.org
Telephone: (703) 797-6600 Fax: (703) 797-6700

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date 03/31/2006

By Ernesto A. Lanza
(Name)

Senior Associate General Counsel
(Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Ernesto Lanza, elanza@msrb.org

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information

Add Remove View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

Add Remove View

Exhibit Sent As Paper Document

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Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

Add Remove View

Exhibit Sent As Paper Document

☐

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

Add Remove View

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

Add Remove View

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) The Municipal Securities Rulemaking Board (the "MSRB" or "Board") is hereby filing with the Securities and Exchange Commission (the "SEC" or "Commission") a proposed rule change (the "proposed rule change") consisting of interpretive guidance on customer protection obligations of brokers, dealers and municipal securities dealers ("dealers") relating to the marketing of 529 college savings plans. The MSRB proposes an effective date for the proposed rule change of 60 calendar days after Commission approval. The proposed rule change is as follows:

INTERPRETATION ON CUSTOMER PROTECTION OBLIGATIONS RELATING TO THE MARKETING OF 529 COLLEGE SAVINGS PLANS

The Municipal Securities Rulemaking Board ("MSRB") is publishing this interpretation to ensure that brokers, dealers and municipal securities dealers ("dealers") effecting transactions in the 529 college savings plan market fully understand their fair practice and disclosure duties to their customers.[1]

Basic Customer Protection Obligation

At the core of the MSRB's customer protection rules is Rule G-17, which provides that, in the conduct of its municipal securities activities, each dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest or unfair practice. The rule encompasses two basic principles: an anti-fraud prohibition similar to the standard set forth in Rule 10b-5 adopted by the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934 (the "Exchange Act"), and a general duty to deal fairly even in the absence of fraud. All activities of dealers must be viewed in light of these basic principles, regardless of whether other MSRB rules establish specific requirements applicable to such activities.

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[1] 529 college savings plans are established by states under Section 529(b)(A)(ii) of the Internal Revenue Code as "qualified tuition programs" through which individuals make investments for the purpose of accumulating savings for qualifying higher education costs of beneficiaries. Section 529 of the Internal Revenue Code also permits the establishment of so-called prepaid tuition plans by states and higher education institutions, which are not treated as 529 college savings plans for purposes of this notice.

Disclosure

The MSRB has interpreted Rule G-17 to require a dealer, in connection with any transaction in municipal securities, to disclose to its customer, at or prior to the sale of the securities to the customer (the "time of trade"), all material facts about the transaction known by the dealer, as well as material facts about the security that are reasonably accessible to the market.[2] This duty applies to any dealer transaction in a 529 college savings plan interest regardless of whether the transaction has been recommended by the dealer.

Many states offer favorable state tax treatment or other valuable benefits to their residents in connection with investments in their own 529 college savings plan. In the case of sales of out-of-state 529 college savings plan interests to a customer, the MSRB views Rule G-17 as requiring a dealer to make, at or prior to the time of trade, additional disclosures that:

(i) depending upon the laws of the home state of the customer or designated beneficiary, favorable state tax treatment or other benefits offered by such home state for investing in 529 college savings plans may be available only if the customer invests in the home state's 529 college savings plan;

(ii) any state-based benefit offered with respect to a particular 529 college savings plan should be one of many appropriately weighted factors to be considered in making an investment decision; and

(iii) the customer should consult with his or her financial, tax or other adviser to learn more about how state-based benefits (including any limitations) would apply to the customer's specific circumstances and also may wish to contact his or her home state or any other 529 college savings plan to learn more about the features, benefits and limitations of that state's 529 college savings plan.

This disclosure obligation is hereinafter referred to as the "out-of-state disclosure obligation."[3]

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2 *See* Rule G-17 Interpretation – Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts, March 20, 2002, *reprinted in* MSRB Rule Book.

3 This out-of-state disclosure obligation constitutes an expansion of, and supersedes, certain disclosure requirements with respect to out-of-state 529 college savings plan transactions established under "Application of Fair Practice and Advertising Rules to Municipal Securities," May 14, 2002, published in *MSRB Rule Book*.

The out-of-state disclosure obligation may be met if the disclosure appears in the program disclosure document, so long as the program disclosure document has been delivered to the customer at or prior to the time of trade and the disclosure appears in the program disclosure document in a manner that is reasonably likely to be noted by an investor.[4] A presentation of this disclosure in the program disclosure document in close proximity and with equal prominence to the principal presentation of substantive information regarding other federal or state tax-related consequences of investing in the 529 college savings plan, and the inclusion of a reference to this disclosure in close proximity and with equal prominence to each other presentation of information regarding state tax-related consequences of investing in the 529 college savings plan, would be deemed to satisfy this requirement.[5]

The MSRB has no authority to mandate inclusion of any particular items in the issuer's program disclosure document.[6] Dealers who wish to rely on the program disclosure

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[4] As used in this notice, the term "program disclosure document" has the same meaning as "official statement" under the rules of the MSRB and SEC. The delivery of the program disclosure document to customers pursuant to Rule G-32, which requires delivery by settlement of the transaction, would be timely for purposes of Rule G-17 only if such delivery is accelerated so that it is received by the customer by no later than the time of trade.

[5] Thus, if the program disclosure document contains a series of sections in which the principal disclosures of substantive information on federal or state-tax related consequences of investing in the 529 college savings plan appear, a single inclusion of the required disclosure within, at the beginning or at the end of such series would be satisfactory for purposes of the inclusion with the principal presentation of such other disclosures. Similarly, if the program disclosure document includes any other series of statements on state-tax related consequences, such as might exist in a summary statement appearing at the beginning of some program disclosure documents, a single prominent reference in the summary statement to the fuller disclosure made pursuant to the out-of-state disclosure obligation appearing elsewhere in the program disclosure document would be satisfactory.

[6] However, the MSRB notes that Exchange Act Rule 15c2-12(f)(3) of the SEC defines a "final official statement" as:

> a document or set of documents prepared by an issuer of municipal securities or its representatives that is complete as of the date delivered to the Participating Underwriter(s) and that sets forth information concerning the terms of the proposed issue of securities; information, including financial information or operating data, concerning such

(continued . . .)

document for fulfillment of the out-of-state disclosure obligation are responsible for understanding what is included within the program disclosure document of any 529 college savings plan they market and for determining whether such information is sufficient to meet this disclosure obligation. Notwithstanding any of the foregoing, disclosure through the program disclosure document as described above is not the sole manner in which a dealer may fulfill its out-of-state disclosure obligation. Thus, if the issuer has not included this information in the program disclosure document in the manner described, inclusion in the program disclosure document in another manner may nonetheless fulfill the dealer's out-of-state disclosure obligation so long as disclosure in such other manner is reasonably likely to be noted by an investor. Otherwise, the dealer would remain obligated to disclose such information separately to the customer under Rule G-17 by no later than the time of trade.[7]

If the dealer proceeds to provide information to an out-of-state customer about the state tax or other benefits available through such customer's home state, Rule G-17 requires that the dealer ensure that the information is not false or misleading. For example, a dealer would violate Rule G-17 if it were to inform a customer that investment in the 529 college savings plan of the customer's home state did not provide the customer with any state tax benefit even though such a state tax benefit is in fact available. Furthermore, a dealer would

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(. . . continued)

> issuers of municipal securities and those other entities, enterprises, funds, accounts, and other persons material to an evaluation of the Offering; and a description of the undertakings to be provided pursuant to paragraph (b)(5)(i), paragraph (d)(2)(ii), and paragraph (d)(2)(iii) of this section, if applicable, and of any instances in the previous five years in which each person specified pursuant to paragraph (b)(5)(ii) of this section failed to comply, in all material respects, with any previous undertakings in a written contract or agreement specified in paragraph (b)(5)(i) of this section.

Section (b) of that rule requires that the participating underwriter of an offering review a "deemed-final" official statement and contract to receive the final official statement from the issuer. *See* Rule D-12 Interpretation – Interpretation Relating to Sales of Municipal Fund Securities in the Primary Market, January 18, 2001, published in *MSRB Rule Book*, for a discussion of the applicability of Rule 15c2-12 to offerings of 529 college savings plans.

[7] Although Rule G-17 does not dictate the precise manner in which material facts must be disclosed to the customer at or prior to the time of trade, dealers must ensure that such disclosure is effectively provided to the customer in connection with the specific transaction and cannot merely rely on the inclusion of a disclosure in general advertising materials.

violate Rule G-17 if it were to inform a customer that investment in the 529 college savings plan of another state would provide the customer with the same state tax benefits as would be available if the customer were to invest in his or her home state's 529 college savings plan even though this is not the case.[8] Dealers should make certain that information they provide to their customers, whether provided under an affirmative disclosure obligation imposed by MSRB rules or in response to questions from customers, is correct and not misleading.

Dealers are reminded that this out-of-state disclosure obligation is in addition to their general obligation under Rule G-17 to disclose to their customers at or prior to the time of trade all material facts known by dealers about the 529 college savings plan interests they are selling to their customers, as well as material facts about such 529 college savings plan that are reasonably accessible to the market. Further, dealers are reminded that disclosures made to customers as required under MSRB rules with respect to 529 college savings plans do not relieve dealers of their suitability obligations – including the obligation to consider the customer's financial status, tax status and investment objectives – if they have recommended investments in 529 college savings plans.

Suitability

Under Rule G-19, a dealer that recommends to a customer a transaction in a security must have reasonable grounds for believing that the recommendation is suitable, based upon information available from the issuer of the security or otherwise and the facts disclosed by or otherwise known about the customer.[9] To assure that a dealer effecting a recommended transaction with a non-institutional customer has the information needed about the customer to make its suitability determination, the rule requires the dealer to make reasonable efforts to obtain information concerning the customer's financial status, tax status and investment objectives, as well as any other information reasonable and necessary in making the

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[8] Dealers should note that these examples are illustrative and do not limit the circumstances under which, depending on the facts and circumstances, a Rule G-17 violation could occur.

[9] The MSRB has previously stated that most situations in which a dealer brings a municipal security to the attention of a customer involve an implicit recommendation of the security to the customer, but determining whether a particular transaction is in fact recommended depends on an analysis of all the relevant facts and circumstances. *See* Rule G-19 Interpretive Letter – Recommendations, February 17, 1998, published in *MSRB Rule Book*. The MSRB also has provided guidance on recommendations in the context of on-line communications in Rule G-19 Interpretation – Notice Regarding Application of Rule G-19, on Suitability of Recommendations and Transactions, to Online Communications, September 25, 2002, published in *MSRB Rule Book*.

recommendation.[10] Dealers are reminded that the obligation arising under Rule G-19 in connection with a recommended transaction requires a meaningful analysis**,** taking into consideration the information obtained about the customer and the security, that establishes the reasonable grounds for believing that the recommendation is suitable. Such suitability determinations should be based on the appropriately weighted factors that are relevant in any particular set of facts and circumstances, which factors may vary from transaction to transaction.[11] Pursuant to Rule G-27(c), dealers must have written supervisory procedures in place that are reasonably designed to ensure compliance with this Rule G-19 obligation to undertake a suitability analysis in connection with every recommended transaction, and dealers must enforce these procedures to ensure that such meaningful analysis does in fact occur in connection with the dealer's recommended transactions.

In the context of a recommended transaction relating to a 529 college savings plan, the MSRB believes that it is crucial for dealers to remain cognizant of the fact that these instruments are designed for a particular purpose and that this purpose generally should match the customer's investment objective. For example, dealers should bear in mind the potential tax consequences of a customer making an investment in a 529 college savings plan where the dealer understands that the customer's investment objective may not involve use of such funds for qualified higher education expenses.[12] Dealers also should consider whether a recommendation is consistent with the customer's tax status and any customer investment objectives materially related to federal or state tax consequences of an investment.

Furthermore, investors generally are required to designate a specific beneficiary under a 529 college savings plan. The MSRB believes that information known about the designated beneficiary generally would be relevant in weighing the investment objectives of the customer, including (among other things) information regarding the age of the beneficiary and the number of years until funds will be needed to pay qualified higher education expenses of

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10 Rule G-8(a)(xi)(F) requires that dealers maintain records for each customer of such information about the customer used in making recommendations to the customer.

11 Although certain factors relating to recommended transactions in 529 college savings plans are discussed in this notice, whether such enumerated factors or any other considerations are relevant in connection with a particular recommendation is dependent upon the facts and circumstances. The factors that may be relevant with respect to a specific transaction in a 529 college savings plan generally include the various considerations that would be applicable in connection with the process of making suitability determinations for recommendations of any other type of security.

12 *See* Section 529(c)(3) of the Internal Revenue Code. State tax laws also may result in certain adverse consequences for use of funds other than for educational costs.

the beneficiary. The MSRB notes that, since the person making the investment in a 529 college savings plan retains significant control over the investment (*e.g.*, may withdraw funds, change plans, or change beneficiary, etc.), this person is appropriately considered the customer for purposes of Rule G-19 and other MSRB rules. As noted above, information regarding the designated beneficiary should be treated as information relating to the customer's investment objective for purposes of Rule G-19.

In many cases, dealers may offer the same investment option in a 529 college savings plan sold with different commission structures. For example, an A share may have a front-end load, a B share may have a contingent deferred sales charge or back-end load that reduces in amount depending upon the number of years that the investment is held, and a C share may have an annual asset-based charge. A customer's investment objective – particularly, the number of years until withdrawals are expected to be made – can be a significant factor in determining which share class would be suitable for the particular customer.

Rule G-19(e), on churning, prohibits a dealer from recommending transactions to a customer that are excessive in size or frequency, in view of information known to such dealer concerning the customer's financial background, tax status and investment objectives. Thus, for example, where the dealer knows that a customer is investing in a 529 college savings plan with the intention of receiving the available federal tax benefit, such dealer could, depending upon the facts and circumstances, violate rule G-19(e) if it were to recommend roll-overs from one 529 college savings plan to another with such frequency as to lose the federal tax benefit. Even where the frequency does not imperil the federal tax benefit, roll-overs recommended year after year by a dealer could, depending upon the facts and circumstances (including consideration of legitimate investment and other purposes), be viewed as churning. Similarly, depending upon the facts and circumstances, where a dealer recommends investments in one or more plans for a single beneficiary in amounts that far exceed the amount that could reasonably be used by such beneficiary to pay for qualified higher education expenses, a violation of rule G-19(e) could result.[13]

Other Sales Practice Principles

Dealers must keep in mind the requirements under Rule G-17 – that they deal fairly with all persons and that they not engage in any deceptive, dishonest or unfair practice – when

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[13] The MSRB understands that investors may change designated beneficiaries and therefore amounts in excess of what a single beneficiary could use ultimately might be fully expended by additional beneficiaries. The MSRB expresses no view as to the applicability of federal tax law to any particular plan of investment and does not interpret its rules to prohibit transactions in furtherance of legitimate tax planning objectives, so long as any recommended transaction is suitable.

considering the appropriateness of day-to-day sales-related activities with respect to municipal fund securities, including 529 college savings plans. In some cases, certain sales-related activities are governed in part by specific MSRB rules, such as Rule G-19 (as described above) and Rule G-30(b), on commissions.[14] Other activities may not be explicitly addressed by a specific MSRB rule. In either case, the general principles of Rule G-17 always apply.

In particular, dealers must ensure that they do not engage in transactions primarily designed to increase commission revenues in a manner that is unfair to customers under Rule G-17. Thus, in addition to being a potential violation of Rule G-19 as discussed above, recommending a particular share class to a customer that is not suitable for that customer, or engaging in churning, may also constitute a violation of Rule G-17 if the recommendation was made for the purpose of generating higher commission revenues. Also, where a dealer offers investments in multiple 529 college savings plans, consistently recommending that customers invest in the one 529 college savings plan that offers the dealer the highest compensation may, depending on the facts and circumstances, constitute a violation of Rule G-17 if the recommendation of such 529 college savings plan over the other 529 college savings plans offered by the dealer does not reflect a legitimate investment-based purpose.

Further, recommending transactions to customers in amounts designed to avoid commission discounts (*i.e.*, sales below breakpoints where the customer would be entitled to lower commission charges) may also violate Rule G-17, depending upon the facts and circumstances. For example, a recommendation that a customer make two smaller investments in separate but nearly identical 529 college savings plans for the purposes of avoiding a reduced commission rate that would be available upon investing the full amount in a single 529 college savings plan, or that a customer time his or her multiple investments in a 529 college savings plan so as to avoid being able to take advantage of a lower commission rate, in either case without a legitimate investment-based purpose, could violate Rule G-17.

With respect to sales incentives, the MSRB has previously interpreted Rule G-20, relating to gifts, gratuities and non-cash compensation, to require a dealer that sponsors a sales contest involving representatives who are not employed by the sponsoring dealer to have

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[14] The MSRB has previously provided guidance on dealer commissions in Rule G-30 Interpretation – Interpretive Notice on Commissions and Other Charges, Advertisements and Official Statements Relating to Municipal Fund Securities, December 19, 2001, published in *MSRB Rule Book*. The MSRB believes that Rule G-30(b), as interpreted in this 2001 guidance, should effectively maintain dealer charges for 529 college savings plan sales at a level consistent with, if not lower than, the sales loads and commissions charged for comparable mutual fund sales.

in place written agreements with these representatives.[15] In addition, the general principles of Rule G-17 are applicable. Thus, if a dealer or any of its associated persons engages in any marketing activities that result in a customer being treated unfairly, or if the dealer or any of its associated persons engages in any deceptive, dishonest or unfair practice in connection with such marketing activities, Rule G-17 could be violated. The MSRB believes that, depending upon the specific facts and circumstances, a dealer may violate Rule G-17 if it acts in a manner that is reasonably likely to induce another dealer or such other dealer's associated persons to violate the principles of Rule G-17 or other MSRB customer protection rules, such as Rule G-19 or Rule G-30. Dealers are also reminded that Rule G-20 establishes standards regarding incentives for sales of municipal securities, including 529 college savings plan interests, that are substantially similar to those currently applicable to sales of mutual fund shares under NASD rules.

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(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was adopted by the MSRB at its February 15-16, 2006 meeting. Questions concerning this filing may be directed to Ernesto A. Lanza, Senior Associate General Counsel, at (703) 797-6600.

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

(a) In a May 14, 2002 notice (the "2002 Notice"), the MSRB interpreted Rule G-17, on fair dealing, to require dealers selling out-of-state 529 college savings plan interests to customers to disclose at or prior to the sale to the customer (the "time of trade") that, depending upon the laws of the customer's home state, favorable state tax treatment for investing in a 529 college savings plan may be limited to investments made in a 529 college savings plan offered by the customer's home state.[16] In addition, the MSRB provided guidance in the 2002 Notice on the application of Rule G-19, on suitability of

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15 *See* Rule G-20 Interpretive Letter – Authorization of sales contests, June 25, 1982, published in *MSRB Rule Book*.

16 *See* Rule G-21 Interpretation – Application of Fair Practice and Advertising Rules to Municipal Fund Securities, May 14, 2002, *reprinted in* MSRB Rule Book.

recommendations and transactions, and other customer protection rules in the context of 529 college savings plan transactions.

The proposed rule change broadens the existing time-of-trade disclosure obligation with respect to the marketing of out-of-state 529 college savings plans. Under the proposed rule change, dealers selling out-of-state 529 college savings plan interests are required to disclose to the customer, at or prior to the time of trade, that: (i) depending on the laws of the home state of the customer or designated beneficiary, favorable state tax treatment or other benefits offered by such home state may be available only if the customer invests in the home state's 529 college savings plan; (ii) state-based benefits should be one of many appropriately weighted factors to be considered in making an investment decision; and (iii) the customer should consult with his or her financial, tax or other adviser about how such state-based benefits would apply to the customer's specific circumstances and may wish to contact his or her home state or any other 529 college savings plan to learn more about their features. Guidance is provided as to the manner of delivering this revised out-of-state disclosure to ensure that such information is noted by the customer, and dealers are reminded that all disclosures made to customers, regardless of whether they are made pursuant to a regulatory mandate, must not be false or misleading.

The proposed rule change further reminds dealers that providing disclosures to customers does not relieve them of their suitability duties – including their obligation to consider the customer's financial status, tax status and investment objectives – arising in connection with recommended transactions. The proposed rule change describes certain basic suitability principles applicable to recommended transactions in 529 college savings plans, advising dealers to consider whether a recommendation is consistent with the customer's tax status and any federal or state tax-related investment objectives of the customer. The proposed rule change emphasizes that any dealer that recommends a transaction must undertake an active suitability process involving a meaningful analysis that takes into consideration information about the customer and the security. Dealers are further advised that suitability determinations should be based on the various appropriately weighted factors that are relevant in any particular set of facts and circumstances. Finally, the proposed rule change reaffirms existing guidance from the 2002 Notice on other customer protection obligations applicable to dealer sales practices in the 529 college savings plan market.

(b) The MSRB has adopted the proposed rule change pursuant to Section 15B(b)(2)(C) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which provides that MSRB's rules shall:

> be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and

open market in municipal securities, and, in general, to protect investors and the public interest.

The MSRB believes that the proposed rule change is consistent with the Exchange Act because it will further investor protection by strengthening and clarifying dealers' customer protection obligations relating to the marketing of 529 college savings plans, including but not limited to the duty to provide important disclosures to customers investing in out-of-state 529 college savings plans and to undertake active suitability analyses for recommended transactions based on appropriately weighted factors.

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

The MSRB does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act since it would apply equally to all dealers.

5. Self-Regulatory Organization's Statement on Comments Received on the Proposed Rule Change by Members, Participants, or Others

On June 10, 2004, the MSRB published for comment draft interpretive guidance relating to, among other things, the disclosure obligations of dealers selling out-of-state 529 college savings plans, strengthening the out-of-state disclosures originally mandated in the 2002 Notice (the "2004 Proposal").[17] The MSRB received comments on the 2004 Proposal from eight commentators.[18] After reviewing these comments, considering the concerns of

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[17] *See* MSRB Notice 2004-16 (June 10, 2004). The 2004 Proposal, together with a related proposal (MSRB Notice 2004-17 (June 15, 2004)), represented a comprehensive initiative of the MSRB to strengthen a broad range of customer protection obligations set out in the 2002 Notice. Portions of the 2004 Proposal significantly strengthening 529 college savings plan advertising requirements have been adopted, with certain additional requirements and modifications, by the MSRB and approved by the Commission. *See* Exchange Act Release No. 51736 (May 24, 2005), 70 FR 31551 (June 1, 2005). *See also* Exchange Act Release No. 52289 (August 18, 2005), 70 FR 49699 (August 24, 2005. In addition, the strengthened customer protection obligations with respect to 529 college savings plan sales incentives proposed in the related June 15, 2004 proposal have been adopted by the MSRB and approved by the Commission. *See* Exchange Act Release No. 52555 (October 3, 2005), 70 FR 59106 (October 11, 2005). The current proposed rule change represents the final stage of the MSRB's 2004 customer protection initiative.

[18] Letters from: Kenneth B. Roberts, Hawkins Delafield & Wood LLP ("Hawkins"), to Ernesto A. Lanza, Senior Associate General Counsel, MSRB, dated August 20, 2004;

(continued . . .)

NASD and others regarding high levels of out-of-state sales and consulting with Commission staff, the MSRB published on May 19, 2005 a notice seeking further comment on a revised version of the draft interpretive guidance (the "2005 Proposal").[19] The 2005 Proposal included a discussion of existing resources and challenges in connection with obtaining disclosure information in the 529 college savings plan marketplace and sought comment on the possible substantial expansion of the disclosure and suitability obligations described in the 2002 Notice. The MSRB received comments on the 2005 Proposal from 22 commentators.[20]

(. . . continued)

Mary L. Schapiro, Vice Chairman, NASD, and President, Regulatory Policy and Oversight, to Mr. Lanza, dated September 9, 2004; Tamara K. Salmon, Senior Associate Counsel, Investment Company Institute ("ICI"), to Mr. Lanza, dated September 10, 2004; David J. Pearlman, Chairman, College Savings Foundation ("CSF"), to Mr. Lanza, dated September 13, 2004; Elizabeth L. Bordowitz, General Counsel, Finance Authority of Maine ("FAME"), to Mr. Lanza, dated September 13, 2004; Diana F. Cantor, Chair, College Savings Plan Network ("CSPN"), and Executive Director, Virginia College Savings Plan, to Mr. Lanza, dated September 15, 2004; Elizabeth Varley and Michael D. Udoff, Co-Staff Advisers, Securities Industry Association ("SIA") Ad Hoc 529 Plans Committee, to Mr. Lanza, dated September 15, 2004; and Raquel Alexander, PhD, Assistant Professor, and LeAnn Luna, PhD, Assistant Professor, University of North Carolina at Wilmington ("UNCW"), to Mr. Lanza, dated September 15, 2004.

19 *See* MSRB Notice 2005-28 (May 19, 2005).

20 Letters from: Ms. Alexander, Assistant Professor of Accounting, University of Kansas, and Ms. Luna, Assistant Professor of Accounting, University of Tennessee ("Alexander & Luna"), to Mr. Lanza, dated July 26, 2005; Judith A. Wilson, Compliance Attorney, 1st Global Capital Corp. ("1st Global"), to Mr. Lanza, dated July 28, 2005; Diana Scott, Senior Vice President & General Manager, John Hancock Financial Services ("Hancock"), to Mr. Lanza, dated July 28, 2005; John C. Heywood, Principal, Vanguard Group, Inc. ("Vanguard"), to Mr. Lanza, dated July 28, 2005; Mr. Pearlman, CSF, to Mr. Lanza, dated July 29, 2005 and February 13, 2006; Tim Berry, Chair, CSPN, and Indiana State Treasurer, to Mr. Lanza, dated July 29, 2005; Ms. Salmon, ICI, to Mr. Lanza, dated July 29, 2005; Jacqueline T. Williams, Executive Director, Ohio Tuition Trust Authority ("Ohio TTA"), to Mr. Lanza and Ghassan Hitti, Assistant General Counsel, MSRB, dated July 29, 2005; Ira D. Hammerman, Senior Vice President & General Counsel, SIA, to Mr. Lanza, dated July 29, 2005; Ms. Cantor, Executive Director, Virginia College Savings Plan ("Virginia CSP"), to Mr. Lanza, dated July 29, 2005; John D. Perdue, Chairman, Board of Trustees of the West Virginia College Prepaid Tuition and Savings Program, and State Treasurer ("West Virginia"), to Mr. Lanza, dated July 29, 2005; James F. Lynch, Associate Vice

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The 2004 and 2005 Proposals, as well as the comments received on these proposals, are discussed below. The MSRB has considered these comments, together with important developments in the mechanisms for ensuring the free and effective flow of information to the public about all 529 college savings plans offered in the marketplace (discussed below), in determining to file this proposed rule change.

GENERAL

The 2004 Proposal proposed expanding the existing obligation of dealers under the 2002 Notice to advise their out-of-state 529 college savings plan customers of the potential loss of in-state benefits. The 2004 Proposal did not address issues relating to suitability. All commentators on the 2004 Proposal supported the importance of ensuring some degree of disclosure to customers of the existence of potential in-state benefits of 529 college savings plans but some commentators suggested changes to the specific proposal.

The 2005 Proposal covered a wider range of topics than the portion of the 2004 Proposal relating to disclosure. The 2005 Proposal sought to expand the time-of-trade disclosure obligation for out-of-state sales proposed in the 2004 Proposal to include a requirement that dealers identify for their out-of-state customers the specific tax and other benefits that each of their respective home states offer and that such customers would forego by investing in an out-of-state 529 college savings plan (the "special home state disclosure

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President for Finance, University of Alaska ("University of Alaska"), to Mr. Lanza, dated July 29, 2005; Eileen M. Smiley, Vice President & Assistant Secretary, USAA Investment Management Company ("USAA"), to Mr. Lanza, dated July 29, 2005; Ronald C. Long, Senior Vice President, Wachovia Securities, LLC ("Wachovia"), to Mr. Lanza, dated July 29, 2005; Michael L. Fitzgerald, State Treasurer of Iowa ("Iowa"), to Mr. Lanza, received August 1, 2005; Henry H. Hopkins, Vice President, Director & Chief Legal Counsel, T. Rowe Price Investment Services, Inc. ("T. Rowe"), to Mr. Lanza, dated August 1, 2005; Thomas M. Yacovino, Vice President, A.G. Edwards and Sons, Inc., ("AG Edwards"), to Mr. Lanza, dated August 3, 2005; W. Daniel Ebersole, Director, Georgia Office of Treasury and Fiscal Services ("Georgia"), to Mr. Lanza, dated August 4, 2005; Nancy K. Kopp, Treasurer, State of Maryland, and Chair, College Savings Plans of Maryland ("CSP-Maryland"), to Mr. Lanza, dated August 10, 2005; Mr. Pearlman, Senior Vice President and Deputy General Counsel, Fidelity Investments ("Fidelity"), to Mr. Lanza, dated December 7, 2005; James W. Pasman, Senior Vice President & Managing Director, PFPC Inc. ("PFPC"), to Mr. Lanza, dated December 12, 2005; and Randall Edwards, President, National Association of State Treasurers ("NAST"), and Oregon State Treasurer, to Amelia A.J. Bond, Chair, MSRB, dated March 20, 2006.

proposal"). More broadly, the 2005 Proposal discussed general disclosure practices and mechanisms in the 529 college savings plan market, including the possible establishment of centralized information sources. Dealers were reminded that disclosures made to customers do not relieve dealers of their suitability duties – including their obligation to consider the customer's financial status, tax status and investment objectives – arising in connection with recommended transactions. The 2005 Proposal discussed existing suitability standards as applied to recommendations of 529 college savings plan transactions and proposed expanding such standards to require dealers recommending out-of-state 529 college savings plan investments to undertake a comparative suitability analysis involving a comparison of the recommended out-of-state 529 college savings plan with the customer's home state 529 college savings plan (the "comparative suitability proposal"). Finally, the 2005 Proposal discussed other sales practice obligations under the MSRB's fair practice rule.[21] Although some commentators supported the concept of centralized information sources for the 529 college savings plan market and the clarification of certain elements of existing basic disclosure and suitability obligations, the vast majority of commentators opposed any requirements to disclose specific in-state features foregone as a result of an out-of-state investment or to undertake a comparative suitability analysis.

The MSRB has determined to strengthen the existing time-of-trade disclosure and basic suitability obligations as applied to transactions in 529 college savings plans. However, in view of significant developments toward the maturation of the disclosure dissemination system for this market and with due regard to concerns expressed by the commentators and in press reports regarding the potentially substantial impact of the special home state disclosure and comparative suitability proposals, the MSRB has determined at this time not to adopt these two proposals pending further assessment of the efficacy of developments in the disclosure infrastructure.

DISCLOSURE

General Time-of-Trade Disclosure Obligation and Established Industry Sources

Summary. The 2005 Proposal described dealers' obligations to make time-of-trade disclosures of all material facts about a 529 college savings plan investment they are selling to their customers that are known to the dealer or that are reasonably accessible from established industry sources.[22] The 2005 Proposal included a discussion of established industry sources

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21 These provisions did not generate comments and have been included in the proposed rule change with only minimal modifications.

22 Established industry sources include the system of nationally recognized municipal securities information repositories, the MSRB's Municipal Securities Information Library® system and Real-Time Transaction Reporting System, rating agency reports

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for 529 college savings plan information[23] and requested comments on whether one or more centralized web-based sources of information should be established by the private sector, industry associations or the MSRB. The 2005 Proposal noted that such a resource would ideally provide on-site summary information formatted to allow dealers and customers to make meaningful comparisons of the material features of 529 college savings plans, together with direct links to all 529 college savings plan official statements (typically referred to as "program disclosure documents") and related information. The types of material features summarized on such a site might include (among other things) state tax treatment, other state-based benefits, costs associated with investments and performance information. The 2005 Proposal suggested that such a centralized website could embed within its posted summary information direct hyperlinks to the portions of the program disclosure document or other 529 college savings plan materials that provide more detailed descriptions of the summarized information.[24] The 2004 Proposal did not address these issues.

Comments. Two commentators on the 2005 Proposal supported the establishment of a centralized website for summary 529 college savings plan information with links to 529 college savings plan materials for more detailed information.[25] They stated that such a website would allow dealers and customers to make meaningful comparisons of features and reduce the complexity of gathering accurate, complete and timely information. Alexander & Luna listed what they viewed as several weaknesses of current third-party websites: (i) information that is frequently out-of-date, incomplete or inaccurate; (ii) comparison information that is not universally available; (iii) information that is "summarized at a very

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and other sources of information relating to the municipal securities transaction generally used by dealers that effect transactions in the type of municipal securities at issue. *See* Rule G-17 Interpretation – Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts, March 20, 2002, published in *MSRB Rule Book*.

23 The MSRB noted that many of the traditional established industry sources are designed specifically for debt securities, not 529 college savings plans, and that it viewed established industry sources for 529 college savings plans as encompassing a broad variety of information sources that professionals in this market can and do use to obtain material information about these investments and the state programs.

24 The 2005 Proposal noted that the centralized website could, for example, provide hyperlinks to websites, or other contact information for sources, providing performance data current to the most recent month-end, as required under Rule G-21(e)(ii)(C) relating to 529 college savings plan advertisements containing performance information.

25 1st Global; Alexander & Luna.

high level;" (iv) website tools that are often over-simplified, which can distort results and ultimately provide incorrect guidance; and (v) many current websites that require users to pay for subscriptions in order to obtain basic information.

Many commentators opposed, or questioned the feasibility of, establishing a centralized website.[26] Some commentators expressed concern that disparate features of 529 college savings plans make presentation of parallel information nearly impossible and that information presented in a summary manner may omit material information or portray such information inaccurately.[27] Some commentators expressed concerns about potential liabilities for dealers that might rely on summarized information obtained from any such centralized website.[28] Hancock stated that existing websites are adequate for the marketplace.

CSPN stated that the creation of an MSRB-sponsored website would be contrary to the municipal securities exemption under federal securities laws and that it is already working to address 529 college savings plan disclosure concerns through its disclosure principles and its own website. CSPN noted that it had recently developed Disclosure Principles Statement No. 2 ("DP-2") which, "along with the information available on the CSPN website will be the most effective and appropriate approach to enhancing investor accessibility to pertinent 529 Plan information."[29] CSPN stated that DP-2 included "an expanded locator concept, which will assist investors in finding similar information in the offering materials prepared by various State issuers, while still using only the materials authorized by that State issuer."[30]

Although the 2004 Proposal did not address broader disclosure issues in the 529 college savings plan market, two commentators on the 2004 Proposal made suggestions in this regard, stating that the MSRB should put in place a broader set of disclosure requirements to accompany the proposed disclosures described in the draft guidance.[31] NASD suggested

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[26] AG Edwards, CSF, CSPN (with the concurrence of CSP-Maryland, Georgia, Iowa, Ohio TTA, University of Alaska, Virginia CSP, West Virginia), Hancock, and USAA.

[27] CSF, CSPN, Hancock.

[28] Hancock, Vanguard.

[29] DP-2 updated CSPN's Voluntary Disclosure Principles Statement No. 1 ("DP-1"), which CSPN published in 2004 to provide guidance to state programs in preparing their program disclosure documents. *See also* NAST.

[30] CSP-Maryland, Georgia, Iowa, Ohio TTA, University of Alaska, Virginia CSP and West Virginia supported CSPN's position.

[31] NASD and UNCW.

that the MSRB require standardized point-of-sale disclosure of fees and compensation in a manner similar to the point-of-sale disclosure requirements included by the Commission in its proposed Exchange Act Rule 15c2-3.[32] UNCW described an academic study on factors influencing investor choices of 529 college savings plans and concluded that "investors appear to be choosing high fee/broker sold funds rather than the lower fee, direct investment options . . . [and] appear to be ignoring state tax benefits." Stating that its study suggested that investors may not have sufficient information in these areas, UNCW supported mandating disclosure of not only state tax benefits but also uniform disclosure of fees and performance for each 529 college savings plan portfolio and for each underlying fund in such portfolio, as well as the percentage of total investments that each underlying fund represents with respect to such 529 college savings plan portfolio.

MSRB Response. Since publishing the 2005 Proposal, the MSRB has engaged the 529 college savings plan industry and other federal securities regulators in a dialogue regarding the 2005 Proposal. In particular, the MSRB has emphasized that a crucial factor underlying the special home state disclosure and comparative suitability proposals for out-of-state sales was the difficulty that the average investor faces in obtaining and understanding the key items of information relevant in making an informed investment decision in the context of the varied and complex national 529 college savings plan marketplace.[33]

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[32] *See* Securities Act Release No. 8358 (January 29, 2004), 69 FR 6438 (February 10, 2004). *See also* Securities Act Release No. 8544 (February 28, 2005), 70 FR 10521 (March 4, 2005). The proposed rulemaking by the Commission would apply to dealer sales of 529 college savings plan interests, in addition to sales of mutual funds and variable annuities. The MSRB observes that NASD has provided comments to the Commission on this proposal that are similar to those provided to the MSRB. The MSRB also has provided comments to the Commission in support of its point-of-sale disclosure proposal (available at www.sec.gov/rules/proposed/s70604/s70604-629.pdf). The MSRB has taken NASD's suggestions in this regard under advisement pending final action by the Commission on proposed Rule 15c2-3.

[33] Investor confusion has often been reported to result from the large number of states offering valuable state tax or other benefits for investing in-state and the fact that virtually every plan has unique and sometimes complicated features not included in most other plans. The difficulties that investors face finding and understanding relevant information (in spite of the existence of a handful of web-based resources on 529 college savings plans), as well as some recent steps toward improving the ability of investors to understand their choices in the marketplace, have been detailed by the press. *See, e.g.*, Ross Kerber, "Complaints Mounting over College Savings Accounts," Boston Globe, February 14, 2006, at www.boston.com/business/personalfinance/articles/2006/02/14/complaints_mounting_over_college_savings_accounts; John Wasik, "How to Find the Best 529 College Savings Programs,"

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The MSRB has long been an advocate for the best possible disclosure practices by the 529 college savings plan community, having previously noted that investor protection concerns dictate that disclosure in this market should be based on six basic characteristics: comprehensiveness, understandability, comparability, universality, timeliness and accessibility.[34] However, neither the MSRB nor the Commission have the authority to mandate that 529 college savings plans make specific disclosures, including disclosure of costs associated with investments in the plans, descriptions of the state tax consequences of investing in their plans or in out-of-state plans, or disclosure of performance under uniform standards.[35]

The MSRB is of the view that a more comprehensive and user-friendly system of established industry sources is needed in the 529 college savings plan market. Such a system would be based on centralized websites providing direct access to official issuer disclosure

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Bloomberg.com, February 13, 2006, at quote.bloomberg.com/apps/news?pid =10000039&refer=columnist_wasik&sid=aUh68emzUVEE; Albert B. Crenshaw, "529 College Savings Plans and State of Confusion," Washington Post, February 12, 2006, at F8; Aleksandra Todorova, "529 Plans Get Report Card," SmartMoney.com, February 10, 2006, at www.smartmoney.com/consumer/index.cfm?story=20060210; Jonathan Clements, "Choosing a 529 College-Savings Plan: When It Makes Sense to Go Out of State," Wall Street Journal, January 4, 2006, at D1; Michelle Singletary, "Get the Straight Facts on Section 529," Washington Post, December 1, 2005, at D2; Ashlea Ebling, "College Savers Unite!" Forbes.com, September 28, 2005, at www.forbes.com/estateplanning/2005/09/27/beltway-college-savings-cz_ae_0928beltway.html.

[34] *See* Oversight Hearing on 529 College Savings Plans, Hearing Before the Subcomm. on Financial Management, The Budget, and International Security of the Senate Comm. on Governmental Affairs, 108th Cong. (Sept. 30, 2004) (testimony of Ernesto A. Lanza, Senior Associate General Counsel, MSRB).

[35] When dealers market 529 college savings plans, the MSRB requires time-of-trade disclosures of material information to customers, including but not limited to disclosure of the possible loss of state tax benefits if investing out-of-state. Proposed Exchange Act Rule 15c2-3, if adopted, would mandate that point-of-sale fee disclosures be made by dealers in a uniform manner. Furthermore, the MSRB has adopted uniform requirements for the calculation and presentation of up-to-date performance data in 529 college savings plan advertisements published by dealers that also require that advertisements disclose the possible loss of state tax benefits if investing out-of-state.

materials for the entire universe of 529 college savings plan offerings, together with understandable educational information and tools allowing for side-by-side comparisons of different 529 college savings plans. It is crucial that dealers and other investment professionals seeking to provide advice to their customers on their college savings options are able to do so with a full view of the available alternatives. In addition, this maturation of the disclosure dissemination system for the 529 college savings plan market would be particularly crucial to allowing customers to have direct access to the types of information and other resources they need to make informed investment decisions, thereby promoting investor confidence in their own abilities to make such informed choices, whether with the advice of an investment professional or as a self-directed investor.

The MSRB understands that CSPN has undertaken to upgrade its existing website to provide a comprehensive centralized web-based utility for the 529 college savings plan market.[36] This CSPN utility is expected to provide a combination of on-site and hyperlinked resources, including summary information formatted to allow meaningful comparisons of many of the material features of different 529 college savings plans, together with direct links to all 529 college savings plan program disclosure documents and related information as well as to other sources providing tools designed for analyzing potential 529 college savings plan investments. The MSRB understands that the types of material features to be disclosed through this utility include, but are not limited to, state tax treatment and other state-based benefits, costs associated with investments, types of underlying investments, performance information and other important features that can vary considerably from state to state, with hyperlinks embedded within such summary information providing direct links to a full description of such specific feature in the issuer's official program disclosure document or other reliable sources. CSPN has also recently published its DP-2, which updates its baseline disclosure standards designed to assist the states in improving the quality and comparability of their 529 college savings plan disclosures in the program disclosure document. In the 2005 Proposal, the MSRB had urged CSPN and the individual 529 college savings plans to strive for the maximum possible ease of access to, and uniformity of content in, the program disclosure documents consistent with providing information that is complete, understandable and not misleading. The MSRB views the upcoming implementation of the CSPN website disclosure utility and the development and universal adoption of DP-2 as significant steps toward achieving the goals the MSRB had set out for the 529 college savings plan market.

The CSPN utility will join other commercial, industry group and regulator web-based resources providing useful information for individuals seeking to save for college expenses and for investment professionals active in the 529 college savings plan market. Several commercial ventures already provide, in summary and often tabular form, some categories of information for all available 529 college savings plans. Such information can include fees

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[36] NAST. CSPN is an affiliate of NAST.

and expenses, minimum and maximum investments, nature of the underlying investments, distribution channels, and state tax treatment, as well as proprietary ratings based on varying criteria. Much of this information is available at no cost, with some sources making available, for a fee, premium or membership-based services for professionals that provide greater detail or more comprehensive analyses of the available information. Many of these commercial websites have taken recent steps to augment and refine the information they offer to the public, and the MSRB understands that alternative pricing structures suitable for retail investors for access to these premium services are being considered. In addition, the MSRB, the Commission, NASD and the North American Securities Administrators Association ("NASAA") all provide general information about investing in 529 college savings plans useful to individual investors and market participants.[37] NASD plans to introduce on its website in the near future an improved expense analyzer for the 529 college savings plan market using a live datafeed that should allow for more reliable calculations and cost comparisons among different 529 college savings plans. The CSPN utility is expected to serve as a central hub through which investors can easily access many of these other web-based resources.

The MSRB believes that improved disclosures can only be effective if potential investors actually access such disclosures with sufficient time to make use of the information in coming to an investment decision. The MSRB urges dealers and other participants in the 529 college savings plan market to provide the investing public with easy access to, and to affirmatively encourage the use of, this market-wide information. The MSRB will monitor the 529 college savings plan market closely with respect to the concerns it sought to address through the 2005 Proposal. The MSRB will be acutely sensitive to, and will consider whether further rulemaking would be appropriate in the event of, any significant failures in the further development of the disclosure dissemination system or in the efficacy of this dissemination system to address the MSRB's stated investor protection concerns.

Time-of-Trade Disclosure Obligation in Connection with Out-of-State Sales

Summary. Currently, a dealer's time-of-trade disclosure obligation under Rule G-17 requires the dealer, when selling an out-of-state 529 college savings plan interest to a

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37 The MSRB provides information for investors in 529 college savings plans at www.msrb.org/msrb1/mfs/ruleinfo.asp. The Commission also has published an investor-oriented introduction to 529 college savings plans at www.sec.gov/investor/pubs/intro529.htm. NASD has created a college savings center for investors at apps.nasd.com/investor_Information/Smart/529/000100.asp. NASAA, an association of state securities regulators, has published (in conjunction with CSPN and ICI) a brochure on understanding college savings plans, available at www.nasaa.org/Investor_Education/3136.cfm.

customer, to disclose that, depending upon the laws of the customer's home state, favorable state tax treatment for investing in a 529 college savings plan may be limited to investments made in a 529 college savings plan offered by the customer's home state.[38] The 2004 Proposal sought to broaden this time-of-trade disclosure obligation to include reference to other potential benefits (such as scholarships to in-state colleges, matching grants into 529 college savings plan accounts, or reduced or waived program fees, among other benefits), in addition to state tax benefits, offered solely in connection with in-state investments.[39]

The 2005 Proposal retained the baseline time-of-trade disclosure proposed in the 2004 Proposal, with a modification to include reference to the designated beneficiary's home state in addition to that of the customer. The 2005 Proposal also would add to the baseline time-of-trade disclosure a requirement that the dealer advise the customer that any state-based benefits offered with respect to a particular 529 college savings plan should be considered as one of many appropriately weighted factors that should be considered by the customer in making his or her investment decision. The dealer also would be required to suggest that the customer consult with his or her financial, tax or other adviser to learn more about how such home state features (including any limitations) may apply to the customer's specific circumstances, and that the customer also may wish to contact his or her home state or any other 529 college savings plan to learn more about any state-based benefits (and any limitations thereto) that might be available in conjunction with an investment in that state's 529 college savings plan.

In a significant expansion from the 2004 Proposal, the 2005 Proposal sought to impose the special home state disclosure proposal in addition to the baseline time-of-trade disclosure described above. Under this special home state disclosure proposal, a dealer would be required to inquire of any out-of-state customer as to whether the realization of state-based benefits was an important factor in the customer's investment decision. If the customer were to answer affirmatively, the dealer would be required to disclose (i) material information available from established industry sources about state-based benefits offered by the home state of the customer or designated beneficiary for investing in its 529 college savings plan and (ii) whether such state-based benefits are available in the case of an investment in an out-of-state 529 college savings plan.

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38 The 2002 Notice also stated that such disclosure, coupled with a suggestion that the customer consult a tax adviser about any state tax consequences of the investment, would provide adequate notice of the potential loss of in-state tax benefits.

39 The 2004 Proposal would require the dealer to suggest that the customer consult with a qualified adviser or contact his or her home state's 529 college savings plan to learn more about any state tax or other benefits that might be available in conjunction with an investment in that state's 529 college savings plan.

Finally, the 2005 Proposal reminded dealers that the time-of-trade disclosure obligation with respect to sales of out-of-state 529 college savings plan interests is in addition to dealers' existing general obligation under Rule G-17 to disclose to their customers at the time of trade all material facts known by dealers about the 529 college savings plan interests they are selling to the customers, as well as material facts about such 529 college savings plan that are reasonably accessible to the market through established industry sources. Further, the 2005 Proposal reminded dealers that disclosures made to customers as required under MSRB rules do not relieve dealers of their suitability obligations – including the obligation to consider the customer's financial status, tax status and investment objectives – if they have recommended investments in 529 college savings plans.

Comments. All commentators on the 2004 Proposal supported the importance of ensuring disclosure to customers of the potential existence of state-specific features of 529 college savings plans, with many providing suggested modifications. CSF expressed concern about the potential for over-emphasizing state variations in a way that may detract from more fundamental considerations in making an investment decision. Two commentators stated that not every difference in state treatment ultimately will be a benefit to the investor, particularly in view of potential recapture of state tax benefits or other restrictions that some states impose under certain circumstances.[40] These commentators suggested that the best course would be to remind investors to carefully review the program disclosure documents of their home state programs and to consult their own advisors before investing, with one commentator stating that it would be inappropriate to suggest to investors that they seek help from their home state programs because it is unclear whether the programs can provide complete information regarding such consequences and because some states may seek to persuade investors to make an investment in their program rather than to impart disinterested information.[41] Two other commentators stated that the proposed disclosure should reflect that some benefits may be dependent on the designated beneficiary's home state (rather than or in addition to the home state of the investor).[42]

Most commentators on the 2005 Proposal accepted the modified baseline time-of-trade disclosure. However, most commentators strongly opposed the newly proposed special home state disclosure proposal requiring disclosure of specific in-state features that an out-of-state

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40 CSF and SIA.

41 CSF. However, Hawkins disagreed, stating that with respect to non-tax state benefits, customers should be directed to the specific state program for more information.

42 CSPN and FAME.

investor may forego,[43] with no commentator expressing support for this proposal. Several commentators argued that the specific disclosures under the special home state disclosure proposal would inevitably result in state-based benefits being given disproportionate weight as compared to the many other important factors to be considered in making an investment decision.[44] In addition, commentators observed that, without a reliable source of market-wide information, dealers would be required to undertake substantial effort (with concomitant expenditure of resources) to understand and track the details of constantly changing state law treatment of all 529 college savings plans.[45] Two commentators warned that requiring dealers to make specific disclosures about 529 college savings plans they do not offer could result in potential liability.[46] SIA stated that the special home state disclosure proposal would have the counter-intuitive result of compromising a dealer's ability to develop in-depth expertise regarding the range of investment products it is reasonably capable of servicing. Wachovia expressed concern that this requirement would have the potential to paralyze investors with an overabundance of information.

The University of Alaska stated that it did not wish to have its program features explained by dealers who are not authorized to market its 529 college savings plan, with other commentators echoing the concern that dealers would often be required to disclose information about a security they do not offer and about which they may not have sufficient expertise.[47] CSF observed that the burden this requirement would place on the 529 college savings plan market does not exist for any other type of security. Two commentators suggested that the MSRB await final action by the Commission on its point-of-sale disclosure proposal before finalizing any significant changes in 529 college savings plan disclosure requirements.[48]

MSRB Response. The MSRB continues to believe that it is important that investors are informed that they may be foregoing state tax and other benefits offered by their home states by investing in out-of-state 529 college savings plans. At the same time, the MSRB

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43 AG Edwards, CSF, CSP-Maryland, CSPN, Georgia, ICI, Iowa, Ohio TTA, SIA, T. Rowe, University of Alaska, USAA, Vanguard, Virginia CSP, Wachovia and West Virginia.

44 AG Edwards, CSF, ICI and Vanguard.

45 Hancock, ICI, SIA, T. Rowe, USAA, Vanguard and Wachovia.

46 Hancock and ICI.

47 ICI and Vanguard.

48 USAA and Wachovia.

agrees that there is a potential for over-emphasizing the importance of a particular state's beneficial state tax treatment of an investment in its 529 college savings plan, such as where a state offers a tax benefit that ultimately is relatively small in value compared to the financial impact that a marginally higher expense figure may have or under a variety of other circumstances. As a result, the MSRB has adopted the revised out-of-state disclosure obligation, which retains the baseline time-of-trade disclosure as modified in the 2005 Proposal. The MSRB believes that this time-of-trade disclosure in connection with out-of-state sales of 529 college savings plans, as embodied in the revised out-of-state disclosure obligation, achieves the appropriate balance between providing for the disclosure to customers of material information about the potential loss of state tax or other benefits relevant to their investment decision in 529 college savings plans without imposing a significant burden on dealers and other 529 college savings plan market participants that could possibly result in an over-simplification of the complexity of state law factors or an over-emphasis of state law factors as compared to other relevant investment factors. The MSRB has also retained the reminders in the 2005 Proposal to the effect that these disclosures do not obviate other disclosure requirements or suitability obligations arising as a result of a recommendation.

The MSRB has determined not to retain the proposal to expand the time-of-trade disclosure obligation to include disclosures of specific state tax and other state-based features of the investor's home state as set out in the special home state disclosure proposal. The MSRB has based this determination in large measure on the potential adverse impact of this proposal and the significant steps currently in process toward improvements in the 529 college savings plan disclosure system.

Fulfilling the Revised Out-of-State Disclosure Obligation Through the Program Disclosure Document

Summary. The 2004 Proposal would have clarified that dealers could meet their baseline time-of-trade disclosure obligation with respect to potentially foregone in-state benefits through the issuer's program disclosure document so long as the program disclosure document is provided to the customer at or prior to the time of trade. The 2004 Proposal also would have strengthened the minimum standards for prominence in the program disclosure document in order to meet the baseline time-of-trade disclosure obligation. Thus, to meet this obligation through the program disclosure document, the disclosure must appear in a manner that is reasonably likely to be noted by an investor. A presentation of this disclosure in the program disclosure document in close proximity and with equal prominence to the first presentation of information regarding other federal or state tax-related consequences of investing in the 529 college savings plan, and in close proximity and with equal prominence to each other presentation of information regarding state tax-related consequences of investing in the 529 college savings plan, would be deemed to satisfy this requirement. The 2005 Proposal modified this presentation standard to provide for equal prominence with the principal (rather than first) presentation of substantive information regarding other federal or

state tax-related consequences of investing in the 529 plan, and the inclusion of a reference to this disclosure (rather than restating such disclosure in full) in close proximity and with equal prominence to each other presentation of information regarding state tax-related consequences of investing in the 529 plan. Neither proposal required that such disclosure be made through the program disclosure document, noting that the MSRB does not have the authority to mandate the inclusion of any particular item of information in the issuer's disclosure document. Both proposals provided that dealers would be required to separately make such disclosure if the program disclosure document did not include the information in the manner prescribed.

Comments. Two commentators expressed concern that the 2004 Proposal would effectively establish requirements for what information must be included in the program disclosure document.[49] They noted that the MSRB does not have authority to directly impose such requirements. CSF stated that the MSRB should not establish specific requirements for how such disclosure should appear in the program disclosure document, while two other commentators suggested limiting some of the presentation requirements described in the 2004 Proposal.[50] SIA stated that the requirement that the information appearing in the program disclosure document must appear in a manner "reasonably likely to be noted by an investor" would place dealers in the position to question the judgment of the state issuers and suggested that there should be a presumption that the placement and adequacy of the disclosure in the program disclosure document is reasonable.

CSPN also expressed concern with respect to the reformulation of this language in the 2005 Proposal, stating that dealers would have to determine whether the issuer has satisfactorily made such disclosures, potentially calling into question the issuer's determination to include or omit particular information.[51] CSPN stated that this would create a constant second-guessing aspect as to the validity of offering materials created and distributed by state issuers. SIA stated that this provision would likely lead dealers to create their own disclosure documents for use in marketing 529 college savings plans, conflicting with most distribution agreements and program disclosure documents.

MSRB Response. The MSRB reaffirms its view that it has no authority to mandate the inclusion of any particular items in the issuer's program disclosure document. As noted in

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49 CSPN and FAME. These commentators, as well as Hawkins, noted that CSPN's DP-1 already contained language on this topic.

50 Hawkins and ICI.

51 CSP-Maryland, Georgia, Iowa, Ohio TTA, University of Alaska, Virginia CSP and West Virginia supported CSPN's position.

both the 2004 and 2005 Proposals, disclosure through the program disclosure document in the manner described by the MSRB is not the sole manner in which a dealer may fulfill the revised out-of-state disclosure obligation. Just as a dealer could meet this disclosure obligation through a separate communication, it stands to reason that a disclosure made through the program disclosure document in a manner that is reasonably likely to be noted by an investor could also be used by a dealer to fulfill this duty. Thus, the MSRB has provided in the proposed rule change that, if the issuer has not included the information in the program disclosure document in the manner described, inclusion in the program disclosure document in another manner may nonetheless fulfill the dealer's out-of-state disclosure obligation so long as disclosure in such other manner is reasonably likely to be noted by an investor.[52]

General Suitability Obligations

Summary. The 2005 Proposal reaffirmed the guidance originally provided in the 2002 Notice regarding general suitability standards under Rule G-19 for recommended transactions in 529 college savings plans. The 2005 Proposal added reminders to dealers to the effect that their suitability obligation requires a meaningful analysis that establishes the reasonable grounds for believing that the recommendation is suitable and that they must have and enforce written supervisory procedures reasonably designed to ensure compliance with this obligation for every recommended transaction. The 2004 Proposal did not address suitability issues.

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[52] Some commentators stated that certain portions of the 2005 Proposal might not be consistent with the notion that the issuer's program disclosure document serves as "the fundamental, stand-alone disclosure" for the offering of its securities. *See, e.g.,* AG Edwards. The MSRB believes that dealers generally may view the issuer's program disclosure document as the definitive source from which to obtain information about the securities they are selling to their customers. The requirement that a dealer make the revised out-of-state disclosure separately if such disclosure is not included in the program disclosure document in a manner reasonably likely to be noted by an investor is not intended to imply otherwise, consistent with prior Commission guidance regarding the obligations of underwriters and other dealers in connection with municipal issuers' disclosure materials under the federal securities laws. *See* Exchange Act Release No. 26100 (September 22, 1988), 53 FR 37778 (Section III – Municipal Underwriter Responsibilities), as modified by Exchange Act Release No. 26985 (June 28, 1989), 54 FR 28799 (Section III – Interpretation of Underwriter Responsibilities), and as reaffirmed by Exchange Act Release No. 33741 (March 9, 1994), 59 FR 12748 (Section V – Interpretive Guidance with Respect to Obligations of Municipal Securities Dealers).

Comments. No commentator opposed the 2005 Proposal's discussion of general suitability standards.

MSRB Response. The MSRB has retained this discussion of general suitability standards.

Comparative Suitability Obligation for Out-of-State Sales

Summary. The 2005 Proposal would require a dealer to undertake a comparative suitability analysis if the dealer has recommended an out-of-state 529 college savings plan transaction to a customer who has indicated that one of his or her investment objectives is realization of state-based benefits, as contemplated under the special home state disclosure proposal. This would involve the consideration of the state-based benefits available from the customer's home state 529 college savings plan in a comparative analysis with the out-of-state 529 college savings plan being offered. Any such state-based benefits offered with respect to a particular 529 college savings plan would be considered as one of many appropriately weighted factors that have an ultimate bearing on the relative strengths of a particular investment, and the existence of state-based benefits would not create a presumption that investment in the home state 529 college savings plan is necessarily superior to an out-of-state 529 college savings plan. If a dealer were to conclude that an investment in the home state 529 college savings plan would be superior to an investment in the offered out-of-state 529 college savings plan under every reasonable scenario, then the dealer would be obligated to inform the customer of this determination and would be permitted to effect a transaction in the offered out-of-state 529 college savings plan only if the customer has directed to do so after this suitability determination has been disclosed and if the out-of-state 529 college savings plan would, without regard to the comparative analysis with the home state 529 college savings plan, be suitable for the customer under traditional suitability standards. The 2004 Proposal did not contain comparable language.

Comments. Most commentators strongly opposed the comparative suitability proposal,[53] although two commentators conceded that, depending on the facts and circumstances, the availability of in-state benefits may be one of many appropriate factors to consider in making a suitability determination under traditional suitability standards.[54] Three commentators stated that there has been no evidence of abuse in the offering of out-of-state

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53 AG Edwards, CSF, CSP-Maryland, CSPN, Fidelity, Georgia, Hancock, ICI, Iowa, NAST, Ohio TTA, PFPC, SIA, T. Rowe, University of Alaska, USAA, Virginia CSP, Wachovia and West Virginia. No commentator expressed support for the comparative suitability proposal.

54 AG Edwards and Hancock.

529 college savings plans to justify these new requirements, observing that no enforcement actions have been taken.[55] Several commentators observed that federal securities regulation has never been premised on the concept that a dealer is obligated to determine the most suitable investment of a particular type for any customer and that the comparative suitability proposal is inconsistent with the application of the suitability rule to every other product sold by dealers.[56] Two commentators stated that comparisons are highly disfavored by NASD rules.[57] The University of Alaska noted that one result of a more stringent suitability obligation for recommendations of 529 college savings plan transactions might be that dealers would place their clients in other investment vehicles that do not carry such regulatory risk.

Many commentators viewed the comparative suitability proposal as effectively requiring dealers to become fully familiar with the terms of all 529 college savings plans before offering any particular 529 college savings plan.[58] These commentators argued that this extraordinary burden is unprecedented and is likely to significantly discourage the marketing of 529 college savings plans. NAST agreed, emphasizing that the comparative suitability proposal would have substantially increased the burden on the states themselves. Wachovia suggested that the MSRB undertake a cost-benefit analysis before adopting the comparative suitability proposal, while USAA stated that the incremental costs associated with meeting this standard would cause firms to reevaluate whether offering 529 college savings plans continues to make sense or to pass the incremental costs on to investors. AG Edwards argued that it is untenable to require a dealer to inform a client that one 529 college savings plan is unequivocally superior to another. Two other commentators stated that they

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55 CSF, ICI and USAA. NASD subsequently announced on October 26, 2005 that it had reached a settlement agreement with Ameriprise Financial Services, Inc., in connection with the failure of the firm to establish and maintain supervisory systems and procedures reasonably designed to achieve compliance with suitability obligations relating to recommended transactions in 529 college savings plans. *See* www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE &ssDocName=NASDW_015319. This settlement agreement appears to have been the basis for concern expressed by Fidelity and PFPC that NASD may be incorporating the comparative suitability proposal into its enforcement posture prior to its final approval. The MSRB understands that NASD did not intend certain language included in the settlement agreement to imply that the comparative suitability proposal is currently in effect.

56 CSF, Fidelity, Hancock, PFPC, SIA, University of Alaska and USAA.

57 CSF and SIA.

58 CSPN (with the concurrence of CSP-Maryland, Georgia, Iowa, Ohio TTA, University of Alaska, Virginia CSP, West Virginia), Hancock, ICI, T. Rowe Price and Wachovia.

are receiving anecdotal evidence that some selling dealers are withdrawing from the 529 college savings plan market in response to this proposal and to recent NASD enforcement activity.[59] CSF noted that one potential result may be that some customers who are accustomed to relying on their financial advisors and who otherwise might invest in suitable 529 college savings plans may ultimately never make such an investment.

SIA expressed concern that the comparison contemplated by the proposal would be difficult to implement from a practical standpoint. ICI agreed, identifying a number of specific practical concerns. Some commentators stated that the comparative suitability proposal would place inordinate focus on state benefits while effectively ignoring the many other reasons why an investor might choose to invest in an out-of-state 529 college savings plan.[60] Other commentators predicted that the potential liabilities that would arise under the comparative suitability proposal would result in many dealers limiting their sales solely to the in-state 529 college savings plan, regardless of its advantage or disadvantage.[61] CSF requested that the MSRB defer action on the comparative suitability proposal pending implementation of the planned CSPN website enhancement.

MSRB Response. The MSRB has determined not to retain the comparative suitability proposal, based in large measure on the potential adverse impact of this proposal and the significant steps currently in process toward dramatic improvements in the 529 college savings plan disclosure system. However, the MSRB agrees with those commentators that noted that the availability of in-state benefits may be one of many appropriate factors to consider in making a suitability determination under traditional suitability standards, depending on all the facts and circumstances. Thus, the MSRB has added guidance to this effect in the proposed rule change, in conjunction with additional guidance to the effect that dealers should consider whether a recommendation is consistent with the customer's tax

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59 Fidelity and PFPC. Concerns regarding the negative impact of the comparative suitability proposal have also been detailed in press reports. *See* Charles Paikert, "MSRB to Decide on Controversial 529 Proposals," Investment News, February 13, 2006, at 2; Terry Savage, "Political Issues Put the Hurt on College Savings," The Street, February 10, 2006, at www.thestreet.com/funds/investing/10267688.html; Jilian Mincer, "Sales of 529 College Savings Plans Fell in '05 Amid Scrutiny," Wall Street Journal, February 9, 2006, at D2; Jilian Mincer, "Disclosure Proposals for 529s Risk a Broker Backlash," Wall Street Journal, January 3, 2006, at D2; Lauren Barack, "Will Reform Drive Brokers From 529 Sales?" Registered Rep, November 1, 2005, at registeredrep.com/mag/finance_reform_drive_brokers.

60 ICI, Hancock and Wachovia.

61 AG Edwards, Fidelity and PFPC.

status and any customer investment objectives materially related to federal or state tax consequences of an investment.

6. Extension of Time Period for Commission Action

The MSRB declines to consent to an extension of the time period specified in Section 19(b)(2) of the Exchange 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. Federal Register Notice.

2. June 10, 2004 and May 19, 2005 notices and comment letters.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-MSRB-2006-03)

SELF-REGULATORY ORGANIZATIONS

Proposed Rule Change by the Municipal Securities Rulemaking Board
Consisting of Interpretive Guidance on Customer Protection Obligations of Brokers, Dealers and Municipal Securities Dealers Relating to the Marketing of 529 College Savings Plans

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(b)(1)) (the "Act") and Rule 19b-4 thereunder (17 CFR 240.19b-4), notice is hereby given that on March 31, 2006 the Municipal Securities Rulemaking Board ("MSRB" or "Board") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the MSRB. 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

The MSRB is filing with the Commission a proposed rule change consisting of interpretive guidance on customer protection obligations of brokers, dealers and municipal securities dealers ("dealers") relating to the marketing of 529 college savings plans. The MSRB proposes an effective date for the proposed rule change of 60 calendar days after Commission approval. The text of the proposed rule change is set forth below.

INTERPRETATION ON CUSTOMER PROTECTION OBLIGATIONS RELATING TO THE MARKETING OF 529 COLLEGE SAVINGS PLANS

The Municipal Securities Rulemaking Board ("MSRB") is publishing this interpretation to ensure that brokers, dealers and municipal securities dealers ("dealers") effecting transactions in the 529 college savings plan market fully understand their fair practice and disclosure duties to their customers.[1]

Basic Customer Protection Obligation

At the core of the MSRB's customer protection rules is Rule G-17, which provides that, in the conduct of its municipal securities activities, each dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest or unfair practice. The rule encompasses two basic principles: an anti-fraud prohibition similar to the standard set forth in Rule 10b-5 adopted by the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934 (the "Exchange Act"), and a general duty to deal fairly even in the absence of fraud. All activities of dealers must be viewed in light of these basic principles, regardless of whether other MSRB rules establish specific requirements applicable to such activities.

Disclosure

The MSRB has interpreted Rule G-17 to require a dealer, in connection with any transaction in municipal securities, to disclose to its customer, at or prior to the sale of the

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[1] 529 college savings plans are established by states under Section 529(b)(A)(ii) of the Internal Revenue Code as "qualified tuition programs" through which individuals make investments for the purpose of accumulating savings for qualifying higher education costs of beneficiaries. Section 529 of the Internal Revenue Code also permits the establishment of so-called prepaid tuition plans by states and higher education institutions, which are not treated as 529 college savings plans for purposes of this notice.

securities to the customer (the "time of trade"), all material facts about the transaction known by the dealer, as well as material facts about the security that are reasonably accessible to the market.[2] This duty applies to any dealer transaction in a 529 college savings plan interest regardless of whether the transaction has been recommended by the dealer.

Many states offer favorable state tax treatment or other valuable benefits to their residents in connection with investments in their own 529 college savings plan. In the case of sales of out-of-state 529 college savings plan interests to a customer, the MSRB views Rule G-17 as requiring a dealer to make, at or prior to the time of trade, additional disclosures that:

(i) depending upon the laws of the home state of the customer or designated beneficiary, favorable state tax treatment or other benefits offered by such home state for investing in 529 college savings plans may be available only if the customer invests in the home state's 529 college savings plan;

(ii) any state-based benefit offered with respect to a particular 529 college savings plan should be one of many appropriately weighted factors to be considered in making an investment decision; and

(iii) the customer should consult with his or her financial, tax or other adviser to learn more about how state-based benefits (including any limitations) would apply to the customer's specific circumstances and also may wish to contact his or her home state or any other 529 college savings plan to

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[2] *See* Rule G-17 Interpretation – Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts, March 20, 2002, *reprinted in* MSRB Rule Book.

learn more about the features, benefits and limitations of that state's 529 college savings plan.

This disclosure obligation is hereinafter referred to as the "out-of-state disclosure obligation."[3]

The out-of-state disclosure obligation may be met if the disclosure appears in the program disclosure document, so long as the program disclosure document has been delivered to the customer at or prior to the time of trade and the disclosure appears in the program disclosure document in a manner that is reasonably likely to be noted by an investor.[4] A presentation of this disclosure in the program disclosure document in close proximity and with equal prominence to the principal presentation of substantive information regarding other federal or state tax-related consequences of investing in the 529 college savings plan, and the inclusion of a reference to this disclosure in close proximity and with equal prominence to each other presentation of information regarding state tax-related consequences of investing in the 529 college savings plan, would be deemed to satisfy this requirement.[5]

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[3] This out-of-state disclosure obligation constitutes an expansion of, and supersedes, certain disclosure requirements with respect to out-of-state 529 college savings plan transactions established under "Application of Fair Practice and Advertising Rules to Municipal Securities," May 14, 2002, published in *MSRB Rule Book*.

[4] As used in this notice, the term "program disclosure document" has the same meaning as "official statement" under the rules of the MSRB and SEC. The delivery of the program disclosure document to customers pursuant to Rule G-32, which requires delivery by settlement of the transaction, would be timely for purposes of Rule G-17 only if such delivery is accelerated so that it is received by the customer by no later than the time of trade.

[5] Thus, if the program disclosure document contains a series of sections in which the principal disclosures of substantive information on federal or state-tax related consequences of investing in the 529 college savings plan appear, a single

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The MSRB has no authority to mandate inclusion of any particular items in the issuer's program disclosure document.[6] Dealers who wish to rely on the program disclosure document for fulfillment of the out-of-state disclosure obligation are responsible for understanding what is included within the program disclosure document of any 529 college savings plan they market and for determining whether such

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inclusion of the required disclosure within, at the beginning or at the end of such series would be satisfactory for purposes of the inclusion with the principal presentation of such other disclosures. Similarly, if the program disclosure document includes any other series of statements on state-tax related consequences, such as might exist in a summary statement appearing at the beginning of some program disclosure documents, a single prominent reference in the summary statement to the fuller disclosure made pursuant to the out-of-state disclosure obligation appearing elsewhere in the program disclosure document would be satisfactory.

[6] However, the MSRB notes that Exchange Act Rule 15c2-12(f)(3) of the SEC defines a "final official statement" as:

> a document or set of documents prepared by an issuer of municipal securities or its representatives that is complete as of the date delivered to the Participating Underwriter(s) and that sets forth information concerning the terms of the proposed issue of securities; information, including financial information or operating data, concerning such issuers of municipal securities and those other entities, enterprises, funds, accounts, and other persons material to an evaluation of the Offering; and a description of the undertakings to be provided pursuant to paragraph (b)(5)(i), paragraph (d)(2)(ii), and paragraph (d)(2)(iii) of this section, if applicable, and of any instances in the previous five years in which each person specified pursuant to paragraph (b)(5)(ii) of this section failed to comply, in all material respects, with any previous undertakings in a written contract or agreement specified in paragraph (b)(5)(i) of this section.

Section (b) of that rule requires that the participating underwriter of an offering review a "deemed-final" official statement and contract to receive the final official statement from the issuer. *See* Rule D-12 Interpretation – Interpretation Relating to Sales of Municipal Fund Securities in the Primary Market, January 18, 2001, published in *MSRB Rule Book*, for a discussion of the applicability of Rule 15c2-12 to offerings of 529 college savings plans.

information is sufficient to meet this disclosure obligation. Notwithstanding any of the foregoing, disclosure through the program disclosure document as described above is not the sole manner in which a dealer may fulfill its out-of-state disclosure obligation. Thus, if the issuer has not included this information in the program disclosure document in the manner described, inclusion in the program disclosure document in another manner may nonetheless fulfill the dealer's out-of-state disclosure obligation so long as disclosure in such other manner is reasonably likely to be noted by an investor. Otherwise, the dealer would remain obligated to disclose such information separately to the customer under Rule G-17 by no later than the time of trade.[7]

If the dealer proceeds to provide information to an out-of-state customer about the state tax or other benefits available through such customer's home state, Rule G-17 requires that the dealer ensure that the information is not false or misleading. For example, a dealer would violate Rule G-17 if it were to inform a customer that investment in the 529 college savings plan of the customer's home state did not provide the customer with any state tax benefit even though such a state tax benefit is in fact available. Furthermore, a dealer would violate Rule G-17 if it were to inform a customer that investment in the 529 college savings plan of another state would provide the customer with the same state tax benefits as would be available if the customer were to invest in his or her home state's 529 college savings plan even though this is not the

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[7] Although Rule G-17 does not dictate the precise manner in which material facts must be disclosed to the customer at or prior to the time of trade, dealers must ensure that such disclosure is effectively provided to the customer in connection with the specific transaction and cannot merely rely on the inclusion of a disclosure in general advertising materials.

case.[8] Dealers should make certain that information they provide to their customers, whether provided under an affirmative disclosure obligation imposed by MSRB rules or in response to questions from customers, is correct and not misleading.

Dealers are reminded that this out-of-state disclosure obligation is in addition to their general obligation under Rule G-17 to disclose to their customers at or prior to the time of trade all material facts known by dealers about the 529 college savings plan interests they are selling to their customers, as well as material facts about such 529 college savings plan that are reasonably accessible to the market. Further, dealers are reminded that disclosures made to customers as required under MSRB rules with respect to 529 college savings plans do not relieve dealers of their suitability obligations – including the obligation to consider the customer's financial status, tax status and investment objectives – if they have recommended investments in 529 college savings plans.

Suitability

Under Rule G-19, a dealer that recommends to a customer a transaction in a security must have reasonable grounds for believing that the recommendation is suitable, based upon information available from the issuer of the security or otherwise and the facts disclosed by or otherwise known about the customer.[9] To assure that a dealer

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8 Dealers should note that these examples are illustrative and do not limit the circumstances under which, depending on the facts and circumstances, a Rule G-17 violation could occur.

9 The MSRB has previously stated that most situations in which a dealer brings a municipal security to the attention of a customer involve an implicit recommendation of the security to the customer, but determining whether a particular transaction is in fact recommended depends on an analysis of all the relevant facts and circumstances. *See* Rule G-19 Interpretive Letter –

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effecting a recommended transaction with a non-institutional customer has the information needed about the customer to make its suitability determination, the rule requires the dealer to make reasonable efforts to obtain information concerning the customer's financial status, tax status and investment objectives, as well as any other information reasonable and necessary in making the recommendation.[10] Dealers are reminded that the obligation arising under Rule G-19 in connection with a recommended transaction requires a meaningful analysis**,** taking into consideration the information obtained about the customer and the security, that establishes the reasonable grounds for believing that the recommendation is suitable. Such suitability determinations should be based on the appropriately weighted factors that are relevant in any particular set of facts and circumstances, which factors may vary from transaction to transaction.[11] Pursuant to Rule G-27(c), dealers must have written supervisory procedures in place that are reasonably designed to ensure compliance with this Rule G-19 obligation to undertake a

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Recommendations, February 17, 1998, published in *MSRB Rule Book*. The MSRB also has provided guidance on recommendations in the context of on-line communications in Rule G-19 Interpretation – Notice Regarding Application of Rule G-19, on Suitability of Recommendations and Transactions, to Online Communications, September 25, 2002, published in *MSRB Rule Book*.

10 Rule G-8(a)(xi)(F) requires that dealers maintain records for each customer of such information about the customer used in making recommendations to the customer.

11 Although certain factors relating to recommended transactions in 529 college savings plans are discussed in this notice, whether such enumerated factors or any other considerations are relevant in connection with a particular recommendation is dependent upon the facts and circumstances. The factors that may be relevant with respect to a specific transaction in a 529 college savings plan generally include the various considerations that would be applicable in connection with the process of making suitability determinations for recommendations of any other type of security.

suitability analysis in connection with every recommended transaction, and dealers must enforce these procedures to ensure that such meaningful analysis does in fact occur in connection with the dealer's recommended transactions.

In the context of a recommended transaction relating to a 529 college savings plan, the MSRB believes that it is crucial for dealers to remain cognizant of the fact that these instruments are designed for a particular purpose and that this purpose generally should match the customer's investment objective. For example, dealers should bear in mind the potential tax consequences of a customer making an investment in a 529 college savings plan where the dealer understands that the customer's investment objective may not involve use of such funds for qualified higher education expenses.[12] Dealers also should consider whether a recommendation is consistent with the customer's tax status and any customer investment objectives materially related to federal or state tax consequences of an investment.

Furthermore, investors generally are required to designate a specific beneficiary under a 529 college savings plan. The MSRB believes that information known about the designated beneficiary generally would be relevant in weighing the investment objectives of the customer, including (among other things) information regarding the age of the beneficiary and the number of years until funds will be needed to pay qualified higher education expenses of the beneficiary. The MSRB notes that, since the person making the investment in a 529 college savings plan retains significant control over the investment (*e.g.*, may withdraw funds, change plans, or change beneficiary, etc.), this person is

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12 *See* Section 529(c)(3) of the Internal Revenue Code. State tax laws also may result in certain adverse consequences for use of funds other than for educational costs.

appropriately considered the customer for purposes of Rule G-19 and other MSRB rules. As noted above, information regarding the designated beneficiary should be treated as information relating to the customer's investment objective for purposes of Rule G-19.

In many cases, dealers may offer the same investment option in a 529 college savings plan sold with different commission structures. For example, an A share may have a front-end load, a B share may have a contingent deferred sales charge or back-end load that reduces in amount depending upon the number of years that the investment is held, and a C share may have an annual asset-based charge. A customer's investment objective – particularly, the number of years until withdrawals are expected to be made – can be a significant factor in determining which share class would be suitable for the particular customer.

Rule G-19(e), on churning, prohibits a dealer from recommending transactions to a customer that are excessive in size or frequency, in view of information known to such dealer concerning the customer's financial background, tax status and investment objectives. Thus, for example, where the dealer knows that a customer is investing in a 529 college savings plan with the intention of receiving the available federal tax benefit, such dealer could, depending upon the facts and circumstances, violate rule G-19(e) if it were to recommend roll-overs from one 529 college savings plan to another with such frequency as to lose the federal tax benefit. Even where the frequency does not imperil the federal tax benefit, roll-overs recommended year after year by a dealer could, depending upon the facts and circumstances (including consideration of legitimate investment and other purposes), be viewed as churning. Similarly, depending upon the facts and circumstances, where a dealer recommends investments in one or more plans

for a single beneficiary in amounts that far exceed the amount that could reasonably be used by such beneficiary to pay for qualified higher education expenses, a violation of rule G-19(e) could result.[13]

Other Sales Practice Principles

Dealers must keep in mind the requirements under Rule G-17 – that they deal fairly with all persons and that they not engage in any deceptive, dishonest or unfair practice – when considering the appropriateness of day-to-day sales-related activities with respect to municipal fund securities, including 529 college savings plans. In some cases, certain sales-related activities are governed in part by specific MSRB rules, such as Rule G-19 (as described above) and Rule G-30(b), on commissions.[14] Other activities may not be explicitly addressed by a specific MSRB rule. In either case, the general principles of Rule G-17 always apply.

In particular, dealers must ensure that they do not engage in transactions primarily designed to increase commission revenues in a manner that is unfair to customers under Rule G-17. Thus, in addition to being a potential violation of Rule G-19 as discussed

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13 The MSRB understands that investors may change designated beneficiaries and therefore amounts in excess of what a single beneficiary could use ultimately might be fully expended by additional beneficiaries. The MSRB expresses no view as to the applicability of federal tax law to any particular plan of investment and does not interpret its rules to prohibit transactions in furtherance of legitimate tax planning objectives, so long as any recommended transaction is suitable.

14 The MSRB has previously provided guidance on dealer commissions in Rule G-30 Interpretation – Interpretive Notice on Commissions and Other Charges, Advertisements and Official Statements Relating to Municipal Fund Securities, December 19, 2001, published in *MSRB Rule Book*. The MSRB believes that Rule G-30(b), as interpreted in this 2001 guidance, should effectively maintain dealer charges for 529 college savings plan sales at a level consistent with, if not lower than, the sales loads and commissions charged for comparable mutual fund sales.

above, recommending a particular share class to a customer that is not suitable for that customer, or engaging in churning, may also constitute a violation of Rule G-17 if the recommendation was made for the purpose of generating higher commission revenues. Also, where a dealer offers investments in multiple 529 college savings plans, consistently recommending that customers invest in the one 529 college savings plan that offers the dealer the highest compensation may, depending on the facts and circumstances, constitute a violation of Rule G-17 if the recommendation of such 529 college savings plan over the other 529 college savings plans offered by the dealer does not reflect a legitimate investment-based purpose.

Further, recommending transactions to customers in amounts designed to avoid commission discounts (*i.e.*, sales below breakpoints where the customer would be entitled to lower commission charges) may also violate Rule G-17, depending upon the facts and circumstances. For example, a recommendation that a customer make two smaller investments in separate but nearly identical 529 college savings plans for the purposes of avoiding a reduced commission rate that would be available upon investing the full amount in a single 529 college savings plan, or that a customer time his or her multiple investments in a 529 college savings plan so as to avoid being able to take advantage of a lower commission rate, in either case without a legitimate investment-based purpose, could violate Rule G-17.

With respect to sales incentives, the MSRB has previously interpreted Rule G-20, relating to gifts, gratuities and non-cash compensation, to require a dealer that sponsors a sales contest involving representatives who are not employed by the sponsoring dealer to

have in place written agreements with these representatives.[15] In addition, the general principles of Rule G-17 are applicable. Thus, if a dealer or any of its associated persons engages in any marketing activities that result in a customer being treated unfairly, or if the dealer or any of its associated persons engages in any deceptive, dishonest or unfair practice in connection with such marketing activities, Rule G-17 could be violated. The MSRB believes that, depending upon the specific facts and circumstances, a dealer may violate Rule G-17 if it acts in a manner that is reasonably likely to induce another dealer or such other dealer's associated persons to violate the principles of Rule G-17 or other MSRB customer protection rules, such as Rule G-19 or Rule G-30. Dealers are also reminded that Rule G-20 establishes standards regarding incentives for sales of municipal securities, including 529 college savings plan interests, that are substantially similar to those currently applicable to sales of mutual fund shares under NASD rules.

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

In its filing with the Commission, the MSRB 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. The MSRB has prepared summaries, set forth in Sections A, B and C below, of the most significant aspects of such statements.

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15 *See* Rule G-20 Interpretive Letter – Authorization of sales contests, June 25, 1982, published in *MSRB Rule Book*.

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

1. Purpose

In a May 14, 2002 notice (the "2002 Notice"), the MSRB interpreted Rule G-17, on fair dealing, to require dealers selling out-of-state 529 college savings plan interests to customers to disclose at or prior to the sale to the customer (the "time of trade") that, depending upon the laws of the customer's home state, favorable state tax treatment for investing in a 529 college savings plan may be limited to investments made in a 529 college savings plan offered by the customer's home state.[16] In addition, the MSRB provided guidance in the 2002 Notice on the application of Rule G-19, on suitability of recommendations and transactions, and other customer protection rules in the context of 529 college savings plan transactions.

The proposed rule change broadens the existing time-of-trade disclosure obligation with respect to the marketing of out-of-state 529 college savings plans. Under the proposed rule change, dealers selling out-of-state 529 college savings plan interests are required to disclose to the customer, at or prior to the time of trade, that: (i) depending on the laws of the home state of the customer or designated beneficiary, favorable state tax treatment or other benefits offered by such home state may be available only if the customer invests in the home state's 529 college savings plan; (ii) state-based benefits should be one of many appropriately weighted factors to be considered in making an investment decision; and (iii) the customer should consult with his or her financial, tax or other adviser about how such state-based benefits would apply

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16 *See* Rule G-21 Interpretation – Application of Fair Practice and Advertising Rules to Municipal Fund Securities, May 14, 2002, *reprinted in* MSRB Rule Book.

to the customer's specific circumstances and may wish to contact his or her home state or any other 529 college savings plan to learn more about their features. Guidance is provided as to the manner of delivering this revised out-of-state disclosure to ensure that such information is noted by the customer, and dealers are reminded that all disclosures made to customers, regardless of whether they are made pursuant to a regulatory mandate, must not be false or misleading.

The proposed rule change further reminds dealers that providing disclosures to customers does not relieve them of their suitability duties – including their obligation to consider the customer's financial status, tax status and investment objectives – arising in connection with recommended transactions. The proposed rule change describes certain basic suitability principles applicable to recommended transactions in 529 college savings plans, advising dealers to consider whether a recommendation is consistent with the customer's tax status and any federal or state tax-related investment objectives of the customer. The proposed rule change emphasizes that any dealer that recommends a transaction must undertake an active suitability process involving a meaningful analysis that takes into consideration information about the customer and the security. Dealers are further advised that suitability determinations should be based on the various appropriately weighted factors that are relevant in any particular set of facts and circumstances. Finally, the proposed rule change reaffirms existing guidance from the 2002 Notice on other customer protection obligations applicable to dealer sales practices in the 529 college savings plan market.

2. Statutory Basis

The MSRB believes that the proposed rule change is consistent with Section 15B(b)(2)(C) of the Act, which provides that MSRB rules shall:

> be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest.

The MSRB believes that the proposed rule change is consistent with the Exchange Act because it will further investor protection by strengthening and clarifying dealers' customer protection obligations relating to the marketing of 529 college savings plans, including but not limited to the duty to provide important disclosures to customers investing in out-of-state 529 college savings plans and to undertake active suitability analyses for recommended transactions based on appropriately weighted factors.

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

The MSRB does not believe that the proposed rule change will result in any burden on competition not necessary or appropriate in furtherance of the purposes of the Act since it would apply equally to all dealers.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

On June 10, 2004, the MSRB published for comment draft interpretive guidance relating to, among other things, the disclosure obligations of dealers selling out-of-state 529 college savings plans, strengthening the out-of-state disclosures originally mandated

in the 2002 Notice (the "2004 Proposal").[17] The MSRB received comments on the 2004 Proposal from eight commentators.[18] After reviewing these comments, considering the concerns of NASD and others regarding high levels of out-of-state sales and consulting with Commission staff, the MSRB published on May 19, 2005 a notice seeking further comment on a revised version of the draft interpretive guidance (the "2005 Proposal").[19] The 2005 Proposal included a discussion of existing resources and challenges in

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17 *See* MSRB Notice 2004-16 (June 10, 2004). The 2004 Proposal, together with a related proposal (MSRB Notice 2004-17 (June 15, 2004)), represented a comprehensive initiative of the MSRB to strengthen a broad range of customer protection obligations set out in the 2002 Notice. Portions of the 2004 Proposal significantly strengthening 529 college savings plan advertising requirements have been adopted, with certain additional requirements and modifications, by the MSRB and approved by the Commission. *See* Exchange Act Release No. 51736 (May 24, 2005), 70 FR 31551 (June 1, 2005). *See also* Exchange Act Release No. 52289 (August 18, 2005), 70 FR 49699 (August 24, 2005. In addition, the strengthened customer protection obligations with respect to 529 college savings plan sales incentives proposed in the related June 15, 2004 proposal have been adopted by the MSRB and approved by the Commission. *See* Exchange Act Release No. 52555 (October 3, 2005), 70 FR 59106 (October 11, 2005). The current proposed rule change represents the final stage of the MSRB's 2004 customer protection initiative.

18 Letters from: Kenneth B. Roberts, Hawkins Delafield & Wood LLP ("Hawkins"), to Ernesto A. Lanza, Senior Associate General Counsel, MSRB, dated August 20, 2004; Mary L. Schapiro, Vice Chairman, NASD, and President, Regulatory Policy and Oversight, to Mr. Lanza, dated September 9, 2004; Tamara K. Salmon, Senior Associate Counsel, Investment Company Institute ("ICI"), to Mr. Lanza, dated September 10, 2004; David J. Pearlman, Chairman, College Savings Foundation ("CSF"), to Mr. Lanza, dated September 13, 2004; Elizabeth L. Bordowitz, General Counsel, Finance Authority of Maine ("FAME"), to Mr. Lanza, dated September 13, 2004; Diana F. Cantor, Chair, College Savings Plan Network ("CSPN"), and Executive Director, Virginia College Savings Plan, to Mr. Lanza, dated September 15, 2004; Elizabeth Varley and Michael D. Udoff, Co-Staff Advisers, Securities Industry Association ("SIA") Ad Hoc 529 Plans Committee, to Mr. Lanza, dated September 15, 2004; and Raquel Alexander, PhD, Assistant Professor, and LeAnn Luna, PhD, Assistant Professor, University of North Carolina at Wilmington ("UNCW"), to Mr. Lanza, dated September 15, 2004.

19 *See* MSRB Notice 2005-28 (May 19, 2005).

connection with obtaining disclosure information in the 529 college savings plan marketplace and sought comment on the possible substantial expansion of the disclosure and suitability obligations described in the 2002 Notice. The MSRB received comments on the 2005 Proposal from 22 commentators.[20]

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[20] Letters from: Ms. Alexander, Assistant Professor of Accounting, University of Kansas, and Ms. Luna, Assistant Professor of Accounting, University of Tennessee ("Alexander & Luna"), to Mr. Lanza, dated July 26, 2005; Judith A. Wilson, Compliance Attorney, 1st Global Capital Corp. ("1st Global"), to Mr. Lanza, dated July 28, 2005; Diana Scott, Senior Vice President & General Manager, John Hancock Financial Services ("Hancock"), to Mr. Lanza, dated July 28, 2005; John C. Heywood, Principal, Vanguard Group, Inc. ("Vanguard"), to Mr. Lanza, dated July 28, 2005; Mr. Pearlman, CSF, to Mr. Lanza, dated July 29, 2005 and February 13, 2006; Tim Berry, Chair, CSPN, and Indiana State Treasurer, to Mr. Lanza, dated July 29, 2005; Ms. Salmon, ICI, to Mr. Lanza, dated July 29, 2005; Jacqueline T. Williams, Executive Director, Ohio Tuition Trust Authority ("Ohio TTA"), to Mr. Lanza and Ghassan Hitti, Assistant General Counsel, MSRB, dated July 29, 2005; Ira D. Hammerman, Senior Vice President & General Counsel, SIA, to Mr. Lanza, dated July 29, 2005; Ms. Cantor, Executive Director, Virginia College Savings Plan ("Virginia CSP"), to Mr. Lanza, dated July 29, 2005; John D. Perdue, Chairman, Board of Trustees of the West Virginia College Prepaid Tuition and Savings Program, and State Treasurer ("West Virginia"), to Mr. Lanza, dated July 29, 2005; James F. Lynch, Associate Vice President for Finance, University of Alaska ("University of Alaska"), to Mr. Lanza, dated July 29, 2005; Eileen M. Smiley, Vice President & Assistant Secretary, USAA Investment Management Company ("USAA"), to Mr. Lanza, dated July 29, 2005; Ronald C. Long, Senior Vice President, Wachovia Securities, LLC ("Wachovia"), to Mr. Lanza, dated July 29, 2005; Michael L. Fitzgerald, State Treasurer of Iowa ("Iowa"), to Mr. Lanza, received August 1, 2005; Henry H. Hopkins, Vice President, Director & Chief Legal Counsel, T. Rowe Price Investment Services, Inc. ("T. Rowe"), to Mr. Lanza, dated August 1, 2005; Thomas M. Yacovino, Vice President, A.G. Edwards and Sons, Inc., ("AG Edwards"), to Mr. Lanza, dated August 3, 2005; W. Daniel Ebersole, Director, Georgia Office of Treasury and Fiscal Services ("Georgia"), to Mr. Lanza, dated August 4, 2005; Nancy K. Kopp, Treasurer, State of Maryland, and Chair, College Savings Plans of Maryland ("CSP-Maryland"), to Mr. Lanza, dated August 10, 2005; Mr. Pearlman, Senior Vice President and Deputy General Counsel, Fidelity Investments ("Fidelity"), to Mr. Lanza, dated December 7, 2005; James W. Pasman, Senior Vice President & Managing Director, PFPC Inc. ("PFPC"), to Mr. Lanza, dated December 12, 2005; and Randall Edwards,

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The 2004 and 2005 Proposals, as well as the comments received on these proposals, are discussed below. The MSRB has considered these comments, together with important developments in the mechanisms for ensuring the free and effective flow of information to the public about all 529 college savings plans offered in the marketplace (discussed below), in determining to file this proposed rule change.

GENERAL

The 2004 Proposal proposed expanding the existing obligation of dealers under the 2002 Notice to advise their out-of-state 529 college savings plan customers of the potential loss of in-state benefits. The 2004 Proposal did not address issues relating to suitability. All commentators on the 2004 Proposal supported the importance of ensuring some degree of disclosure to customers of the existence of potential in-state benefits of 529 college savings plans but some commentators suggested changes to the specific proposal.

The 2005 Proposal covered a wider range of topics than the portion of the 2004 Proposal relating to disclosure. The 2005 Proposal sought to expand the time-of-trade disclosure obligation for out-of-state sales proposed in the 2004 Proposal to include a requirement that dealers identify for their out-of-state customers the specific tax and other benefits that each of their respective home states offer and that such customers would forego by investing in an out-of-state 529 college savings plan (the "special home state disclosure proposal"). More broadly, the 2005 Proposal discussed general disclosure practices and mechanisms in the 529 college savings plan market, including the possible

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President, National Association of State Treasurers ("NAST"), and Oregon State Treasurer, to Amelia A.J. Bond, Chair, MSRB, dated March 20, 2006.

establishment of centralized information sources. Dealers were reminded that disclosures made to customers do not relieve dealers of their suitability duties – including their obligation to consider the customer's financial status, tax status and investment objectives – arising in connection with recommended transactions. The 2005 Proposal discussed existing suitability standards as applied to recommendations of 529 college savings plan transactions and proposed expanding such standards to require dealers recommending out-of-state 529 college savings plan investments to undertake a comparative suitability analysis involving a comparison of the recommended out-of-state 529 college savings plan with the customer's home state 529 college savings plan (the "comparative suitability proposal"). Finally, the 2005 Proposal discussed other sales practice obligations under the MSRB's fair practice rule.[21] Although some commentators supported the concept of centralized information sources for the 529 college savings plan market and the clarification of certain elements of existing basic disclosure and suitability obligations, the vast majority of commentators opposed any requirements to disclose specific in-state features foregone as a result of an out-of-state investment or to undertake a comparative suitability analysis.

The MSRB has determined to strengthen the existing time-of-trade disclosure and basic suitability obligations as applied to transactions in 529 college savings plans. However, in view of significant developments toward the maturation of the disclosure dissemination system for this market and with due regard to concerns expressed by the commentators and in press reports regarding the potentially substantial impact of the

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[21] These provisions did not generate comments and have been included in the proposed rule change with only minimal modifications.

special home state disclosure and comparative suitability proposals, the MSRB has determined at this time not to adopt these two proposals pending further assessment of the efficacy of developments in the disclosure infrastructure.

DISCLOSURE

General Time-of-Trade Disclosure Obligation and Established Industry Sources

Summary. The 2005 Proposal described dealers' obligations to make time-of-trade disclosures of all material facts about a 529 college savings plan investment they are selling to their customers that are known to the dealer or that are reasonably accessible from established industry sources.[22] The 2005 Proposal included a discussion of established industry sources for 529 college savings plan information[23] and requested comments on whether one or more centralized web-based sources of information should be established by the private sector, industry associations or the MSRB. The 2005 Proposal noted that such a resource would ideally provide on-site summary information formatted to allow dealers and customers to make meaningful comparisons of the material features of 529 college savings plans, together with direct links to all 529 college

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22 Established industry sources include the system of nationally recognized municipal securities information repositories, the MSRB's Municipal Securities Information Library® system and Real-Time Transaction Reporting System, rating agency reports and other sources of information relating to the municipal securities transaction generally used by dealers that effect transactions in the type of municipal securities at issue. *See* Rule G-17 Interpretation – Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts, March 20, 2002, published in *MSRB Rule Book*.

23 The MSRB noted that many of the traditional established industry sources are designed specifically for debt securities, not 529 college savings plans, and that it viewed established industry sources for 529 college savings plans as encompassing a broad variety of information sources that professionals in this market can and do use to obtain material information about these investments and the state programs.

savings plan official statements (typically referred to as "program disclosure documents") and related information. The types of material features summarized on such a site might include (among other things) state tax treatment, other state-based benefits, costs associated with investments and performance information. The 2005 Proposal suggested that such a centralized website could embed within its posted summary information direct hyperlinks to the portions of the program disclosure document or other 529 college savings plan materials that provide more detailed descriptions of the summarized information.[24] The 2004 Proposal did not address these issues.

Comments. Two commentators on the 2005 Proposal supported the establishment of a centralized website for summary 529 college savings plan information with links to 529 college savings plan materials for more detailed information.[25] They stated that such a website would allow dealers and customers to make meaningful comparisons of features and reduce the complexity of gathering accurate, complete and timely information. Alexander & Luna listed what they viewed as several weaknesses of current third-party websites: (i) information that is frequently out-of-date, incomplete or inaccurate; (ii) comparison information that is not universally available; (iii) information that is "summarized at a very high level;" (iv) website tools that are often over-simplified, which can distort results and ultimately provide incorrect guidance; and (v)

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[24] The 2005 Proposal noted that the centralized website could, for example, provide hyperlinks to websites, or other contact information for sources, providing performance data current to the most recent month-end, as required under Rule G-21(e)(ii)(C) relating to 529 college savings plan advertisements containing performance information.

[25] 1st Global; Alexander & Luna.

many current websites that require users to pay for subscriptions in order to obtain basic information.

Many commentators opposed, or questioned the feasibility of, establishing a centralized website.[26] Some commentators expressed concern that disparate features of 529 college savings plans make presentation of parallel information nearly impossible and that information presented in a summary manner may omit material information or portray such information inaccurately.[27] Some commentators expressed concerns about potential liabilities for dealers that might rely on summarized information obtained from any such centralized website.[28] Hancock stated that existing websites are adequate for the marketplace.

CSPN stated that the creation of an MSRB-sponsored website would be contrary to the municipal securities exemption under federal securities laws and that it is already working to address 529 college savings plan disclosure concerns through its disclosure principles and its own website. CSPN noted that it had recently developed Disclosure Principles Statement No. 2 ("DP-2") which, "along with the information available on the CSPN website will be the most effective and appropriate approach to enhancing investor accessibility to pertinent 529 Plan information."[29] CSPN stated that DP-2 included "an expanded locator concept, which will assist investors in finding similar information in the

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26 AG Edwards, CSF, CSPN (with the concurrence of CSP-Maryland, Georgia, Iowa, Ohio TTA, University of Alaska, Virginia CSP, West Virginia), Hancock, and USAA.

27 CSF, CSPN, Hancock.

28 Hancock, Vanguard.

29 DP-2 updated CSPN's Voluntary Disclosure Principles Statement No. 1 ("DP-1"), which CSPN published in 2004 to provide guidance to state programs in preparing their program disclosure documents. *See also* NAST.

offering materials prepared by various State issuers, while still using only the materials authorized by that State issuer."[30]

Although the 2004 Proposal did not address broader disclosure issues in the 529 college savings plan market, two commentators on the 2004 Proposal made suggestions in this regard, stating that the MSRB should put in place a broader set of disclosure requirements to accompany the proposed disclosures described in the draft guidance.[31] NASD suggested that the MSRB require standardized point-of-sale disclosure of fees and compensation in a manner similar to the point-of-sale disclosure requirements included by the Commission in its proposed Exchange Act Rule 15c2-3.[32] UNCW described an academic study on factors influencing investor choices of 529 college savings plans and concluded that "investors appear to be choosing high fee/broker sold funds rather than the lower fee, direct investment options . . . [and] appear to be ignoring state tax benefits." Stating that its study suggested that investors may not have sufficient information in these areas, UNCW supported mandating disclosure of not only state tax benefits but also uniform disclosure of fees and performance for each 529 college savings plan portfolio

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30 CSP-Maryland, Georgia, Iowa, Ohio TTA, University of Alaska, Virginia CSP and West Virginia supported CSPN's position.

31 NASD and UNCW.

32 *See* Securities Act Release No. 8358 (January 29, 2004), 69 FR 6438 (February 10, 2004). *See also* Securities Act Release No. 8544 (February 28, 2005), 70 FR 10521 (March 4, 2005). The proposed rulemaking by the Commission would apply to dealer sales of 529 college savings plan interests, in addition to sales of mutual funds and variable annuities. The MSRB observes that NASD has provided comments to the Commission on this proposal that are similar to those provided to the MSRB. The MSRB also has provided comments to the Commission in support of its point-of-sale disclosure proposal (available at www.sec.gov/rules/proposed/s70604/s70604-629.pdf). The MSRB has taken NASD's suggestions in this regard under advisement pending final action by the Commission on proposed Rule 15c2-3.

and for each underlying fund in such portfolio, as well as the percentage of total investments that each underlying fund represents with respect to such 529 college savings plan portfolio.

MSRB Response. Since publishing the 2005 Proposal, the MSRB has engaged the 529 college savings plan industry and other federal securities regulators in a dialogue regarding the 2005 Proposal. In particular, the MSRB has emphasized that a crucial factor underlying the special home state disclosure and comparative suitability proposals for out-of-state sales was the difficulty that the average investor faces in obtaining and understanding the key items of information relevant in making an informed investment decision in the context of the varied and complex national 529 college savings plan marketplace.[33]

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[33] Investor confusion has often been reported to result from the large number of states offering valuable state tax or other benefits for investing in-state and the fact that virtually every plan has unique and sometimes complicated features not included in most other plans. The difficulties that investors face finding and understanding relevant information (in spite of the existence of a handful of web-based resources on 529 college savings plans), as well as some recent steps toward improving the ability of investors to understand their choices in the marketplace, have been detailed by the press. *See, e.g.*, Ross Kerber, "Complaints Mounting over College Savings Accounts," Boston Globe, February 14, 2006, at www.boston.com/business/personalfinance/articles/2006/02/14/complaints_mounting_over_college_savings_accounts; John Wasik, "How to Find the Best 529 College Savings Programs," Bloomberg.com, February 13, 2006, at quote.bloomberg.com/apps/news?pid=10000039&refer=columnist_wasik&sid=aUh68emzUVEE; Albert B. Crenshaw, "529 College Savings Plans and State of Confusion," Washington Post, February 12, 2006, at F8; Aleksandra Todorova, "529 Plans Get Report Card," SmartMoney.com, February 10, 2006, at www.smartmoney.com/consumer/index.cfm?story=20060210; Jonathan Clements, "Choosing a 529 College-Savings Plan: When It Makes Sense to Go Out of State," Wall Street Journal, January 4, 2006, at D1; Michelle Singletary, "Get the Straight Facts on Section 529," Washington Post, December 1, 2005, at D2; Ashlea Ebling, "College Savers Unite!" Forbes.com, September 28, 2005, at

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The MSRB has long been an advocate for the best possible disclosure practices by the 529 college savings plan community, having previously noted that investor protection concerns dictate that disclosure in this market should be based on six basic characteristics: comprehensiveness, understandability, comparability, universality, timeliness and accessibility.[34] However, neither the MSRB nor the Commission have the authority to mandate that 529 college savings plans make specific disclosures, including disclosure of costs associated with investments in the plans, descriptions of the state tax consequences of investing in their plans or in out-of-state plans, or disclosure of performance under uniform standards.[35]

The MSRB is of the view that a more comprehensive and user-friendly system of established industry sources is needed in the 529 college savings plan market. Such a system would be based on centralized websites providing direct access to official issuer disclosure materials for the entire universe of 529 college savings plan offerings, together with understandable educational information and tools allowing for side-by-side

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www.forbes.com/estateplanning/2005/09/27/beltway-college-savings-cz_ae_0928beltway.html.

34 *See* Oversight Hearing on 529 College Savings Plans, Hearing Before the Subcomm. on Financial Management, The Budget, and International Security of the Senate Comm. on Governmental Affairs, 108th Cong. (Sept. 30, 2004) (testimony of Ernesto A. Lanza, Senior Associate General Counsel, MSRB).

35 When dealers market 529 college savings plans, the MSRB requires time-of-trade disclosures of material information to customers, including but not limited to disclosure of the possible loss of state tax benefits if investing out-of-state. Proposed Exchange Act Rule 15c2-3, if adopted, would mandate that point-of-sale fee disclosures be made by dealers in a uniform manner. Furthermore, the MSRB has adopted uniform requirements for the calculation and presentation of up-to-date performance data in 529 college savings plan advertisements published by dealers that also require that advertisements disclose the possible loss of state tax benefits if investing out-of-state.

comparisons of different 529 college savings plans. It is crucial for ensuring that dealers and other investment professionals seeking to provide advice to their customers on their college savings options are able to do so with a full view of the available alternatives. In addition, this maturation of the disclosure dissemination system for the 529 college savings plan market would be particularly crucial to allowing customers to have direct access to the types of information and other resources they need to make informed investment decisions, thereby promoting investor confidence in their own abilities to make such informed choices, whether with the advice of an investment professional or as a self-directed investor.

The MSRB understands that CSPN has undertaken to upgrade its existing website to provide a comprehensive centralized web-based utility for the 529 college savings plan market.[36] This CSPN utility is expected to provide a combination of on-site and hyperlinked resources, including summary information formatted to allow meaningful comparisons of many of the material features of different 529 college savings plans, together with direct links to all 529 college savings plan program disclosure documents and related information as well as to other sources providing tools designed for analyzing potential 529 college savings plan investments. The MSRB understands that the types of material features to be disclosed through this utility include, but are not limited to, state tax treatment and other state-based benefits, costs associated with investments, types of underlying investments, performance information and other important features that can vary considerably from state to state, with hyperlinks embedded within such summary information providing direct links to a full description of such specific feature in the

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[36] NAST. CSPN is an affiliate of NAST.

issuer's official program disclosure document or other reliable sources. CSPN has also recently published its DP-2, which updates its baseline disclosure standards designed to assist the states in improving the quality and comparability of their 529 college savings plan disclosures in the program disclosure document. In the 2005 Proposal, the MSRB had urged CSPN and the individual 529 college savings plans to strive for the maximum possible ease of access to, and uniformity of content in, the program disclosure documents consistent with providing information that is complete, understandable and not misleading. The MSRB views the upcoming implementation of the CSPN website disclosure utility and the development and universal adoption of DP-2 as significant steps toward achieving the goals the MSRB had set out for the 529 college savings plan market.

The CSPN utility will join other commercial, industry group and regulator web-based resources providing useful information for individuals seeking to save for college expenses and for investment professionals active in the 529 college savings plan market. Several commercial ventures already provide, in summary and often tabular form, some categories of information for all available 529 college savings plans. Such information can include fees and expenses, minimum and maximum investments, nature of the underlying investments, distribution channels, and state tax treatment, as well as proprietary ratings based on varying criteria. Much of this information is available at no cost, with some sources making available, for a fee, premium or membership-based services for professionals that provide greater detail or more comprehensive analyses of the available information. Many of these commercial websites have taken recent steps to augment and refine the information they offer to the public, and the MSRB understands

that alternative pricing structures suitable for retail investors for access to these premium services are being considered. In addition, the MSRB, the Commission, NASD and the North American Securities Administrators Association ("NASAA") all provide general information about investing in 529 college savings plans useful to individual investors and market participants.[37] NASD plans to introduce on its website in the near future an improved expense analyzer for the 529 college savings plan market using a live datafeed that should allow for more reliable calculations and cost comparisons among different 529 college savings plans. The CSPN utility is expected to serve as a central hub through which investors can easily access many of these other web-based resources.

The MSRB believes that improved disclosures can only be effective if potential investors actually access such disclosures with sufficient time to make use of the information in coming to an investment decision. The MSRB urges dealers and other participants in the 529 college savings plan market to provide the investing public with easy access to, and to affirmatively encourage the use of, this market-wide information. The MSRB will monitor the 529 college savings plan market closely with respect to the concerns it sought to address through the 2005 Proposal. The MSRB will be acutely sensitive to, and will consider whether further rulemaking would be appropriate in the event of, any significant failures in the further development of the disclosure

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[37] The MSRB provides information for investors in 529 college savings plans at www.msrb.org/msrb1/mfs/ruleinfo.asp. The Commission also has published an investor-oriented introduction to 529 college savings plans at www.sec.gov/investor/pubs/intro529.htm. NASD has created a college savings center for investors at apps.nasd.com/investor_Information/Smart/529/000100.asp. NASAA, an association of state securities regulators, has published (in conjunction with CSPN and ICI) a brochure on understanding college savings plans, available at www.nasaa.org/Investor_Education/3136.cfm.

dissemination system or in the efficacy of this dissemination system to address the MSRB's stated investor protection concerns.

Time-of-Trade Disclosure Obligation in Connection with Out-of-State Sales

Summary. Currently, a dealer's time-of-trade disclosure obligation under Rule G-17 requires the dealer, when selling an out-of-state 529 college savings plan interest to a customer, to disclose that, depending upon the laws of the customer's home state, favorable state tax treatment for investing in a 529 college savings plan may be limited to investments made in a 529 college savings plan offered by the customer's home state.[38] The 2004 Proposal sought to broaden this time-of-trade disclosure obligation to include reference to other potential benefits (such as scholarships to in-state colleges, matching grants into 529 college savings plan accounts, or reduced or waived program fees, among other benefits), in addition to state tax benefits, offered solely in connection with in-state investments.[39]

The 2005 Proposal retained the baseline time-of-trade disclosure proposed in the 2004 Proposal, with a modification to include reference to the designated beneficiary's home state in addition to that of the customer. The 2005 Proposal also would add to the baseline time-of-trade disclosure a requirement that the dealer advise the customer that any state-based benefits offered with respect to a particular 529 college savings plan

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38 The 2002 Notice also stated that such disclosure, coupled with a suggestion that the customer consult a tax adviser about any state tax consequences of the investment, would provide adequate notice of the potential loss of in-state tax benefits.

39 The 2004 Proposal would require the dealer to suggest that the customer consult with a qualified adviser or contact his or her home state's 529 college savings plan to learn more about any state tax or other benefits that might be available in conjunction with an investment in that state's 529 college savings plan.

should be considered as one of many appropriately weighted factors that should be considered by the customer in making his or her investment decision. The dealer also would be required to suggest that the customer consult with his or her financial, tax or other adviser to learn more about how such home state features (including any limitations) may apply to the customer's specific circumstances, and that the customer also may wish to contact his or her home state or any other 529 college savings plan to learn more about any state-based benefits (and any limitations thereto) that might be available in conjunction with an investment in that state's 529 college savings plan.

In a significant expansion from the 2004 Proposal, the 2005 Proposal sought to impose the special home state disclosure proposal in addition to the baseline time-of-trade disclosure described above. Under this special home state disclosure proposal, a dealer would be required to inquire of any out-of-state customer as to whether the realization of state-based benefits was an important factor in the customer's investment decision. If the customer were to answer affirmatively, the dealer would be required to disclose (i) material information available from established industry sources about state-based benefits offered by the home state of the customer or designated beneficiary for investing in its 529 college savings plan and (ii) whether such state-based benefits are available in the case of an investment in an out-of-state 529 college savings plan.

Finally, the 2005 Proposal reminded dealers that the time-of-trade disclosure obligation with respect to sales of out-of-state 529 college savings plan interests is in addition to dealers' existing general obligation under Rule G-17 to disclose to their customers at the time of trade all material facts known by dealers about the 529 college savings plan interests they are selling to the customers, as well as material facts about

such 529 college savings plan that are reasonably accessible to the market through established industry sources. Further, the 2005 Proposal reminded dealers that disclosures made to customers as required under MSRB rules do not relieve dealers of their suitability obligations – including the obligation to consider the customer's financial status, tax status and investment objectives – if they have recommended investments in 529 college savings plans.

Comments. All commentators on the 2004 Proposal supported the importance of ensuring disclosure to customers of the potential existence of state-specific features of 529 college savings plans, with many providing suggested modifications. CSF expressed concern about the potential for over-emphasizing state variations in a way that may detract from more fundamental considerations in making an investment decision. Two commentators stated that not every difference in state treatment ultimately will be a benefit to the investor, particularly in view of potential recapture of state tax benefits or other restrictions that some states impose under certain circumstances.[40] These commentators suggested that the best course would be to remind investors to carefully review the program disclosure documents of their home state programs and to consult their own advisors before investing, with one commentator stating that it would be inappropriate to suggest to investors that they seek help from their home state programs because it is unclear whether the programs can provide complete information regarding such consequences and because some states may seek to persuade investors to make an

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[40] CSF and SIA.

investment in their program rather than to impart disinterested information.[41] Two other commentators stated that the proposed disclosure should reflect that some benefits may be dependent on the designated beneficiary's home state (rather than or in addition to the home state of the investor).[42]

Most commentators on the 2005 Proposal accepted the modified baseline time-of-trade disclosure. However, most commentators strongly opposed the newly proposed special home state disclosure proposal requiring disclosure of specific in-state features that an out-of-state investor may forego,[43] with no commentator expressing support for this proposal. Several commentators argued that the specific disclosures under the special home state disclosure proposal would inevitably result in state-based benefits being given disproportionate weight as compared to the many other important factors to be considered in making an investment decision.[44] In addition, commentators observed that, without a reliable source of market-wide information, dealers would be required to undertake substantial effort (with concomitant expenditure of resources) to understand and track the details of constantly changing state law treatment of all 529 college savings plans.[45] Two commentators warned that requiring dealers to make specific disclosures

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41 CSF. However, Hawkins disagreed, stating that with respect to non-tax state benefits, customers should be directed to the specific state program for more information.

42 CSPN and FAME.

43 AG Edwards, CSF, CSP-Maryland, CSPN, Georgia, ICI, Iowa, Ohio TTA, SIA, T. Rowe, University of Alaska, USAA, Vanguard, Virginia CSP, Wachovia and West Virginia.

44 AG Edwards, CSF, ICI and Vanguard.

45 Hancock, ICI, SIA, T. Rowe, USAA, Vanguard and Wachovia.

about 529 college savings plans they do not offer could result in potential liability.[46] SIA stated that the special home state disclosure proposal would have the counter-intuitive result of compromising a dealer's ability to develop in-depth expertise regarding the range of investment products it is reasonably capable of servicing. Wachovia expressed concern that this requirement would have the potential to paralyze investors with an overabundance of information.

The University of Alaska stated that it did not wish to have its program features explained by dealers who are not authorized to market its 529 college savings plan, with other commentators echoing the concern that dealers would often be required to disclose information about a security they do not offer and about which they may not have sufficient expertise.[47] CSF observed that the burden this requirement would place on the 529 college savings plan market does not exist for any other type of security. Two commentators suggested that the MSRB await final action by the Commission on its point-of-sale disclosure proposal before finalizing any significant changes in 529 college savings plan disclosure requirements.[48]

MSRB Response. The MSRB continues to believe that it is important that investors are informed that they may be foregoing state tax and other benefits offered by their home states by investing in out-of-state 529 college savings plans. At the same time, the MSRB agrees that there is a potential for over-emphasizing the importance of a particular state's beneficial state tax treatment of an investment in its 529 college savings

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46 Hancock and ICI.

47 ICI and Vanguard.

48 USAA and Wachovia.

plan, such as where a state offers a tax benefit that ultimately is relatively small in value compared to the financial impact that a marginally higher expense figure may have or under a variety of other circumstances. As a result, the MSRB has adopted the revised out-of-state disclosure obligation, which retains the baseline time-of-trade disclosure as modified in the 2005 Proposal. The MSRB believes that this time-of-trade disclosure in connection with out-of-state sales of 529 college savings plans, as embodied in the revised out-of-state disclosure obligation, achieves the appropriate balance between providing for the disclosure to customers of material information about the potential loss of state tax or other benefits relevant to their investment decision in 529 college savings plans without imposing a significant burden on dealers and other 529 college savings plan market participants that could possibly result in an over-simplification of the complexity of state law factors or an over-emphasis of state law factors as compared to other relevant investment factors. The MSRB has also retained the reminders in the 2005 Proposal to the effect that these disclosures do not obviate other disclosure requirements or suitability obligations arising as a result of a recommendation.

The MSRB has determined not to retain the proposal to expand the time-of-trade disclosure obligation to include disclosures of specific state tax and other state-based features of the investor's home state as set out in the special home state disclosure proposal. The MSRB has based this determination in large measure on the potential adverse impact of this proposal and the significant steps currently in process toward improvements in the 529 college savings plan disclosure system.

Fulfilling the Revised Out-of-State Disclosure Obligation Through the Program Disclosure Document

Summary. The 2004 Proposal would have clarified that dealers could meet their baseline time-of-trade disclosure obligation with respect to potentially foregone in-state benefits through the issuer's program disclosure document so long as the program disclosure document is provided to the customer at or prior to the time of trade. The 2004 Proposal also would have strengthened the minimum standards for prominence in the program disclosure document in order to meet the baseline time-of-trade disclosure obligation. Thus, to meet this obligation through the program disclosure document, the disclosure must appear in a manner that is reasonably likely to be noted by an investor. A presentation of this disclosure in the program disclosure document in close proximity and with equal prominence to the first presentation of information regarding other federal or state tax-related consequences of investing in the 529 college savings plan, and in close proximity and with equal prominence to each other presentation of information regarding state tax-related consequences of investing in the 529 college savings plan, would be deemed to satisfy this requirement. The 2005 Proposal modified this presentation standard to provide for equal prominence with the principal (rather than first) presentation of substantive information regarding other federal or state tax-related consequences of investing in the 529 plan, and the inclusion of a reference to this disclosure (rather than restating such disclosure in full) in close proximity and with equal prominence to each other presentation of information regarding state tax-related consequences of investing in the 529 plan. Neither proposal required that such disclosure be made through the program disclosure document, noting that the MSRB does not have the authority to mandate the inclusion of any particular item of information in the issuer's

disclosure document. Both proposals provided that dealers would be required to separately make such disclosure if the program disclosure document did not include the information in the manner prescribed.

Comments. Two commentators expressed concern that the 2004 Proposal would effectively establish requirements for what information must be included in the program disclosure document.[49] They noted that the MSRB does not have authority to directly impose such requirements. CSF stated that the MSRB should not establish specific requirements for how such disclosure should appear in the program disclosure document, while two other commentators suggested limiting some of the presentation requirements described in the 2004 Proposal.[50] SIA stated that the requirement that the information appearing in the program disclosure document must appear in a manner "reasonably likely to be noted by an investor" would place dealers in the position to question the judgment of the state issuers and suggested that there should be a presumption that the placement and adequacy of the disclosure in the program disclosure document is reasonable.

CSPN also expressed concern with respect to the reformulation of this language in the 2005 Proposal, stating that dealers would have to determine whether the issuer has satisfactorily made such disclosures, potentially calling into question the issuer's determination to include or omit particular information.[51] CSPN stated that this would

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49 CSPN and FAME. These commentators, as well as Hawkins, noted that CSPN's DP-1 already contained language on this topic.

50 Hawkins and ICI.

51 CSP-Maryland, Georgia, Iowa, Ohio TTA, University of Alaska, Virginia CSP and West Virginia supported CSPN's position.

create a constant second-guessing aspect as to the validity of offering materials created and distributed by state issuers. SIA stated that this provision would likely lead dealers to create their own disclosure documents for use in marketing 529 college savings plans, conflicting with most distribution agreements and program disclosure documents.

MSRB Response. The MSRB reaffirms its view that it has no authority to mandate the inclusion of any particular items in the issuer's program disclosure document. As noted in both the 2004 and 2005 Proposals, disclosure through the program disclosure document in the manner described by the MSRB is not the sole manner in which a dealer may fulfill the revised out-of-state disclosure obligation. Just as a dealer could meet this disclosure obligation through a separate communication, it stands to reason that a disclosure made through the program disclosure document in a manner that is reasonably likely to be noted by an investor could also be used by a dealer to fulfill this duty. Thus, the MSRB has provided in the proposed rule change that, if the issuer has not included the information in the program disclosure document in the manner described, inclusion in the program disclosure document in another manner may nonetheless fulfill the dealer's out-of-state disclosure obligation so long as disclosure in such other manner is reasonably likely to be noted by an investor.[52]

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[52] Some commentators stated that certain portions of the 2005 Proposal might not be consistent with the notion that the issuer's program disclosure document serves as "the fundamental, stand-alone disclosure" for the offering of its securities. *See, e.g.*, AG Edwards. The MSRB believes that dealers generally may view the issuer's program disclosure document as the definitive source from which to obtain information about the securities they are selling to their customers. The requirement that a dealer make the revised out-of-state disclosure separately if such disclosure is not included in the program disclosure document in a manner reasonably likely to be noted by an investor is not intended to imply otherwise, consistent with prior Commission guidance regarding the obligations of

(continued . . .)

General Suitability Obligations

Summary. The 2005 Proposal reaffirmed the guidance originally provided in the 2002 Notice regarding general suitability standards under Rule G-19 for recommended transactions in 529 college savings plans. The 2005 Proposal added reminders to dealers to the effect that their suitability obligation requires a meaningful analysis that establishes the reasonable grounds for believing that the recommendation is suitable and that they must have and enforce written supervisory procedures reasonably designed to ensure compliance with this obligation for every recommended transaction. The 2004 Proposal did not address suitability issues.

Comments. No commentator opposed the 2005 Proposal's discussion of general suitability standards.

MSRB Response. The MSRB has retained this discussion of general suitability standards.

Comparative Suitability Obligation for Out-of-State Sales

Summary. The 2005 Proposal would require a dealer to undertake a comparative suitability analysis if the dealer has recommended an out-of-state 529 college savings plan transaction to a customer who has indicated that one of his or her investment objectives is realization of state-based benefits, as contemplated under the special home

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(. . . continued)

underwriters and other dealers in connection with municipal issuers' disclosure materials under the federal securities laws. *See* Exchange Act Release No. 26100 (September 22, 1988), 53 FR 37778 (Section III – Municipal Underwriter Responsibilities), as modified by Exchange Act Release No. 26985 (June 28, 1989), 54 FR 28799 (Section III – Interpretation of Underwriter Responsibilities), and as reaffirmed by Exchange Act Release No. 33741 (March 9, 1994), 59 FR 12748 (Section V – Interpretive Guidance with Respect to Obligations of Municipal Securities Dealers).

state disclosure proposal. This would involve the consideration of the state-based benefits available from the customer's home state 529 college savings plan in a comparative analysis with the out-of-state 529 college savings plan being offered. Any such state-based benefits offered with respect to a particular 529 college savings plan would be considered as one of many appropriately weighted factors that have an ultimate bearing on the relative strengths of a particular investment, and the existence of state-based benefits would not create a presumption that investment in the home state 529 college savings plan is necessarily superior to an out-of-state 529 college savings plan. If a dealer were to conclude that an investment in the home state 529 college savings plan would be superior to an investment in the offered out-of-state 529 college savings plan under every reasonable scenario, then the dealer would be obligated to inform the customer of this determination and would be permitted to effect a transaction in the offered out-of-state 529 college savings plan only if the customer has directed to do so after this suitability determination has been disclosed and if the out-of-state 529 college savings plan would, without regard to the comparative analysis with the home state 529 college savings plan, be suitable for the customer under traditional suitability standards. The 2004 Proposal did not contain comparable language.

Comments. Most commentators strongly opposed the comparative suitability proposal,[53] although two commentators conceded that, depending on the facts and circumstances, the availability of in-state benefits may be one of many appropriate

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53 AG Edwards, CSF, CSP-Maryland, CSPN, Fidelity, Georgia, Hancock, ICI, Iowa, NAST, Ohio TTA, PFPC, SIA, T. Rowe, University of Alaska, USAA, Virginia CSP, Wachovia and West Virginia. No commentator expressed support for the comparative suitability proposal.

factors to consider in making a suitability determination under traditional suitability standards.[54] Three commentators stated that there has been no evidence of abuse in the offering of out-of-state 529 college savings plans to justify these new requirements, observing that no enforcement actions have been taken.[55] Several commentators observed that federal securities regulation has never been premised on the concept that a dealer is obligated to determine the most suitable investment of a particular type for any customer and that the comparative suitability proposal is inconsistent with the application of the suitability rule to every other product sold by dealers.[56] Two commentators stated that comparisons are highly disfavored by NASD rules.[57] The University of Alaska noted that one result of a more stringent suitability obligation for recommendations of 529 college savings plan transactions might be that dealers would place their clients in other investment vehicles that do not carry such regulatory risk.

Many commentators viewed the comparative suitability proposal as effectively requiring dealers to become fully familiar with the terms of all 529 college savings plans

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54 AG Edwards and Hancock.

55 CSF, ICI and USAA. NASD subsequently announced on October 26, 2005 that it had reached a settlement agreement with Ameriprise Financial Services, Inc., in connection with the failure of the firm to establish and maintain supervisory systems and procedures reasonably designed to achieve compliance with suitability obligations relating to recommended transactions in 529 college savings plans. *See* www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE &ssDocName=NASDW_015319. This settlement agreement appears to have been the basis for concern expressed by Fidelity and PFPC that NASD may be incorporating the comparative suitability proposal into its enforcement posture prior to its final approval. The MSRB understands that NASD did not intend certain language included in the settlement agreement to imply that the comparative suitability proposal is currently in effect.

56 CSF, Fidelity, Hancock, PFPC, SIA, University of Alaska and USAA.

57 CSF and SIA.

before offering any particular 529 college savings plan.[58] These commentators argued that this extraordinary burden is unprecedented and is likely to significantly discourage the marketing of 529 college savings plans. NAST agreed, emphasizing that the comparative suitability proposal would have substantially increased the burden on the states themselves. Wachovia suggested that the MSRB undertake a cost-benefit analysis before adopting the comparative suitability proposal, while USAA stated that the incremental costs associated with meeting this standard would cause firms to reevaluate whether offering 529 college savings plans continues to make sense or to pass the incremental costs on to investors. AG Edwards argued that it is untenable to require a dealer to inform a client that one 529 college savings plan is unequivocally superior to another. Two other commentators stated that they are receiving anecdotal evidence that some selling dealers are withdrawing from the 529 college savings plan market in response to this proposal and to recent NASD enforcement activity.[59] CSF noted that one potential result may be that some customers who are accustomed to relying on their

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58 CSPN (with the concurrence of CSP-Maryland, Georgia, Iowa, Ohio TTA, University of Alaska, Virginia CSP, West Virginia), Hancock, ICI, T. Rowe Price and Wachovia.

59 Fidelity and PFPC. Concerns regarding the negative impact of the comparative suitability proposal have also been detailed in press reports. *See* Charles Paikert, "MSRB to Decide on Controversial 529 Proposals," Investment News, February 13, 2006, at 2; Terry Savage, "Political Issues Put the Hurt on College Savings," The Street, February 10, 2006, at www.thestreet.com/funds/investing /10267688.html; Jilian Mincer, "Sales of 529 College Savings Plans Fell in '05 Amid Scrutiny," Wall Street Journal, February 9, 2006, at D2; Jilian Mincer, "Disclosure Proposals for 529s Risk a Broker Backlash," Wall Street Journal, January 3, 2006, at D2; Lauren Barack, "Will Reform Drive Brokers From 529 Sales?" Registered Rep, November 1, 2005, at registeredrep.com/mag/finance _reform_drive_brokers.

financial advisors and who otherwise might invest in suitable 529 college savings plans may ultimately never make such an investment.

SIA expressed concern that the comparison contemplated by the proposal would be difficult to implement from a practical standpoint. ICI agreed, identifying a number of specific practical concerns. Some commentators stated that the comparative suitability proposal would place inordinate focus on state benefits while effectively ignoring the many other reasons why an investor might choose to invest in an out-of-state 529 college savings plan.[60] Other commentators predicted that the potential liabilities that would arise under the comparative suitability proposal would result in many dealers limiting their sales solely to the in-state 529 college savings plan, regardless of its advantage or disadvantage.[61] CSF requested that the MSRB defer action on the comparative suitability proposal pending implementation of the planned CSPN website enhancement.

MSRB Response. The MSRB has determined not to retain the comparative suitability proposal, based in large measure on the potential adverse impact of this proposal and the significant steps currently in process toward dramatic improvements in the 529 college savings plan disclosure system. However, the MSRB agrees with those commentators that noted that the availability of in-state benefits may be one of many appropriate factors to consider in making a suitability determination under traditional suitability standards, depending on all the facts and circumstances. Thus, the MSRB has added guidance to this effect in the proposed rule change, in conjunction with additional guidance to the effect that dealers should consider whether a recommendation is

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60 ICI, Hancock and Wachovia.

61 AG Edwards, Fidelity and PFPC.

consistent with the customer's tax status and any customer investment objectives materially related to federal or state tax consequences of an investment.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The MSRB proposes an effective date for the proposed rule change of 60 calendar days after Commission approval. 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. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-MSRB-2006-03 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-MSRB-2006-03. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). 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, 100 F Street, N.E., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the MSRB. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-MSRB-2006-03 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[62]

Nancy M. Morris
Secretary

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62 17 CFR 200.30-3(a)(12).

EXHIBIT 2

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

The Municipal Securities Rulemaking Board ("MSRB") has established a number of specific interpretive standards under its advertising rule, Rule G-21, in connection with advertisements used or produced by brokers, dealers and municipal securities dealers ("dealers") relating to municipal fund securities, including in particular advertisements for college savings plans.[1] In addition, the MSRB has provided interpretive guidance regarding dealers' point-of-sale disclosure obligations under the MSRB's basic fair practice rule, Rule G-17, as such obligations apply to the marketing of shares of a state's college savings plan to individuals who are residents of a different state. These and other MSRB rules and interpretive positions are designed, among other purposes, to ensure that material information on the municipal fund securities market (particularly the rapidly evolving and growing college savings plan market) is made available in a meaningful and accurate manner to customers who invest in municipal fund securities through dealers.[2]

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[1] Municipal fund securities are defined in Rule D-12 as municipal securities issued by an issuer that, but for the application of Section 2(b) of the Investment Company Act of 1940, would constitute an investment company under the Act. Section 2(b) of the Investment Company Act provides that the Act does not apply to, among others, a state or any political subdivision of a state, or any agency, authority, or instrumentality of a state. There are two principal forms of municipal fund securities that are marketed by dealers: (i) interests or shares in college savings plans, which are established by states under Section 529(b)(A)(ii) of the Internal Revenue Code of 1986 as "qualified tuition programs" through which individuals make investments for the purpose of accumulating savings for qualifying higher education costs of beneficiaries; and (ii) interests or shares in local government investment pools, which are established by state or local governments as vehicles for the pooled investment of public moneys of participating governmental entities. So-called "pre-paid tuition plans" established by states or higher education institutions under Section 529(b)(A)(i) of the Internal Revenue Code generally are not considered municipal fund securities.

[2] Many municipal fund securities are marketed directly to customers by issuer personnel, rather than through dealers. Since the MSRB's rulemaking authority under Section 15B of the Securities Exchange Act of 1934 is limited to dealer transactions in municipal securities, MSRB rules do not apply to issuers or their personnel who market municipal fund securities directly to customers.

In furtherance of the MSRB's statutory mandate to protect investors and the public interest, the MSRB is publishing for industry comment draft amendments to Rule G-21 that would: (i) require that performance data included in advertisements for municipal fund securities be calculated and displayed, together with related legends and disclosures, in the manner required under Securities Act Rule 482 adopted by the Securities and Exchange Commission ("SEC") in connection with mutual fund advertisements, with certain modifications; (ii) require that all advertisements for municipal fund securities include general disclosure language based in part on a similar requirement in SEC Rule 482, with additional language in the case of college savings plan advertisements relating to benefits available solely to state residents; and (iii) incorporate into the rule language the MSRB's previously enunciated interpretive standards, with certain modifications. Furthermore, the MSRB is publishing for industry comment draft interpretive guidance under Rule G-17 that would broaden the existing point-of-sale disclosure obligation relating to out-of-state investments in college savings plans to include disclosures regarding the potential loss of other state benefits (in addition to tax benefits) that may be offered to individuals who invest in their home state college savings plans. The draft amendments and draft interpretive guidance are described more fully below. Comments are due by September 15, 2004.

DRAFT AMENDMENTS TO RULE G-21, ON ADVERTISING

Rule G-21 establishes general ethical standards for dealer advertisements. Under section (b) of the rule, a dealer is prohibited from publishing any advertisement concerning its facilities, services or skills with respect to municipal securities that is materially false or misleading. In addition, a dealer is prohibited under section (c) of the rule from publishing any advertisement concerning municipal securities that it knows or has reason to know is materially false or misleading.[3] Rule G-21 generally does not require that any specific statements or information be included in an advertisement but does require that any statement or information that is included not be materially false or misleading.[4] Advertisements are defined broadly under the rule and generally consist of any materials published or designed for use in the public, including electronic (*e.g.*, Internet web sites, form e-mail messages, scripted telemarketing calls, fax

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[3] The rule also establishes standards for advertising initial reoffering prices or yields of new issue municipal securities under section (d). This provision is designed for advertisements by underwriting syndicates for municipal debt offerings and does not deal with matters relevant to the municipal fund securities markets. The draft amendments would explicitly exempt municipal fund security advertisements from this provision.

[4] For example, if a dealer makes a statement in an advertisement that explicitly or implicitly refers to a particular feature of a security (*e.g.*, the soundness or safety of an investment in the security), the dealer must include any information necessary to ensure that the advertisement is not materially false or misleading with respect to the feature. *See* Rule G-21 Interpretive Letter – Disclosure obligations, May 21, 1998, *reprinted in* MSRB Rule Book.

broadcasts), media (*e.g.*, print, television, radio) or promotional literature designed for dissemination to the public, such as notices, circulars, reports, market letters, form letters, telemarketing scripts or reprints or excerpts of the foregoing. However, issuer-prepared disclosure materials such as program disclosure documents produced in connection with college savings plans or information statements produced in connection with local government investment pools are not considered advertisements for purposes of Rule G-21.[5]

In an interpretive notice published in 2002 (the "2002 MSRB Notice"), the MSRB established specific standards for inclusion of certain types of information in municipal fund security advertisements, with emphasis on college savings plan advertisements.[6] Today, the MSRB is proposing draft amendments to Rule G-21 that would incorporate the advertising standards enunciated in the 2002 MSRB Notice, with certain modifications described below. The standards from the 2002 MSRB Notice would be supplemented by specific requirements regarding the calculation and display of performance data in advertisements in a manner consistent with SEC Rule 482. In addition, the draft amendments would include general disclosure requirements regarding municipal fund securities that are similar in most respects to generalized disclosures currently required for mutual fund advertisements under SEC Rule 482. The draft amendments are included at the end of this notice. If the draft amendments are adopted, the MSRB would expect to withdraw the portions of the 2002 MSRB Notice relating to advertisements. The MSRB seeks comments on all aspects of the draft amendments.

Historical Performance Data

Current Standard. Under current Rule G-21 as interpreted in the 2002 MSRB Notice, the use of historical performance data in an advertisement requires a description of the nature and significance of such data to assure that the advertisement is not false or misleading. Further, depending upon the facts and circumstances, a dealer may be required to disclose information on fees or other charges that may have a material effect on the advertised performance data if necessary to ensure that the advertisement is not materially false or misleading. An advertisement that includes performance data must make clear that such information relates to past performance, which may not be indicative of future investment performance.

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5 Program disclosure documents, information statements and other issuer-prepared disclosure materials used in connection with municipal fund securities are referred to as "official statements" under MSRB and SEC rules. *See infra* footnote 13. The MSRB has no regulatory authority over issuer disclosure documents.

6 *See* Rule G-21 Interpretation – Application of Fair Practice and Advertising Rules to Municipal Fund Securities, May 14, 2002, *reprinted in* MSRB Rule Book. The 2002 MSRB Notice also confirmed previous guidance on advertisements of municipal fund securities published in 2001. *See* Rule G-30 Interpretation – Interpretive Notice on Commissions and Other Charges, Advertisements and Official Statements Relating to Municipal Fund Securities, December 19, 2001, *reprinted in* MSRB Rule Book.

Except as described in the preceding paragraph, the MSRB has not specified that dealers must calculate or display performance data contained in municipal fund security advertisements in any particular manner. This contrasts with existing regulation of mutual fund advertisements that include performance data. SEC Rule 482 sets forth detailed requirements on how such data, if included in mutual fund advertisements, must be calculated and displayed, in part by reference to the registration statements used for registration of mutual funds and variable annuities.[7] Thus, performance data presented by a dealer in a mutual fund advertisement generally must be consistent with performance data presented by the mutual fund itself in its registration statement.

In the case of municipal fund securities, however, issuers are not subject to the registration requirements of the Securities Act of 1933 under Section 3(a)(2) or the Investment Company Act of 1940 under Section 2(b). Thus, there are no mandated methods for issuers of municipal fund securities to calculate performance, nor is there any requirement for such issuers to make such calculations or to present performance data in any document available to investors or others. The methods of computing mutual fund performance under SEC rules are based in part on the assumption that mutual funds are structured in accordance with the limitations imposed by the Investment Company Act. Because issuers of municipal fund securities are exempt from the Investment Company Act and most other federal securities laws, they may act in their best judgment in widely divergent manners in structuring their programs and securities. Some of these structures may introduce variants on the traditional mutual fund models that can result in the SEC calculation methods to be not ideally suited, without modification, for calculating performance of these municipal fund securities.

The 2002 MSRB Notice did not include guidance on performance calculations and other matters covered by SEC Rule 482 since the provisions of that rule were then subject to change as a result of the publication for comment by the SEC of proposed amendments to Rule 482 simultaneously with the publication of the 2002 MSRB Notice.[8] The 2002 MSRB Notice did confirm previous guidance in which the MSRB had stated that a municipal fund security advertisement that would be compliant with the SEC and NASD mutual fund advertising rules, if applied to the municipal fund security advertisement as if municipal fund securities were shares of a registered mutual fund, also would be in compliance with MSRB Rule G-21. Thus, a dealer wishing to include performance data in an advertisement could electively use the methods required by the SEC for mutual fund advertisements under SEC Rule 482 with the assurance that

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7 SEC Rule 482 references Form N-1A (registration statement for open-end management investment companies), Form N-3 (registration statement for variable annuities registered as investment companies) and Form N-4 (registration statement for variable annuities registered as unit investment trusts).

8 *See* Investment Company Act Release No. 25575 (May 17, 2002), 67 FR 36712 (May 24, 2002). The proposed amendments were ultimately adopted by the SEC, with limited modifications, in September 2003 and became fully effective for mutual fund advertisements submitted for publication after March 31, 2004. *See* Investment Company Act Release No. 26195 (September 29, 2003), 68 FR 57760 (October 6, 2003).

the advertisement would be in compliance with the MSRB's advertising rule. However, dealers are not required to use these SEC methods and currently are permitted to display performance in ways that diverge from the standards that exist in the mutual fund industry, so long as the performance data is not false or misleading. The lack of specific required computational and presentation standards could result in significantly less comparability between different municipal fund security advertisements than currently exists for mutual fund advertisements.

Draft Amendments. Proposed new section (e)(ii) of Rule G-21 would require dealer advertisements of municipal fund securities that include performance data to comply with the method of computing and displaying performance data for mutual funds as prescribed in section (d) or (e) of SEC Rule 482, with certain modifications. The modifications included in the draft language reflect the fact that certain items of information that exist in the mutual fund industry – such as the registration statement and the specific items of information required to be disclosed in the prospectus and statement of additional information – do not exist for municipal fund securities. In particular, the draft language provides that: (A) a dealer can use information provided in the issuer's official statement, otherwise made available by the issuer, or otherwise obtained from other reliable sources to calculate performance to the extent such information is not available from a balance sheet in a registration statement or from a prospectus; (B) the life of a municipal fund securities issue should be measured from when the issuer first issues the securities; (C) performance data in advertisements must be calculated as of the most recent calendar quarter ended prior to the submission of the advertisement for publication for which such performance data, or all information required for the calculation of such performance data, is reasonably available to the dealer; and (D) expenses having the same characteristics as those permitted to be paid under Investment Company Act Rule 12b-1 but not technically accrued under a 12b-1 plan must be treated as 12b-1 expenses for purposes of calculating performance.[9] In addition, 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.

Proposed Rule G-21(e)(ii) would effectively provide that, for municipal fund securities other than those that are held out by the issuer as having the characteristics of a money market fund, quotations of performance in an advertisement would be limited to the average annual total return, current yield (but only if accompanied by average annual total return), tax-equivalent yield (but only if accompanied by average annual total return and current yield), after-tax return

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[9] Thus, asset-based charges paid to the program manager or investment advisor, to the issuer or its agents, or to any other party generally would be viewed as being treated as 12b-1 expenses for purposes of calculating performance even if any such charges may not technically be paid under a formal 12b-1 plan. In addition, any 12b-1 expenses incurred in connection with underlying assets of the municipal fund securities also must be treated as 12b-1 expenses of the municipal fund securities to the extent that such expenses are not waived or not included within the asset-based charges described in the preceding sentence.

(but only if accompanied by average annual total return), or other non-prescribed performance measures (but only if accompanied by average annual total return and, if adjusted to reflect the effects of taxes, after-tax return), as provided in SEC Rule 482(d). In the case of municipal fund securities that are held out by the issuer as having the characteristics of a money market fund, quotations of performance in an advertisement would be limited to the current yield, effective yield (but only if accompanied by current yield), tax-equivalent yield or tax-equivalent effective yield (but only if accompanied by current yield), or total return (but only if accompanied by current yield), as provided in SEC Rule 482(e).[10] Performance data included in municipal fund security advertisements would be required to be displayed in the manner provided in section (d) or (e) of SEC Rule 482, as appropriate, with respect to prominence and positioning of information.

The MSRB understands that it is possible that, even with the modifications described above, the methods of calculating performance prescribed under SEC Rule 482(d) or (e) may not be well suited for certain municipal fund security structures. The MSRB seeks specific, detailed comments addressing any shortcomings in the proposed calculation methods for particular structures (including descriptions of the specific features of such structures that cause the proposed calculation methods to be deficient) and what further modifications, deletions or additions would be needed to make such calculation methods produce meaningful information for investors that is not misleading.

In addition, the draft amendments include in new Section (e)(i)(B) certain related legends and disclosures currently required under SEC Rule 482 for mutual funds advertisements that display performance information. These disclosures emphasize that the performance data is historical and does not guarantee future results,[11] that the value of holdings is subject to fluctuation, and that current performance may be different from the performance data included in the advertisement. Pursuant to the draft amendments, advertisements containing performance data also would be required to include the maximum amount of any sales load or other nonrecurring fee and, if such load or fee is not reflected in the performance data, to disclose that the load or fee is not so reflected and that performance would be lower if it had been reflected.[12] The MSRB views the nonrecurring fees that would be the subject of this disclosure as including such fees imposed not only by the dealer but also by the issuer or any other party to the issuance

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[10] As noted above, SEC Rule 482 incorporates the calculation methods set forth in Forms N-1, N-3 and N-4 for purposes of calculating the various types of quotations described in the rule. The MSRB seeks comments on whether, as the draft amendment to Rule G-21(e)(ii) is formulated, it would be clear which SEC registration form would be applicable to each type of municipal fund security structure in existence or whether any of the specified registration forms should be excluded for purposes of draft section (e)(ii).

[11] The 2002 MSRB Notice already requires this disclosure, as described above.

[12] Under the 2002 MSRB Notice, similar disclosures might be required depending on the facts and circumstances, as described above.

of the municipal fund securities or the maintenance of investments therein. New Section (e)(i)(C) would require that these legends and disclosures be presented in the same format required under SEC Rule 482.

General Disclosures

SEC Rule 482 requires that most mutual fund advertisements include generalized disclosure that investors should consider the fund's investment objectives, risks and charges before investing; that the prospectus contains this and other information about the fund; that the prospectus should be read carefully before investing; and identifying where a prospectus can be obtained. In the case of a money market fund, Rule 482 also requires disclosure that investments are not insured and, if the fund seeks to maintain a stable net asset value, it is still possible to lose money. Such disclosures are not currently required under MSRB Rule G-21 for municipal fund security advertisements.

The draft amendments would include in section (e)(i)(A) of Rule G-21 a provision modeled after these SEC general disclosure requirements, with certain modifications. The modifications recognize the difference between the prospectus required for mutual funds and the official statement indirectly required for municipal fund securities under Exchange Act Rule 15c2-12 adopted by the SEC.[13] In addition, new section (e)(i)(A)(1) would require that advertisements of college savings plans include a statement that advises investors to consider whether their home states offer tax or other benefits that are only available when investing in their home states' college savings plan.[14] New section (e)(i)(C) would require that these general disclosures be presented in the same format required under SEC Rule 482.

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[13] SEC Rule 15c2-12 provides, among other things, that the underwriter for most primary offerings of municipal securities must obtain and review the issuer's near-final official statement before purchasing or offering the securities, contract with the issuer to receive copies of the final official statement within specified timeframes after the final agreement to purchase or offer the securities, and distribute copies of the official statement to potential customers upon request. For purposes of the rule, a final official statement must set forth information concerning the terms of the issue; information, including financial or operating data, concerning the issuer and other entities, enterprises, funds, accounts and other persons material to an evaluation of the offering; and a description of undertakings regarding the provision of secondary market information, as well as disclosure of any failures to provide such information during the past five years.

[14] This is similar to the disclosure that is required on a customer-by-customer basis pursuant to the 2002 MSRB Notice under a dealer's Rule G-17 point-of-sale disclosure obligation in the case of sales to a customer of college savings plan interests issued by a state other than the customer's home state, as more fully described below. However, it is broadened to refer not only to state tax benefits but also to other benefits that may be provided under state law (*e.g.*, lower fees, matching grants, scholarships to state colleges, or other financial benefits). As described below, the MSRB is proposing to expand the point-of-

(continued . . .)

The MSRB observes that municipal fund securities consisting of interests in college savings plans are oriented exclusively to retail investors and entail a number of features with which most potential investors may not be familiar. In addition, the perception that college savings plan interests and mutual fund shares are substantially the same investment product may not reflect reality and may lead many investors to believe that the same rules and structures apply in the college savings plan market as in the mutual fund market. The MSRB currently provides general information regarding college savings plans and certain information for investors at its web site.[15] The MSRB seeks comment on whether the proposed general disclosure language required under new section (e)(i)(A)(1) for advertisements of college savings plans also should include specific reference to an MSRB-maintained web site where generalized information of this nature would be provided and, if so, the extent to which the information currently provided on the MSRB web site described above should be included, modified, supplemented or deleted.[16]

Additional Amendments Based on 2002 MSRB Notice

The 2002 MSRB Notice provides guidance with respect to a number of other elements that may appear in municipal fund security advertisements. These relate to the nature of the issuer and the securities, the capacity of the dealer and other parties, tax consequences, and information about the mutual funds in which municipal fund security assets are invested. The draft amendments would include new paragraphs (iii) through (vi) of section (e) that would codify into the rule language these interpretive positions, with limited modifications noted below.

Nature of Issuer and Security. Draft section (e)(iii) would require that an advertisement: (i) for a specific municipal fund security provide sufficient information to identify the specific security in a manner that is not false or misleading; (ii) that identifies a specific municipal fund security include the name of the issuer, presented in a manner no less prominent than any other entity identified in the advertisement, and not imply that a different entity is the issuer of the municipal fund security; (iii) not raise an inference that, because municipal fund securities are issued under a government-sponsored plan, investors are guaranteed against investment losses if no such guarantee exists; and (iv) that concerns a specific class or category of an issuer's municipal fund securities (*e.g.*, A shares versus B shares; direct

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(. . . continued)
sale disclosure requirement to also reference the possible existence of other non-tax state benefits.

15 Product information is provided at www.msrb.org/msrb1/mfs/mfs529csp.asp and information for investors is provided at www.msrb.org/msrb1/mfs/ruleinfo.asp.

16 For example, the general disclosure for a college savings plan advertisement might include a statement that general information about investing in college savings plans is available on-line at http://about529s.msrb.org.

sale shares versus advisor shares; in-state shares versus national shares; etc.) clearly disclose this fact in a manner no less prominent than the information provided with respect to such class or category.[17]

Capacity of Dealer and Other Parties. Draft section (e)(iv) would require an advertisement that relates to or describes services provided with respect to municipal fund securities to clearly indicate the entity providing such services. In addition, an advertisement soliciting purchases of municipal fund securities that would be effected by any party other than the dealer that publishes the advertisement (*i.e.*, the issuer or another dealer) must clearly state which entity would effect the transaction.

Tax Consequences and Other Features. Draft section (e)(v) would require that any discussion of tax implications or other benefits or features of investments in municipal fund securities included in an advertisement not be false or misleading.[18] In the case of an advertisement that includes statements regarding tax or other benefits offered under state or federal law, the advertisement must make clear the nature of such benefits and that the availability of such benefits may be materially limited based upon residency, purpose for or timing of share redemptions, or other factors, as applicable, which limitations must be described in the advertisement and presented in close proximity to, and in a manner no less prominent than, the description of such benefits.[19]

Underlying Registered Securities. Draft section (e)(vi) would require 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. However, details of the underlying security so included in the

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17 The draft amendment would modify the existing interpretive guidance by requiring that the disclosure that an advertisement concerns a specific class of securities be presented in the specified manner.

18 The draft amendment would modify the existing interpretive guidance by extending the applicability of the language to discussions of other benefits or features in addition to tax-related matters.

19 The draft amendment would modify the existing interpretive guidance by providing specific examples of certain limitations on benefits. For example, if an advertisement notes that investors in a particular college savings plan may qualify for scholarships or matching grants, the advertisement may also need to state that such scholarships or matching grants are available only for attendance at in-state colleges or to in-state investors, if that is in fact the case. The draft amendment also would modify the existing interpretive guidance by requiring that such limitations be presented in the specified manner.

advertisement must be accompanied by any further statements relating to such details 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.[20] Further, the draft rule language would make clear that 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.[21]

DRAFT INTERPRETIVE GUIDANCE ON DISCLOSURE OF IN-STATE BENEFITS UNDER RULE G-17

The MSRB has interpreted Rule G-17 to require a dealer to disclose to its customer at or prior to the time of trade (*i.e.*, at the point-of-sale) all material facts about the transaction known by the dealer, as well as material facts about the security that are reasonably accessible to the market.[22] In the 2002 MSRB Notice, the MSRB stated that Rule G-17 also obligates a dealer that sells to a customer an out-of-state college savings plan interest to disclose that, depending upon the laws of the customer's home state, favorable state tax treatment for investing in a college savings plan may be limited to investments made in a college savings plan offered by the customer's home state.[23] The obligation to disclose the potential loss of state tax benefits could be met if the required disclosure is included in the official statement delivered to the customer, appearing in a manner reasonably likely to be noted by an investor. This disclosure is required

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20 The draft amendment would modify the existing language of the interpretive guidance to explicitly state that further clarifying information may need to be included to ensure that the advertisement is not false or misleading. Because Rule G-21 already requires that advertisements not be false or misleading, this would not be a new principle under the rule.

21 This language, which does not appear in the existing interpretive language, recognizes that other regulatory organizations may apply their own rules to the extent of their regulatory jurisdiction. *See, e.g.*, NASD Special Notice to Members 03-17 – Sales Material for Municipal Fund Securities, March 25, 2003.

22 *See* Rule G-17 Interpretation – Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts, March 20, 2002, *reprinted in* MSRB Rule Book.

23 Since dealers could not reasonably be expected to become expert in state tax laws throughout the country, the MSRB noted that such disclosure, coupled with a suggestion that the customer consult a tax adviser about any state tax consequences of the investment, would provide adequate notice of the potential loss of in-state tax benefits. The MSRB observed, however, that if the dealer proceeded to provide information about state tax consequences, it must ensure under Rule G-17 that the information is not false or misleading.

in all transactions effected by a dealer with a customer investing in an out-of-state college savings plan, regardless of whether the dealer has made a recommendation to the customer.

In addition to state tax benefits, some states offer some or all of their residents, if they invest in their in-state college savings plan, other benefits such as scholarships to in-state colleges, matching grants into their college savings plan accounts, or reduced or waived program fees, among other benefits. In some cases, the value of these other benefits can be considerably higher than the state tax benefits offered by some states. This can be particularly true for those benefits that the state may specifically target toward its lower-income residents. The nature of these other benefits can vary from state to state even more than state tax benefits and may be even less well understood by the general investing public.

Thus, the MSRB is publishing for comment draft interpretive guidance that would broaden the existing Rule G-17 point-of-sale disclosure interpretation to include reference to other potential benefits offered solely in connection with in-state investments. The guidance would clarify that such disclosure made through the issuer's official statement is effective for purposes of the Rule G-17 point-of-sale disclosure obligation only if the official statement is provided to the customer at or prior to the time of trade and would strengthen the minimum standards for prominence in the official statement required to satisfy the disclosure obligation by means of the official statement.

The draft interpretive language is set forth below:

In the case of sales to a customer of out-of-state college savings plan interests, Rule G-17 requires a dealer to disclose, at or prior to the time of trade, that, depending upon the laws of the customer's home state, favorable state tax treatment for investing in a college savings plan or other benefits offered under state law in connection with investing in college savings plans may be available only if the customer invests in a college savings plan offered by the customer's home state. The dealer also must suggest to such customer that he or she consult with a qualified adviser or contact his or her home state's college savings plan to learn more about any state tax or other benefits that might be available in conjunction with an investment in that state's college savings plan.

This disclosure obligation may be met if the disclosure appears in the official statement, so long as the official statement has been delivered to the customer by the time of trade and the disclosure appears in the official statement in a manner that is reasonably likely to be noted by an investor. A presentation of this disclosure in the official statement in close proximity and with equal prominence to the first presentation of information regarding other federal or state tax-related consequences of investing in the college savings plan, and in close proximity and with equal prominence to each other presentation of information regarding state tax-related consequences of investing in the college savings plan, would be deemed to satisfy this requirement. However, the MSRB has no authority to mandate inclusion of any particular items in the official statement. Thus, if the issuer has not included this information in the official

statement in the described manner, the dealer would remain obligated to disclose such information separately to the customer under Rule G-17.

Of course, should the dealer proceed to provide information about state tax or other benefits available to an out-of-state investor, it must ensure that the information is not false or misleading. For example, a dealer would violate Rule G-17 if it were to inform a customer that investment in the college savings plan of the customer's own state did not provide the customer with any state tax or other benefit when the dealer knows or has reason to know that such benefit likely would be available. A dealer also would violate Rule G-17 if it were to inform a customer that investment in the college savings plan of another state would provide the customer with the same tax or other benefits as would be available if the customer were to invest in his or her own state's plan, if the dealer knows or has reason to know that this is not the case.

If the draft interpretive guidance is adopted, the MSRB would expect to withdraw the portions of the 2002 MSRB Notice relating to such Rule G-17 point-of-sale disclosure obligation. The MSRB seeks comments on all aspects of the draft interpretive guidance.

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Comments from all interested parties are welcome. Comments should be submitted no later than September 15, 2004 and may be directed to Ernesto A. Lanza, Senior Associate General Counsel, or Jill C. Finder, Assistant General Counsel. Written comments will be available for public inspection.

June 10, 2004

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TEXT OF DRAFT AMENDMENTS TO RULE G-21[24]

Rule G-21. Advertising.

(a)-(c) No change.

(d) *New Issue Advertisements*. In addition to the requirements of section (c), all advertisements for new issue municipal securities **(other than municipal fund securities)** shall ~~**also**~~ be subject to the following requirements:

(i)-(ii) No change.

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[24] Underlining signifies insertions; strikethrough signifies deletions.

(e) **[NEW SECTION]** *Municipal Fund Security Advertisements*. In addition to the requirements of section (c), all advertisements for municipal fund securities shall be subject to the following requirements:

(i) *Required disclosures*. Each advertisement for municipal fund securities:

(A) must include a statement that advises an investor to consider the investment objectives, risks, and charges and expenses associated with the municipal fund securities before investing; explains that more information about the securities is available in the issuer's official statement; identifies a source from which an investor may obtain an official statement; and states that the official statement should be read carefully before investing. In addition, the following disclosures must be included, as applicable:

(1) if the advertisement relates to municipal fund securities issued by a qualified tuition program under Internal Revenue Code Section 529, a statement that advises an investor to consider, before investing, whether the investor's home state offers any state tax or other benefits that are only available for investments in such state's qualified tuition program.

(2) if the advertisement is for a municipal fund security that the issuer holds out as having the characteristics of a money market fund, statements to the effect that an investment in the security is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency (unless such guarantee is provided by or on behalf of such issuer) and, if the security is held out as maintaining a stable net asset value, that although the issuer seeks to preserve the value of the investment at $1.00 per share or such other applicable fixed share price, it is possible to lose money by investing in the security.

(B) that includes performance data must include:

(1) a legend disclosing that the performance data included in the advertisement represents past performance; that past performance does not guarantee future results; that the investment return and the value of the investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost; and that current performance may be lower or higher than the performance data included in the advertisement; and

(2) if a sales load or any other nonrecurring fee is charged, the maximum amount of the load or fee and, if the sales load or fee is not reflected in the performance data included in the advertisement, a statement that the performance data does not reflect the deduction of the sales load or fee and that the performance data would be lower if such load or fee were included.

(C) must present the statements required by clauses (A) and (B) of this paragraph, when in a print advertisement, in a type size at least as large as and of a style different from, but at least as prominent as, that used in the major portion of the advertisement,

provided that when performance data is presented in a type size smaller than that of the major portion of the advertisement, the statements required by clause (B) of this paragraph may appear in a type size no smaller than that of the performance data. If an advertisement is delivered through an electronic medium, the legibility requirements for the statements required by clauses (A) and (B) of this paragraph relating to type size and style may be satisfied by presenting the statements in any manner reasonably calculated to draw investor attention to them. In a radio or television advertisement, the statements required by clauses (A) and (B) of this paragraph must be given emphasis equal to that used in the major portion of the advertisement. The statements required by clause (B) of this paragraph must be presented in close proximity to the performance data and, in a print advertisement, must be presented in the body of the advertisement and not in a footnote unless the performance data appears only in such footnote.

(ii) *Performance data*. Each advertisement that includes performance data relating to municipal fund securities must present performance data in the format, and calculated pursuant to the methods, prescribed in paragraph (d) of Securities Act Rule 482 (or, in the case of a municipal fund security that the issuer holds out as having the characteristics of a money market fund, paragraph (e) of Securities Act Rule 482), provided that:

(A) to the extent that information necessary to calculate performance data is not available from an applicable balance sheet included in a registration statement, or from a prospectus, the broker, dealer or municipal securities dealer shall use information derived from the issuer's official statement, otherwise made available by the issuer or its agents, or (when unavailable from the official statement, the issuer or the issuer's agents) derived from such other sources which the broker, dealer or municipal securities dealer reasonably believes are reliable;

(B) if the issuer first began issuing the municipal fund securities fewer than one, five, or ten years prior to the date of the submission of the advertisement for publication, such shorter period shall be substituted for any otherwise prescribed longer period in connection with the calculation of average annual total return or any similar returns;

(C) performance data shall be calculated as of the most recent calendar quarter ended prior to the submission of the advertisement for publication for which such performance data, or all information required for the calculation of such performance data, is reasonably available to the broker, dealer or municipal securities dealer as described in clause (A) of this paragraph;

(D) where such calculation is required to include expenses accrued under a plan adopted under Investment Company Act Rule 12b-1, the broker, dealer or municipal securities dealer shall include all such expenses as well as any expenses having the same characteristics as expenses under such a plan where such a plan is not required to be adopted under said Rule 12b-1 as a result of Section 2(b) of the Investment Company Act of 1940;

(E) notwithstanding any of the foregoing, this paragraph shall apply solely to the calculation of performance relating to municipal fund securities and does not apply to, or limit the applicability of any rule of the Commission, NASD or any other regulatory body relating to, the calculation of performance for any security held as an underlying asset of the municipal fund securities.

(iii) *Nature of issuer and security*. An advertisement for a specific municipal fund security must provide sufficient information to identify such specific security in a manner that is not false or misleading. An advertisement that identifies a specific municipal fund security must include the name of the issuer, presented in a manner no less prominent than any other entity identified in the advertisement, and must not imply that a different entity is the issuer of the municipal fund security. An advertisement must not raise an inference that, because municipal fund securities are issued under a government-sponsored plan, investors are guaranteed against investment losses if no such guarantee exists. If an advertisement concerns a specific class or category of an issuer's municipal fund securities (*e.g.*, A shares versus B shares; direct sale shares versus advisor shares; in-state shares versus national shares; etc.), this must clearly be disclosed in a manner no less prominent than the information provided with respect to such class or category.

(iv) *Capacity of dealer and other parties*. An advertisement that relates to or describes services provided with respect to municipal fund securities must clearly indicate the entity providing those services. An advertisement soliciting purchases of municipal fund securities that would be effected by a broker, dealer or municipal securities dealer or any other entity other than the broker, dealer or municipal securities dealer that publishes the advertisement must clearly state which entity would effect the transaction.

(v) *Tax consequences and other features*. Any discussion of tax implications or other benefits or features of investments in municipal fund securities included in an advertisement must not be false or misleading. In the case of an advertisement that includes statements regarding tax or other benefits offered under state or federal law, the advertisement must make clear the nature of such benefits and that the availability of such benefits may be materially limited based upon residency, purpose for or timing of share redemptions, or other factors, as applicable, which limitations must be described in the advertisement and presented in close proximity to, and in a manner no less prominent than, the description of such benefits.

(vi) *Underlying registered securities*. 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 must be presented in a manner that would be in compliance with any Commission or NASD advertising rules that would be applicable if the advertisement related solely to such underlying security; provided that details of the underlying security must be accompanied by any further statements relating to such details as are 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 paragraph does not limit the applicability of any rule of the Commission, 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 securities. **[END NEW SECTION]**

(f) ~~**(e)**~~ No change.

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The text of SEC Rule 482 is available at http://www.sec.gov/rules/final/33-8294.htm.
SEC Form N-1A is available at http://www.sec.gov/about/forms/formn-1a.pdf.
SEC Form N-3 is available at http://www.sec.gov/about/forms/formn-3.pdf.
SEC Form N-4 is available at http://www.sec.gov/about/forms/formn-4.pdf.

MSRB Notice 2005-28
(May 19, 2005)

Request for Comments on Draft Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans

Introduction

On May 14, 2002, the Municipal Securities Rulemaking Board ("MSRB") published interpretive guidance on the basic customer protection obligations that brokers, dealers and municipal securities dealers ("dealers") have when effecting transactions in municipal fund securities (the "2002 Notice").[1] During the three years since publication of the 2002 Notice, the 529 college savings plan ("529 plan") market has evolved and grown considerably, becoming a much more complex market involving a wider variety of investment options, a more diversified distribution system, and a constantly shifting backdrop of state tax treatment and other state-specific benefits and limitations.[2] In addition, concerns have been expressed about the quality of 529 plan disclosure, including the ability of investors to make meaningful comparisons among 529 plans; varying state tax treatment; the levels of fees and commissions charged in the 529 plan market; and questionable dealer sales practices. These concerns have triggered Congressional hearings on the 529 plan market and the formation of the Chairman's Task Force on College Savings Plans by the Securities and Exchange Commission ("SEC") to review market practices. Further, NASD has preliminarily found that many dealers market 529 plans predominantly to customers who are not residents of the state that offers the 529 plans sold, calling into question whether dealers are adequately undertaking suitability determinations in connection with their recommended transactions.[3]

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1 *See* "Application of Fair Practice and Advertising Rules to Municipal Securities," May 14, 2002, published in *MSRB Rule Book*.

2 529 college savings plans are established by states under Section 529(b)(A)(ii) of the Internal Revenue Code as "qualified tuition programs" through which individuals make investments for the purpose of accumulating savings for qualifying higher education costs of beneficiaries. Section 529 of the Internal Revenue Code also permits the establishment of so-called prepaid tuition plans by states and higher education institutions. All references to 529 plans are intended to encompass only 529 college savings plans established under Section 529(b)(A)(ii).

3 *See Oversight Hearing on 529 College Savings Plans, Hearing Before the Subcomm. on Financial Management, The Budget, and International Security of the Senate Comm. on Governmental Affairs*, 108th Cong. (2004) (testimony of Mary L. Schapiro, Vice Chairman and President, Regulatory Policy and Oversight, NASD).

As a result, the MSRB today is publishing for comment additional interpretive guidance on the disclosure, suitability and other customer protection obligations of dealers in connection with their marketing of 529 plans.

Background

***Advertising and Non-Cash Compensation*.** The 2002 Notice had provided guidance on dealer advertisements of municipal fund securities under Rule G-21, on advertising, as well as on dealer sales practices involving gifts or other sales inducements under Rule G-20, on gifts and gratuities, and Rule G-17, on fair dealing. In June 2004, the MSRB published for comment two rulemaking proposals that sought to substantially expand upon portions of the guidance provided in the 2002 Notice. On June 10, 2004, the MSRB published for comment draft amendments to Rule G-21 relating to advertisements of municipal fund securities and draft interpretive guidance on disclosures in connection with out-of-state sales of 529 plan shares.[4] The MSRB subsequently filed the advertising amendments with the SEC on December 16, 2004, at which time the MSRB also published for comment certain additional draft amendments to Rule G-21 to supplement the original amendments.[5] In addition, on June 15, 2004, the MSRB published for comment draft amendments to Rule G-20 to (among other things) incorporate provisions relating to non-cash compensation that would parallel existing requirements that apply to mutual fund sales.[6] The MSRB subsequently filed the Rule G-20 amendments with the SEC on January 13, 2005.

***Disclosures in Connection with Out-of-State Sales of 529 Plan Shares*.** In the 2002 Notice, the MSRB had established for the first time a requirement under Rule G-17 that dealers disclose to customers the potential loss of state tax benefits if investing in an out-of-state 529 plan rather than in the home state 529 plan. The MSRB has continued to review issues pertaining to the circumstances when a dealer markets a state's 529 plan to a customer who is not a resident of that state. The MSRB has also reviewed the comments it received on the portion of the June 10, 2004 notice relating to the draft interpretive guidance on disclosures in connection with out-of-state sales of 529 plan shares.[7] These comments are discussed briefly

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4 *See* MSRB Notice 2004-16 (June 10, 2004).

5 *See* MSRB Notice 2004-42 (December 16, 2004) and MSRB Notice 2004-43 (December 16, 2004).

6 *See* MSRB Notice 2004-17 (June 15, 2004).

7 The draft guidance sought to extend the existing disclosure obligation under Rule G-17 with respect to the possible loss of state tax benefits if investing in an out-of-state 529 plan to also include disclosure about the possible loss of other state-based benefits, as well as to establish certain presentation standards for satisfying this disclosure obligation through the program disclosure document.

below and have been carefully considered in the process of drafting portions of the draft interpretation that is being published today and appears below.

All commentators supported the importance of ensuring some degree of disclosure to customers of state-specific features of 529 plans but many suggested technical changes, took issue with various portions of the draft interpretive guidance, or sought more extensive point-of-sale disclosures. Some commentators questioned whether the MSRB should be establishing presentation standards for satisfying the proposed disclosure requirement in the program disclosure document. Others suggested that the MSRB adopt language to the same general effect as language included in the Voluntary Disclosure Principles Statement No. 1 adopted on December 2, 2004 by the College Savings Plan Network, an affiliate of the National Association of State Treasurers.

Some commentators emphasized that assessing the state-to-state differences in tax treatment and other unique features of 529 plans is extremely complex and expressed concern that disclosure at the point-of-sale of these issues may be incomplete and, therefore, possibly misleading. In addition, they stated that not every difference in state treatment ultimately will be a benefit to the investor. They suggested that the best course would be to remind investors to carefully review the program disclosure document of their home state programs and to consult their own advisors before investing. However, one commentator stated that it would be inappropriate to suggest to investors that they seek help from their home state programs because it is unclear whether the programs can provide complete information regarding such consequences and because some states may seek to persuade investors to make an investment in their program rather than to impart disinterested information. This commentator also was concerned about the potential for over-emphasizing state variations in a way that may detract from more fundamental considerations in making an investment decision.

Two commentators stated that the MSRB should put in place a broader set of disclosure requirements to accompany the proposed disclosures described in the draft guidance. One commentator suggested that the MSRB require standardized point-of-sale disclosure of fees and compensation in a manner similar to the point-of-sale disclosure requirements included by the SEC in its proposed Exchange Act Rule 15c2-3.[8] The proposed rulemaking by the SEC would apply to dealer sales of 529 plan interests, in addition to sales of mutual funds and variable annuities. Another commentator described an academic study on the tax and non-tax factors that influence investors' choices of 529 plans and concluded that "investors appear to be choosing high fee/broker sold funds rather than the lower fee, direct investment options . . . [and] appear to be ignoring state tax benefits." Stating that its study suggested that investors may not have sufficient information in these areas, this commentator supported mandating disclosure of not only state tax benefits but also uniform disclosure of fees and performance for each 529 plan

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[8] *See* Securities Act Release No. 8358 (January 29, 2004) and Securities Act Release No. 8544 (February 28, 2005).

portfolio and for each underlying fund in such portfolio, as well as the percentage of total investments that each underlying fund represents with respect to such 529 plan portfolio.

Revised Draft Interpretation

The MSRB agrees that understanding the full repercussions of state tax and other state law treatment of investments in 529 plans can be extraordinarily difficult and time consuming. The MSRB also agrees that not all differences in treatment necessarily result in a net benefit to any particular customer. The MSRB has previously stated that there is a potential for over-emphasizing the importance of a particular state's beneficial state tax treatment of an investment in its 529 plan, such as where a state offers a tax benefit that ultimately is relatively small in value compared to the financial impact that a marginally higher expense figure may have. As a result, the MSRB has stated that any state tax benefits offered with respect to a particular 529 plan should be considered as one of many appropriately weighted factors that have an ultimate influence on a customer's investment decision.[9]

The MSRB has been informed that some dealers may have taken the view that the disclosure obligation with respect to out-of-state investments established in the 2002 Notice was intended to conclusively limit the obligation of dealers to make disclosures at the point-of-sale with respect to state tax matters solely to the statement that the investor's home state may offer state tax benefits only for in-state investments. In addition, some dealers may have taken the view that this disclosure obligation was intended to obviate the need to consider any state tax matters when making a suitability determination in connection with a recommended transaction. Both of these views are unwarranted, as the specific disclosures first established under the 2002 Notice do not limit the previously existing obligation under Rule G-17 for dealers to disclose at the point-of-sale all material facts known by dealers about the 529 plan interests they are selling to customers, as well as material facts about such investments reasonably accessible to the market through established industry sources.[10] Further, these specific disclosures do not relieve dealers of their suitability obligations – including their obligation to consider the customer's financial status, tax status and investment objectives – if they have recommended the transaction.

In view of the changes to the 529 plan market, the challenges that this market faces, the preliminary findings of NASD and the apparent misunderstanding of the interplay between disclosure and suitability requirements – as well as after consultations with SEC staff – the MSRB believes that it would be appropriate to provide further guidance in this area. To that

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9 *See Oversight Hearing on 529 College Savings Plans, Hearing Before the Subcomm. on Financial Management, The Budget, and International Security of the Senate Comm. on Governmental Affairs*, 108th Cong. (2004) (testimony of Ernesto A. Lanza, Senior Associate General Counsel, MSRB).

10 *See* Rule G-17 Interpretation – Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts, March 20, 2002, published in *MSRB Rule Book*.

end, the MSRB is publishing the following draft interpretation for industry comment. In order to ensure that dealers fully understand their fair practice and disclosure duties to their customers in the specific context of the 529 plan market, the draft interpretation provides a substantially more detailed discussion of several areas previously reviewed in the 2002 Notice.[11]

The MSRB welcomes comments from all interested parties on all aspects of the draft interpretive guidance that follows. **Comments should be submitted no later than July 29, 2005 and may be directed to Ernesto A. Lanza, Senior Associate General Counsel, or Ghassan Hitti, Assistant General Counsel.** Written comments will be available for public inspection.

May 19, 2005

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[11] For example, the draft interpretation substantially reworks the draft interpretive guidance published on June 10, 2004 and provides new guidance as to the broader disclosure requirements under Rule G-17. In addition, the draft interpretation significantly expands upon the discussion of suitability that appears in the 2002 Notice. Other portions of the 2002 Notice are also included in the draft interpretation with little or no change as the 2002 Notice will be superseded once the draft interpretation, as well as the advertising and Rule G-20 amendments described above, become effective.

DRAFT INTERPRETATION ON CUSTOMER PROTECTION OBLIGATIONS RELATING TO THE MARKETING OF 529 COLLEGE SAVINGS PLANS

The 529 college savings plan ("529 plan") market is continuously evolving and represents a unique intersection between the investment company market and the public sector financial market.[1] The convergence of these two seemingly dissimilar markets can result in some confusion as to how otherwise familiar customer protection rules of fair practice and disclosure are meant to apply to the activities of brokers, dealers and municipal securities dealers ("dealers") with their customers. The Municipal Securities Rulemaking Board ("MSRB") is publishing this interpretation to ensure that dealers in this market fully understand their fair practice and disclosure duties to their customers. The MSRB emphasizes that the guidance provided in this interpretation, except where otherwise specifically noted, applies to dealer activities solely in the 529 plan market and necessarily arises from the unique context of this market.

Basic Customer Protection Obligation

At the core of the MSRB's customer protection rules is Rule G-17, which provides that, in the conduct of its municipal securities activities, each dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest or unfair practice. The rule encompasses two basic principles: an anti-fraud prohibition similar to the standard set forth in Rule 10b-5 adopted by the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934 (the "Exchange Act"), and a general duty to deal fairly even in the absence of fraud. All activities of dealers must be viewed in light of these basic principles, regardless of whether other MSRB rules establish specific requirements applicable to such activities.

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[1] 529 college savings plans are established by states under Section 529(b)(A)(ii) of the Internal Revenue Code as "qualified tuition programs" through which individuals make investments for the purpose of accumulating savings for qualifying higher education costs of beneficiaries. Section 529 of the Internal Revenue Code also permits the establishment of so-called prepaid tuition plans by states and higher education institutions. All references herein to "529 plans" are intended to encompass only 529 college savings plans established under Section 529(b)(A)(ii). In addition, Rule D-12 defines municipal fund security as a municipal security issued by an issuer that, but for the application of Section 2(b) of the Investment Company Act of 1940, would constitute an investment company within the meaning of Section 3 of that Act. This guidance applies solely to investments in 529 plans, with the exception that the discussion under the heading "Other Sales-Related Activities" below is applicable more broadly to other forms of municipal fund securities as well, such as interests in local government investment pools. However, no portion of this guidance shall apply to municipal securities other than municipal fund securities.

Disclosure

Point-of-Sale Disclosures and Established Industry Sources. The MSRB has previously interpreted Rule G-17 to require a dealer to disclose to its customer at or prior to the time of trade (or point-of-sale) all material facts about a municipal security transaction (including a 529 plan transaction) known by the dealer, as well as material facts about the municipal security that are reasonably accessible to the market.[2] Thus, a dealer would be responsible for disclosing to a customer any material fact concerning a municipal security transaction made publicly available through sources such as the system of nationally recognized municipal securities information repositories ("NRMSIRs"), the MSRB's Municipal Securities Information Library® system and Real-Time Transaction Reporting System ("RTRS"), rating agency reports and other sources of information relating to the municipal securities transaction generally used by dealers that effect transactions in the type of municipal securities at issue (collectively, "established industry sources"). This duty applies in every transaction, regardless of whether the transaction has been recommended by the dealer.

In considering what would constitute established industry sources, the MSRB has observed that the customs and practices of the industry suggest that the sources of information generally used by a dealer that effects transactions in municipal securities may vary with the type of municipal security. Among other things, a more complex security generally would dictate that a dealer take into account a broader range of information sources than it would for a simpler security.[3] Due to the complexity of the 529 plan market and the decentralized nature of information sources in this market, the MSRB views established industry sources for the 529 plan market as encompassing a broad variety of information sources that professionals in this marketplace can and do use to obtain material information about these investments and the programs through which they are issued.[4]

For example, each 529 plan currently hosts an internet website where information concerning the plan, including the program disclosure document,[5] can be reviewed. Centralized

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2 *See* Rule G-17 Interpretation – Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts, March 20, 2002, published in *MSRB Rule Book*.

3 *Id*.

4 The MSRB observes that most of the traditional centralized established industry sources in the municipal securities market (including but not limited to the NRMSIRs, RTRS and the municipal securities information vendors) are designed specifically for debt securities and do not currently have established methods for making any information they may have with respect to 529 plans readily available to dealers or investors.

5 As used in this notice, the term "program disclosure document" has the same meaning as official statement under MSRB and SEC rules.

directories of links to these websites are available from a number of sources, including the website of the College Savings Plan Network ("CSPN") and certain commercial websites devoted exclusively or in part to the 529 plan market. The MSRB views these centralized websites providing links to the official 529 plan websites, as well as such official 529 plan websites themselves (whether accessed directly or through one of the centralized websites), as established industry sources for information on 529 plans.

Many of the centralized websites also provide, in summary and often tabular form, some categories of information for all available 529 plans. Such information can include fees and expenses, minimum and maximum investments, distribution channels, and state tax treatment, as well as proprietary ratings based on varying criteria. Much of this information is available at no cost. However, some of these key items of data – particularly information on state tax treatment and fees and expenses – are extremely complex and are difficult to fully summarize in tabular or similar presentations without a significant risk that material facts may be omitted or may not be fully explained. Thus, for a user to fully understand the potential fees and expenses of investing in a particular 529 plan, the potential state tax ramifications for making such an investment, the specific nature of the securities underlying a particular investment option, and a host of other matters, additional diligence must be exercised, including the review of the current program disclosure document and any other relevant information available from the official 529 plan website or other readily available materials of the 529 plan. In the MSRB's view, a dealer cannot be satisfied that it has discovered all material facts about a 529 plan available from established industry sources merely by reviewing information available from one of these centralized websites unless it has previously determined through its own diligence that any such website does in fact provide sufficiently complete and timely information that would otherwise be available from the official 529 plan website or other readily available materials of the 529 plan.

The MSRB seeks comment on the feasibility of creating one or more centralized websites (or enhancing existing web-based resources) that would provide on-site summary information formatted to allow dealers and customers to make meaningful comparisons of the material features of 529 plans, together with direct links to all 529 plan program disclosure documents and related information. The types of material features summarized on such a site would include, but not be limited to, state tax treatment and other state-based benefits (as hereinafter defined) and costs associated with investments and performance information, with the ability to easily access more detailed information directly from the summary information.[6] The goal of

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[6] For example, summary information available on the centralized website could have embedded therein direct hyperlinks to the portions of the program disclosure document or other 529 plan materials that provide more detailed descriptions of the summarized information. In addition, the centralized website could provide hyperlinks to websites, or other contact information for, sources providing performance data current to the most recent month-end, as would be required under the draft amendments to Rule G-

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such on-line sites would be to provide summary information that is sufficiently complete and understandable to permit dealers to fully rely on the websites to meet their obligation to review established industry sources. Is such a centralized resource feasible on a commercial basis or by the appropriate industry organizations, or should the MSRB itself seek to establish a centralized hub for free and ready access to such material information for dealers and investors? The MSRB notes that such a centralized hub would require significant resources to establish and maintain. Were the MSRB to establish such a resource, its prior decision to exempt 529 plan offerings from the underwriting assessment established under Rule A-13 would need to be revisited to ensure adequate funding for its establishment and operation.

The MSRB believes that more comprehensive and complete centralized websites could greatly streamline the process dealers must currently undertake to satisfy their obligation to review what information is available from established industry sources. In addition, such streamlining would greatly improve direct customer access to such information, which is particularly crucial in circumstances where customers may make investments directly through 529 plans without the assistance of dealers.

The program disclosure documents prepared by 529 plans are not required to conform to the prospectus requirements of the Investment Company Act, which establish uniform standards for disclosure in the mutual fund industry.[7] However, the MSRB observes that CSPN has adopted Disclosure Principles Statement No. 1, which is intended to establish baseline standards for disclosure that have assisted in improving the quality and comparability of disclosures made by an increasing number of 529 plans. Although the MSRB understands that the program disclosure documents for 529 plans are available at no cost on the internet, dealers and investors wishing to review program disclosure documents must navigate through widely varying websites to find such documents. It is hoped that, once universal adoption of the Disclosure Principles is attained, users will be able to navigate the program disclosure documents themselves with some ease to find the desired information. The MSRB urges CSPN and the individual 529 plans to strive for the maximum possible ease of access to, and uniformity of content in, the program disclosure documents consistent with providing information that is complete, understandable and not misleading.

Special Disclosure Considerations in Connection with Availability of State-Based Benefits. The MSRB believes that Rule G-17 prohibits a dealer from misleading a customer

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21(e)(ii)(C) previously published by the MSRB and soon to be filed with the SEC. *See* MSRB Notice 2004-43 (December 16, 2004).

[7] Where a dealer serves as primary distributor for a state's 529 plan, such dealer is required to contract with the state plan to receive a program disclosure document from the plan that conforms to the minimal standards of Exchange Act Rule 15c2-12. However, if no broker-dealer is involved in the distribution process for a state's 529 plan, no requirement exists for the state plan to produce or deliver a disclosure document.

regarding the availability of state tax benefits or other valuable benefits[8] offered by the state in connection with an investment in a 529 plan (collectively referred to as "state-based benefits"). For example, a dealer would violate Rule G-17 if it were to inform a customer that investment in the 529 plan of the customer's own state did not provide the customer with any state tax benefit when the dealer knows or has reason to know that such a state tax benefit likely would be available. Furthermore, a dealer would violate Rule G-17 if it were to inform a customer that investment in the 529 plan of another state would provide the customer with the same tax benefits as would be available if the customer were to invest in his or her own state's 529 plan, if the dealer knows or has reason to know that this is not the case.[9] Dealers should make certain that information they provide to their customers, whether provided under an affirmative disclosure obligation imposed by MSRB rules or in response to questions from customers, is correct and not misleading.

In the case of sales to a customer of out-of-state 529 plan interests, the MSRB has determined to modify its existing view of a dealer's Rule G-17 disclosure obligation to now require the dealer to disclose, at or prior to the time of trade, that, depending upon the laws of the home state of the customer or designated beneficiary, favorable state-based benefits offered by the state in connection with investing in 529 plans may be available only if the customer invests in a 529 plan offered by the home state of the customer or designated beneficiary.[10] The dealer

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8 The MSRB recognizes that there are innumerable factors, other than state tax laws, that vary from state to state that can have a positive impact on the economic benefit of a particular investment. Only those state-based benefits that are specifically targeted toward investments in the state's own 529 plan are considered valuable benefits to which the requirements enunciated in this notice apply. For example, a matching grant or scholarship from the state provided only if a customer invests in that state's 529 plan would be considered a valuable benefit. On the other hand, a general state law provision that investments or other assets held in a financial institution or issued by an issuer within the state are afforded certain state bankruptcy protections would not give rise to a valuable benefit under this notice, although a law that specifically singles out investments in the state's 529 plan for such protection would give rise to such a valuable benefit.

9 Dealers should note that these examples are illustrative and do not limit the circumstances under which, depending on the facts and circumstances, a Rule G-17 violation could occur.

10 The laws of the 50 jurisdictions that currently offer 529 plans vary greatly and, as a result, no precise definition is provided for what would be considered the customer's or designated beneficiary's home state. Rather, the MSRB would view the term "home state" to encompass any state in whose 529 plan an investment would likely provide the customer or the designated beneficiary with state-based benefits unavailable to investors not having the types of connections with the state as those of the customer or designated beneficiary. Although legal residence within a state would be presumed to establish such state as a home state, additional states could be considered home states of a particular

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also must advise the customer that any state-based benefit offered with respect to a particular 529 plan should be considered as one of many appropriately weighted factors that should be considered by the customer in making his or her investment decision.

To comply with this point-of-sale disclosure requirement, the dealer has a duty to inquire whether the customer or designated beneficiary is a resident of the state of the 529 plan being marketed to the customer. If the customer or designated beneficiary is not, the MSRB has determined to require that, concomitant with this inquiry and after advising the customer of the possible loss of state-based benefits offered by the home state, the dealer must inquire whether realizing state-based benefits is an important factor in the customer's investment decision. If the customer indicates that realizing state-based benefits is an important factor, the dealer is then required to disclose material information available from established industry sources about state-based benefits offered by the home state of the customer or designated beneficiary for investing in its 529 plan and whether such state-based benefits are available in the case of an investment in an out-of-state 529 plan. In conjunction with this newly-required disclosure, the dealer also must suggest that the customer consult with his or her financial, tax or other adviser to learn more about how such home state features (including any limitations) may apply to the customer's specific circumstances, and that the customer also may wish to contact his or her home state or any other 529 plan to learn more about any state-based benefits (and any limitations thereto) that might be available in conjunction with an investment in that state's 529 plan.[11]

Dealers are reminded that this specific disclosure obligation with respect to sales of out-of-state 529 plan interests – which involves providing information to the customer about an investment option other than the 529 plan interests being offered by such dealers – is in addition to their existing general obligation under Rule G-17 to disclose to their customers at the point-of-sale all material facts known by dealers about the 529 plan interests they are selling to the customers, as well as material facts about such 529 plan that are reasonably accessible to the market through established industry sources. Further, dealers are reminded that disclosures made to customers as required under MSRB rules with respect to 529 plans do not relieve dealers of their suitability obligations – including their obligation to consider the customer's financial status, tax status and investment objectives – if they have recommended investments in 529 plans, as discussed below.

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individual to the extent that the individual is legally able to enjoy state-based benefits that are generally limited to residents of the state. For example, a customer that is a not a legal resident of a state might, depending on the laws of that state, nonetheless incur tax liabilities within the state that can legally be off-set or avoided by investing in that state's 529 plan, such as a partner in a multi-state partnership.

[11] Although this suggestion to consult an advisor does not relieve the dealer of any obligations under MSRB rules, including but not limited to those described in this notice, it does serve to emphasize to customers that investments in 529 plans are complex and that customers should seek advice from those who are best positioned to provide it.

Point-of-Sale Disclosure Through the Program Disclosure Document. The general point-of-sale disclosure obligation under Rule G-17 may be satisfied if the material information required to be disclosed pursuant to that obligation appears in the program disclosure document, so long as the program disclosure document has been delivered to the customer at or prior to the time of trade and the disclosure appears in the program disclosure document in a manner that is reasonably likely to be noted by an investor.[12] With respect to the disclosure regarding state-based benefits, a presentation of this disclosure in the program disclosure document in close proximity and with equal prominence to the principal presentation of substantive information regarding other federal or state tax-related consequences of investing in the 529 plan, and the inclusion of a reference to this disclosure in close proximity and with equal prominence to each other presentation of information regarding state tax-related consequences of investing in the 529 plan, would be deemed to satisfy this requirement.[13] Of course, if the dealer is required to provide to an out-of-state customer information about state-based benefits of his or her home state 529 plan, such disclosure likely would not be included in the program disclosure document of the out-of-state 529 plan and would need to be provided separately.[14]

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[12] The delivery of the program disclosure document to customers pursuant to Rule G-32, which only requires delivery by settlement of the transaction, would be timely for purposes of Rule G-17 only if such delivery is accelerated so that it is received by the customer by no later than the point-of-sale.

[13] Thus, if the program disclosure document contains a series of sections in which the principal disclosures of substantive information on state-tax related consequences of investing in the 529 plan appear, a single inclusion of the required disclosure within, at the beginning or at the end of such series would be satisfactory for purposes of the inclusion with the principal presentation of such other disclosures. Similarly, if the program disclosure document includes any other series of statements on state-tax related consequences, such as might exist in a summary statement appearing at the beginning of some program disclosure documents, a single prominent reference in the summary statement to the fuller disclosure relating to out-of-state investments appearing elsewhere in the program disclosure document would be satisfactory.

[14] Although it is possible that disclosure to the customer of his or her home state's state-based benefits could be provided through the program disclosure document of the home state's 529 plan, such disclosure would be effective only if the discussion included in the program disclosure document describes whether such state-based benefits are also available to an investor who invests in an out-of-state 529 plan. Furthermore, the dealer would be required to direct the customer's attention to the specific discussion included in the program disclosure document, rather than to merely provide a copy of the full program disclosure document without such direction.

The MSRB acknowledges that it has no authority to mandate inclusion of any particular items in the program disclosure document and issuers are free to include in their program disclosure document only such information as they deem appropriate in the manner they deem appropriate.[15] Dealers who wish to rely on the program disclosure document for fulfillment of their disclosure obligations under Rule G-17 are responsible for understanding what is included within the program disclosure document of any 529 plan they market and for determining whether such information is sufficient to meet the dealers' disclosure obligation. Notwithstanding any of the foregoing, disclosure through the program disclosure document as described above is not the sole manner in which a dealer may fulfill its obligation to make the required disclosures under Rule G-17. Thus, if the issuer has not included the material information that the dealer is required to disclose under Rule G-17, or if such information is not presented in the program disclosure document with adequate prominence, the dealer would remain obligated to disclose such information separately to the customer under Rule G-17 by no later than the point-of-sale.

Suitability of Recommended Transactions

General Requirements. Under Rule G-19, a dealer that recommends to a customer a transaction in a security must have reasonable grounds for believing that the recommendation is

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[15] However, the MSRB notes that Exchange Act Rule 15c2-12(f)(3) defines a "final official statement" as:

> a document or set of documents prepared by an issuer of municipal securities or its representatives that is complete as of the date delivered to the Participating Underwriter(s) and that sets forth information concerning the terms of the proposed issue of securities; information, including financial information or operating data, concerning such issuers of municipal securities and those other entities, enterprises, funds, accounts, and other persons material to an evaluation of the Offering; and a description of the undertakings to be provided pursuant to paragraph (b)(5)(i), paragraph (d)(2)(ii), and paragraph (d)(2)(iii) of this section, if applicable, and of any instances in the previous five years in which each person specified pursuant to paragraph (b)(5)(ii) of this section failed to comply, in all material respects, with any previous undertakings in a written contract or agreement specified in paragraph (b)(5)(i) of this section.

Section (b) of that rule requires that the participating underwriter review a "deemed-final" official statement and contract to receive the final official statement from the issuer. *See* Rule D-12 Interpretation – Interpretation Relating to Sales of Municipal Fund Securities in the Primary Market, January 18, 2001, published in *MSRB Rule Book*, for a discussion of the applicability of Exchange Act Rule 15c2-12 to offerings of 529 plans.

suitable, based upon information available from the issuer of the security or otherwise and the facts disclosed by or otherwise known about the customer.[16] To assure that a dealer effecting a recommended transaction with a non-institutional customer has the information needed about the customer to make its suitability determination, the rule requires the dealer to make reasonable efforts to obtain information concerning the customer's financial status, tax status and investment objectives, as well as any other information reasonable and necessary in making the recommendation.[17] Dealers are reminded that the obligation arising under Rule G-19 in connection with a recommended transaction requires a meaningful analysis that establishes the reasonable grounds for believing that the recommendation is suitable. Pursuant to Rule G-27(c), dealers must have written supervisory procedures in place that are reasonably designed to ensure compliance with this obligation to undertake a suitability analysis in connection with every recommended transaction under Rule G-19, and dealers must enforce these procedures to ensure that such meaningful analysis does in fact occur in connection with the dealer's recommended transactions.

In the context of a recommended transaction relating to a 529 plan, the MSRB believes that it is crucial for dealers to remain cognizant of the fact that these instruments are designed for a particular purpose and that this purpose generally should match the customer's investment objective. For example, dealers should bear in mind the potential tax consequences of a customer making an investment in a 529 plan where the dealer understands that the customer's investment objective may not involve use of such funds for qualified higher education expenses.[18] Furthermore, investors generally are required to designate a specific beneficiary under a 529 plan. The MSRB believes that information known about the designated beneficiary generally would be relevant in weighing the investment objectives of the customer, including (among other things) information regarding the age of the beneficiary and the number of years until funds will be needed to pay qualified higher education expenses of the beneficiary. The MSRB notes that, since the person making the investment in a 529 plan retains significant

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16 The MSRB has previously stated that most situations in which a dealer brings a municipal security to the attention of a customer involve an implicit recommendation of the security to the customer, but determining whether a particular transaction is in fact recommended depends on an analysis of all the relevant facts and circumstances. *See* Rule G-19 Interpretive Letter – Recommendations, February 17, 1998, published in *MSRB Rule Book*. The MSRB also has provided guidance on recommendations in the context of on-line communications in Rule G-19 Interpretation – Notice Regarding Application of Rule G-19, on Suitability of Recommendations and Transactions, to Online Communications, September 25, 2002, *MSRB Rule Book.*

17 Rule G-8(a)(xi)(F) requires that dealers maintain records for each customer of such information about the customer used in making recommendations to the customer.

18 *See* Section 529(c)(3) of the Internal Revenue Code. State tax laws also may result in certain adverse consequences for use of funds other than for educational costs.

control over the investment (*e.g.*, may withdraw funds, change plans, or change beneficiary, etc.), this person is appropriately considered the customer for purposes of Rule G-19 and other MSRB rules. As noted above, information regarding the designated beneficiary should be treated as information relating to the customer's investment objective for purposes of Rule G-19.

In many cases, dealers may offer the same investment option in a 529 plan sold with different commission structures. For example, an A share may have a front-end load, a B share may have a contingent deferred sales charge or back-end load that reduces in amount depending upon the number of years that the investment is held, and a C share may have an annual asset-based charge. A customer's investment objective – particularly, the number of years until withdrawals are expected to be made – can be a significant factor in determining which share class would be suitable for the particular customer.

Rule G-19(e), on churning, prohibits a dealer from recommending transactions to a customer that are excessive in size or frequency, in view of information known to such dealer concerning the customer's financial background, tax status and investment objectives. Thus, for example, where the dealer knows that a customer is investing in a 529 plan with the intention of receiving the available federal tax benefit, such dealer could, depending upon the facts and circumstances, violate rule G-19(e) if it were to recommend roll-overs from one 529 plan to another with such frequency as to lose the federal tax benefit. Even where the frequency does not imperil the federal tax benefit, roll-overs recommended year after year by a dealer could, depending upon the facts and circumstances (including consideration of legitimate investment and other purposes), be viewed as churning. Similarly, depending upon the facts and circumstances, where a dealer recommends investments in one or more plans for a single beneficiary in amounts that far exceed the amount that could reasonably be used by such beneficiary to pay for qualified higher education expenses, a violation of rule G-19(e) could result.[19]

Additional Requirements in Connection With Out-of-State Sales. Due to the unique nature of the 529 plan market, the MSRB has determined to now require that a dealer recommending an out-of-state 529 plan to a customer who has indicated that one of his or her investment objectives is the realization of state-based benefits to take this factor into account in undertaking a suitability determination. This would involve – in addition to the traditional suitability analysis to establish the existence of reasonable grounds for recommending the offered security to the customer based on information about that offered security – the consideration of the state-based benefits available from the customer's home state 529 plan in a

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[19] The MSRB understands that investors may change designated beneficiaries and therefore amounts in excess of what a single beneficiary could use ultimately might be fully expended by additional beneficiaries. The MSRB expresses no view as to the applicability of federal tax law to any particular plan of investment and does not interpret its rules to prohibit transactions in furtherance of legitimate tax planning objectives, so long as any recommended transaction is suitable.

comparative analysis with the out-of-state 529 plan being offered. Of course, any state-based benefits offered with respect to a particular 529 plan should be considered as but one of many appropriately weighted factors that have an ultimate bearing on the relative strengths of a particular investment, and the existence of state-based benefits does not create a presumption that investment in the home state 529 plan is necessarily superior to an out-of-state 529 plan.

Thus, depending on the facts and circumstances in connection with a specific customer, it is possible that a dealer undertaking this new comparative suitability analysis might conclude that an investment in the home state 529 plan would be superior to an investment in the offered out-of-state 529 plan under every reasonable scenario. In this case, the dealer would be obligated to inform the customer of this determination and would be permitted to effect a transaction in the offered out-of-state 529 plan only if (1) an investment in such out-of-state 529 plan would be considered suitable for the particular investor under traditional suitability standards (*i.e.*, without regard to the comparison with the 529 plan of the customer's home state), and (2) the customer nonetheless directs that the dealer effect the transaction after having been informed of the dealer's determination that an investment in the 529 plan of the customer's home state would be more suitable.[20] A dealer effecting a transaction under these circumstances would be required to maintain records of any such customer directions and such transactions would require prompt review and approval by a principal. If a customer is making periodic investments pursuant to such a direction, the dealer must confirm such direction at least annually.

Other Sales-Related Activities

Dealers must keep in mind the requirements under Rule G-17 – that they deal fairly with all persons and that they not engage in any deceptive, dishonest or unfair practice – when considering the appropriateness of day-to-day sales-related activities with respect to municipal fund securities, including 529 plans. In some cases, certain sales-related activities are governed in part by specific MSRB rules, such as Rule G-19 (as described above) and Rule G-30(b), on commissions.[21] Other activities may not be explicitly addressed by a specific MSRB rule. In either case, the general principles of Rule G-17 always apply.

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[20] If the dealer is authorized to market the customer's home state 529 plan, it may of course sell such home state 529 plan interests to the customer. If the dealer is not then authorized to market the customer's home state 529 plan, it may wish to contact the 529 plan or its primary distributor (if any) to gain such authorization and to sell the home state 529 plan interests to the customer. The MSRB recognizes that this second option may not always be available, such as where the home state 529 plan is distributed solely through state personnel or through a primary distributor without the use of selling dealers.

[21] The MSRB has previously provided guidance on dealer commissions in Rule G-30 Interpretation – Interpretive Notice on Commissions and Other Charges, Advertisements and Official Statements Relating to Municipal Fund Securities, December 19, 2001, published in *MSRB Rule Book*. The MSRB believes that Rule G-30(b), as interpreted in

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In particular, dealers must ensure that they do not engage in transactions primarily designed to increase commission revenues in a manner that is unfair to customers under Rule G-17. Thus, in addition to being a potential violation of Rule G-19 as discussed above, recommending a particular share class to a customer that is not suitable for that customer, or engaging in churning, may also constitute a violation of Rule G-17 if the recommendation was made for the purpose of generating higher commission revenues. Also, where a dealer offers investments in multiple 529 plans, consistently recommending that customers invest in the one 529 plan that offers the dealer the highest compensation may, depending on the facts and circumstances, constitute a violation of Rule G-17 if the recommendation of such 529 plan over the other 529 plans offered by the dealer does not reflect a legitimate investment-based purpose.

Further, recommending transactions to customers in amounts designed to avoid commission discounts (*i.e.*, sales below breakpoints where the customer would be entitled to lower commission charges) may also violate Rule G-17, depending upon the facts and circumstances. For example, a recommendation that a customer invest in two separate but nearly identical municipal fund securities for the purposes of avoiding a reduced commission rate that would be available upon purchasing a larger quantity of a single such security, or that a customer time his or her multiple investments in a municipal fund security so as to avoid being able to take advantage of a lower commission rate, in either case without a legitimate investment-based purpose, could violate Rule G-17.

With respect to sales incentives, the MSRB has previously interpreted Rule G-20, relating to gifts and gratuities, to require a dealer that sponsors a sales contest involving representatives who are not employed by the sponsoring dealer to have in place written agreements with these representatives.[22] In addition, the general principles of Rule G-17 are applicable. Thus, if a dealer or any of its associated persons engages in any marketing activities that result in a customer being treated unfairly, or if the dealer or any of its associated persons engages in any deceptive, dishonest or unfair practice in connection with such marketing activities, Rule G-17 could be violated. The MSRB believes that, depending upon the specific facts and circumstances, a dealer may violate Rule G-17 if it acts in a manner that is reasonably likely to induce another dealer or such other dealer's associated persons to violate the principles of Rule G-17 or other MSRB customer protection rules, such as Rule G-19 or Rule G-30. Dealers are also reminded that the MSRB has filed with the SEC proposed amendments to Rule G-20 in connection with non-cash compensation that, when approved by the SEC, would establish standards regarding incentives for sales of municipal securities, including 529 plan

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(. . . continued)

this 2001 guidance, should effectively maintain dealer charges for 529 plan sales at a level consistent with, if not lower than, the sales loads and commissions charged for comparable mutual fund sales.

22 *See* Rule G-20 Interpretive Letter – Authorization of sales contests, June 25, 1982, published in *MSRB Rule Book*.

interests, that are substantially similar to those currently applicable to sales of mutual fund shares.

Alphabetical List of Comment Letters on MSRB Notice 2004-16 (June 10, 2004) (the "2004 Proposal") and MSRB Notice 2005-28 (May 19, 2005) (the "2005 Proposal")

1. A.G. Edwards and Sons, Inc.: Letter to Ernesto A. Lanza, MSRB, from Thomas M. Yacovino, Vice President (August 3, 2005) relating to 2005 Proposal
2. Alexander, Raquel, PhD, Assistant Professor of Accounting, University of Kansas, and Luna, LeAnn, PhD., Assistant Professor of Accounting, University of Tennessee: Letter to Ernesto A. Lanza, MSRB (July 26, 1005) relating to 2005 Proposal
3. College Savings Foundation: Letter to Ernesto A. Lanza, MSRB, from David J. Pearlman, Chairman (September 13, 2004) relating to 2004 Proposal
4. College Savings Foundation: Letter to Ernesto A. Lanza, MSRB, from David J. Pearlman, Chairman (July 29, 2005) relating to 2005 Proposal
5. College Savings Foundation: Letter to Ernesto A. Lanza, MSRB, from David J. Pearlman, Chairman (February 13, 2006) relating to 2005 Proposal
6. College Savings Plans Network: Letter to Ernesto A. Lanza, MSRB, from Diana F. Cantor, Chair, and Executive Director, Virginia College Savings Plan (September 15, 2004) relating to 2004 Proposal
7. College Savings Plans Network: Letter to Ernesto A. Lanza, MSRB, from Tim Berry, Chair, and Indiana State Treasurer (July 29, 2005) relating to 2005 Proposal
8. College Savings Plans of Maryland: Letter to Ernesto A. Lanza, MSRB, from Nancy K. Kopp, Chair, and Treasurer, State of Maryland (August 10, 2005) relating to 2005 Proposal
9. Fidelity Investments: Letter to Ernesto A. Lanza, MSRB, from David J. Pearlman, Senior Vice President and Deputy General Counsel (December 7, 2005) relating to 2005 Proposal
10. Finance Authority of Maine: Letter to Ernesto A. Lanza, MSRB, from Elizabeth Bordowitz, General Counsel (September 13, 2004) relating to 2004 Proposal
11. 1st Global Capital Corp.: Letter to Ernesto A. Lanza, MSRB, from Judith A. Wilson, Compliance Attorney (July 28, 2005) relating to 2005 Proposal
12. Georgia Office of Treasury and Fiscal Services: Letter to Ernesto A. Lanza, MSRB, from W. Daniel Ebersole, Director (August 4, 2005) relating to 2005 Proposal
13. Hawkins Delafield & Wood LLP: Letter to Ernesto A. Lanza, MSRB, from Kenneth B. Roberts (August 20, 2004) relating to 2004 Proposal
14. Investment Company Institute: Letter to Ernesto A. Lanza, MSRB, from Tamara K. Salmon, Senior Associate Counsel (September 10, 2004) relating to 2004 Proposal
15. Investment Company Institute: Letter to Ernesto A. Lanza, MSRB, from Tamara K. Salmon, Senior Associate Counsel (July 29, 2005) relating to 2005 Proposal
16. Iowa: Letter to Ernesto A. Lanza, MSRB, from Michael L. Fitzgerald, State Treasurer (August 1, 2005) relating to 2005 Proposal
17. John Hancock Financial Services: Letter to Ernest A. Lanza, MSRB, from Diana Scott, Senior Vice President and General Manager (July 28, 2005) relating to 2005 Proposal
18. NASD: Letter to Ernesto A. Lanza, MSRB, from Mary L. Schapiro, Vice Chairman, and President, Regulatory Policy and Oversight (September 9, 2004) relating to 2004 Proposal
19. National Association of State Treasurers: Letter to Amelia A.J. Bond, MSRB, from Randall Edwards, President and Oregon State Treasurer (March 20, 2006) relating to 2005 Proposal
20. Ohio Tuition Trust Authority: E-mail to Ernie Lanza and Ghassan Hitti, MSRB, from Jacqueline T. Williams, Executive Director (July 29, 2005) relating to 2005 Proposal

21. PFPC, Inc.: Letter to Ernesto A. Lanza, MSRB, from James W. Pasman, Senior Vice President and Managing Director (December 12, 2005) relating to 2005 Proposal
22. Securities Industry Association: Letter to Ernesto A. Lanza, MSRB, from Elizabeth Varley and Michael D. Udoff, Co-Staff Advisers, Ad Hoc 529 Plans Committee (September 15, 2004) relating to 2004 Proposal
23. Securities Industry Association: Letter to Ernesto A. Lanza, MSRB, from Ira D. Hammerman, Senior Vice President and General Counsel (July 29, 2005) relating to 2005 Proposal
24. T. Rowe Price Investment Services, Inc.: Letter to Ernesto A. Lanza, MSRB, from Henry H. Hopkins, Vice President, Director and Chief Legal Counsel (August 1, 2005) relating to 2005 Proposal
25. University of Alaska: Letter to Ernest A. Lanza, MSRB, from James F. Lynch, Associate Vice President for Finance (July 29, 2005) relating to 2005 Proposal
26. University of North Carolina at Wilmington: Letter to Ernesto A. Lanza, MSRB, from Raquel Alexander, PhD, Assistant Professor, and LeAnn Luna, PhD, Assistant Professor (September 15, 2004) relating to 2004 Proposal
27. USAA Investment Management Company: Letter to Ernesto A. Lanza, MSRB, from Eileen M. Smiley, Vice President and Assistant Secretary (July 29, 2005) relating to 2005 Proposal
28. Vanguard Group, Inc.: Letter to Ernesto A. Lanza, MSRB, from John C. Heywood, Principal (July 28, 2005) relating to 2005 Proposal
29. Virginia College Savings Plan: Letter to Ernesto A. Lanza, MSRB, from Diana F. Cantor, Executive Director (July 29, 2005) relating to 2005 Proposal
30. Wachovia Securities, LLC: Letter to Ernesto A. Lanza, MSRB, from Ronald C. Long, Senior Vice President (July 29, 2005) relating to 2005 Proposal
31. West Virginia College Prepaid Tuition and Savings Program: Letter to Ernesto A. Lanza, MSRB, from John D. Perdue, Chairman, and State Treasurer (July 29, 2005) relating to 2005 Proposal

A.G. EDWARDS & SONS, INC.
One North Jefferson
St. Louis, MO 63103

314/955-3000

EDWARDS.

via overnight mail

August 3, 2005

Ernesto A. Lanza, Esquire
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street
Alexandria, VA 22314

Dear Mr. Lanza:

While A.G. Edwards and Sons, Inc. ("Edwards") agrees with the general position of the Municipal Securities Rulemaking Board ("MSRB") as stated in Release 2005-28 ("Rel. 2005-28") – that it is important for the investing public to receive complete and accurate disclosure with regard to 529 College Savings Plan investments and to understand the unique aspects of various 529 Plans so that investors may make meaningful comparisons of Plans when making investment decisions – Edwards has strong reservations with regard to several of the proposed requirements set out in Rel. 2005-28. To begin, Edwards would like to state its strong support for the comments and concerns expressed by the Securities Industry Association ("SIA") in their comment letter to your office dated July 29, 2005 ("SIA Letter"). Additionally, however, Edwards would like your office to consider the comments and concerns of our firm expressed herein.

I. Point-of-Sale Disclosures and Established Industry Sources

Rel. 2005-28 states, "The MSRB has previously interpreted Rule G-17 to require a dealer to disclose to its customer at or prior to the time of trade (or point-of-sale) all material facts about a [529 plan transaction] known by the dealer, as well as material facts about the municipal security, that are reasonably accessible to the market." While Edwards does not dispute or disagree with this statement, Edwards opposes the manner in which the MSRB would require broker-dealers to fulfill this disclosure obligation. To recommend a client review and rely on any information for 529 plan disclosure purposes other than a 529 plan's program document would undermine the precise purpose of the 529 plan program document, which is to serve as the fundamental, stand-alone disclosure piece concerning all plan features, costs and benefits.

Under the MSRB proposal, which would require brokers to direct clients to an "industry source" containing summary 529 plan information, clients will undoubtedly lose incentive to read and rely on the detailed and valuable disclosure information in the program document, and will instead rely on the summary information. Edwards feels this result (client reliance on summary information as opposed to the program document) will cause clients to be less informed and "educated" with regard to the 529 plans

they are considering. The MSRB's efforts to ensure improved client disclosure and understanding should not be directed at designing tertiary sources of information that will detract from the primary 529 plan disclosure document, but rather should be directed at encouraging the states that sponsor the plans to improve the program document and the information available to clients on the plan's website.

II. Special Disclosure Considerations in connection with Availability of State Based Benefits

Edwards agrees with the MSRB's general position that the availability of certain benefits, which include but are not limited to state tax benefits, should be considered when evaluating an in-state plan versus an out-of-state plan. Likewise, Edwards does not take issue with the MSRB's initial position that a broker should disclose that certain benefits may be available if a client purchases an in-state plan that may not otherwise be available if the client purchases an out-of-state plan. However, Edwards is concerned that the MSRB's proposed sales requirements effectively make the receipt of state benefits the most important factor (by far) in determining whether a certain 529 plan is suitable for all clients, regardless of whether those benefits are of any significant benefit to a particular client. Moreover, the MSRB's proposal may have the effect of requiring brokers to recommend the in-state 529 plan in all instances.

Despite the MSRB's stated intentions and assurances to the contrary in Rel. 2005-28, the MSRB's proposal ignores the fact that in-state tax benefits are but one factor that should be considered when determining the suitability of a particular product for clients. Edwards has significant concerns that the MSRB's proposal ignores other factors including, but not limited to, breadth of investment options, manager performance, customer service, ability to work with the client's investment advisor and reporting capabilities, which should receive equal consideration when determining suitability. Moreover, the importance of any one of these factors cannot be uniformly determined, but must be done on a client-by-client basis. The MSRB's proposal, however, significantly limits a broker's ability to work with the client in correctly weighing these factors when evaluating a particular product.

III. Additional Requirement in Connection with Out-of-State Sales

The MSRB's proposal that would require a broker to inform a client that one 529 plan is unequivocally superior in all respects to another is untenable and could potentially expose brokers and brokerage firms to liability for making such a representation. The only instance where one could say that an in-state plan is superior to a specific out-of-state plan is where the two plans are identical in all respects except for the realization of a benefit for investment in the in-state plan that is not otherwise available for an investment in the out-of-state plan. That said, there are no two plans that are identical in every respect, because at the very least each plan has a different state sponsor (and for better or for worse an investor may not have confidence with a product based on nothing other than its sponsoring state). Despite this consideration, the MSRB's proposal would require a broker to make a declaration to a client that one plan is absolutely better in all respects than another. Edwards' significant concerns about this requirement are two-fold:

- First, Edwards believes such a statement would be misleading in most, if not all, instances. The statement implies, at the very least, that the client will be better off in all respects investing in one product as opposed to another. Since every 529 plan product is different in some way and no one can determine how the difference(s) will affect the plan in the future, a broker simply cannot make such a representation.
- Second, Edwards is concerned that such a statement could be viewed or interpreted as a guarantee. Edwards would like the MSRB to consider and address the issue of whether a broker will have any liability to a client where the broker makes a representation that one 529 plan is superior in all respects to another (per the MSRB requirement), and then that "superior" plan ultimately under-performs the "inferior" product to the detriment of the customer.

Consistent with the aforementioned concerns, Edwards contends that its brokers' responsibilities with regard to 529 plan sales should remain the same as with any other investment recommendation – to help the client and identify suitable investment products in light of the client's objectives. Further, Edwards strongly objects to any requirement that would require brokers to make a misleading guarantee that one investment product is and will be the "superior" to other suitable products in all respects.

IV. Additional Considerations

Edwards is very much in favor of a client making an intelligent and informed investment decision when purchasing an investment product, including a 529 Plan. However, Edwards feels strongly that if the limitations proposed by the MSRB in Rel. 2005-28 are placed on brokers, it will signal the end of objective recommendations of 529 plan products. Brokers, to protect themselves, will simply sell the in-state plan regardless of its advantage or disadvantages. In turn, there will be no need for competitive products in the states, which could lead to fewer investment choices, diminished customer service and a general lack of product evolution simply because selling an out-of-state plan has become too onerous to brokers. In this regard, the MSRB's proposed selling requirements will in effect act as anti-competitive barriers and will cause problems for both investors and brokers. Rather, Edwards asserts that investors will benefit if brokers remain free to recommend the products which best meet the client's needs without creating barriers to making such a recommendation or sale. Additionally, a competitive landscape for 529 plans will benefit the investing public by encouraging lower costs, better investment options and improved customer service.

We appreciate the opportunity to make comments to the proposed release and we hope the MSRB will revisit the issue in order to identify more appropriate and effective means to educate the investing public on 529 plan products and ensure that the proper products are sold to appropriate investors. To this end, Edwards would be happy to continue working with the MSRB to discuss alternatives to achieve these results.

Sincerely,

Thomas M. Yacovino

Thomas M. Yacovino
Vice President
Municipal Securities Principal

The University of Kansas

The School of Business
Accounting & Information Systems

July 26, 2005

Mr. Ernesto A. Lanza, Esq.
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, Virginia 22314

Re: Municipal Securities Rulemaking Board "MSRB" Notice 2005-28 Request for Comments on Draft Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans

Dear Mr. Lanza,

We are responding to your request for comments on the feasibility of creating a centralized website to provide summary information to 529 plan dealers and investors.

This topic is of special interest to us because we collect 529 plan data for our academic research. As such, we are familiar with many centralized commercial and non-commercial 529 plan websites and those of the 529 plan program managers. In the past four years, the amount and quality of information available has improved tremendously. We believe that centralized websites will ultimately be quite valuable to both 529 investors and advisors.

Websites can incorporate highly sophisticated tools that can screen in/out plans based on an unlimited number of features. Just as Realtor.com has revolutionized internet home searches, a 529 webpage could be designed to quickly identify the suitable plans based upon certain features. Tools that allow users to compare 529 plan features between plans and to compare all features of several plans are another significant benefit of a centralized webpage.

Further, centralized information collection may lead to more accurate and timely reporting of plan and state-level changes. A centralized website in which all plans must report and update information would better ensure that accurate, complete, and timely information is available to the public. Specifically, information should be pushed down from the program manager, rather than pulled by the website employees.

We support the idea of a centralized webpage but several weaknesses in the current offering of centralized 529 websites should be considered. The following comments are about third-party websites, not those operated by the states or the plans themselves.

Summerfield Hall • 1300 Sunnyside Avenue, Room 350 • Lawrence, KS 66045-7585
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Current Website Weaknesses

1. Plan information on websites is frequently out-of-date. For example, Arkansas passed legislation allowing a state tax deduction for 529 plan contributions in April 2005. Yet, many websites still have not made corrections for this very important change.[1] With over a hundred plans in all fifty states, we recognize the difficulty of staying abreast of plan- and state-level changes. Currently, commercial website must rely upon formal or informal relationship with each plan to receive updates or must constantly monitor for changes.

2. Plan information is often incomplete. For example, Morningstar subscribers can access plan returns. However returns are limited to the years in which the 529 included the mutual fund in the portfolio. Thus, a mutual fund with 10 year history may have return information reported for only those months in which it was part of the 529 plan. This choice by Morningstar may lead consumers to erroneously believe that no return information exists. Data collection problems coupled with weak reporting requirements for 529 plans lead to sometimes significant errors in 529 plan information.

3. Plan information is also often inaccurate. For example, one website shows that the Virginia Savings Plan has total assets of $719,513,000 invested while another website shows the same plan with $10,577,100.[2] These amounts are significantly different and could easily mislead consumers.

4. Comparison information is not universally available. Commercial websites often restrict important tools (e.g., state tax benefit calculator) and important information (e.g., price breakpoints) to 529 advisors or paying subscribers.[3] While non-commercial websites such as CSPN provide comprehensive information at the plan level, the format precludes screening and selecting plans based upon plan- or state-level features.

5. Information is summarized at a very high level. For example, information on asset management fees is frequently reported as a range for investments within the plan (e.g., 0.49-2.1%). Consumers can compare expenses of the actual investment only after accessing plan details from the program manager. Upon closer examination, we frequently find cases in which only the low rate, fixed return investment has the lower fee. Thus, program managers may successfully engage in window-dressing plan fees whenever ranges are used.

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[1] This includes commercial sites such as Education Financial Services (http://www.efs529.com/aiche/incentive.cfm last accessed on 7/18/05) and non-commercial sites such as the College Savings Plan Network (http://www.collegesavings.org/locator/529locatorDetails.asp?ID=5, assessed 7/18/05). Changes that occurred in other states during May and June have also not been updated.

[2] We compared Morningstar 529 Advisor to College Savings Plan Network only for exemplary purposes.

[3] For example, both Morningstar 529 Advisor and Savingforcollege.com limits access to select information and decision-making tools to paying subscribers.

6. Website tools are often over-simplified which can distort results and ultimately, provide incorrect guidance. For example, consider state tax calculators that provide the value of an account with and without a state tax deduction. Many websites assume that the investment will grow for 18 years, thereby minimizing the difference between the in-state and out-of state contribution. Only 30 percent of taxpayers take itemized deductions rather than the standard deduction; however, the tools frequently assume the investor will itemize. Because this decreases the value of a state tax deduction (by the reduced federal deduction for state income taxes), the difference between the in-state and out-of-state contribution is again minimized. Finally, we find that many state tax calculators are incorrectly programmed and do not limit the amount of the deduction to that allowed by the identified state. When valuing the in-state contribution, we are not aware of any commercial website that includes important financial incentives such as matching grants or credits.

7. Finally, websites should include contact information for each 529 Plan including phone numbers and websites. Currently, many commercial websites require investors and prospective investors to pay for subscriptions to obtain this information.

Enclosed please find our forthcoming paper in State Tax Notes that identifies many plan- and state-level differences that contribute to the complexity. We concur with the MSRB that 529 plans are a complex investment that require additional information to advisors and investors. Because we see no movement to reduce the number of plan- and state-level differences, it is incumbent upon the industry to reduce complexity by providing accurate information and helpful comparison tools to the public. Thus, we see distinct advantages to a centralized website in which 529 program managers must report timely information and attest that plan features are accurately presented to the public.

We recognize the complexity of the plans coupled with the complexity of maintaining a website with numerous supporting programs is difficult and expensive. However, the current offerings by centralized webpages frequently provide misleading information to consumers. We believe that a centralized webpage must be maintained by *independent and accountable* third-parties to greater ensure the reliability of the analysis tools. Given that the disclosure rules are less stringent for 529 plans in general, more care must be taken to ensure that information reported to consumers and advisors is timely, accurate and complete.

Sincerely,

Raquel Alexander

LeAnn Luna

Raquel Meyer Alexander
Assistant Professor of Accounting
The University of Kansas

LeAnn Luna
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States battle to Win 529 Plan Investors: State-Level and Plan-Level Differences Lead to Complexity and Confusion

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July 5, 2005

States battle to Win 529 Plan Investors: State-Level and Plan-Level Differences Lead to Complexity and Confusion

INTRODUCTION

College savings Section 529 plans (529 plans) are municipal securities issued and regulated at the state level. Interest in 529 plans exploded after a 2001 federal tax law change allowed for tax-free growth in the plans and tax-exempt withdrawals for educational expenses. Under current law, no state allows investors a deduction for contributions to out-of-state plans. However, several states are debating proposed legislation that extends the state tax deduction to out-of-state plan contributions.

The financial community has lobbied for tax parity because this would minimize the importance of state residency when recommending an investment to a client.[1] Opponents argue that states should limit tax benefits to those municipal securities that the states can control. Further, opponents contend that state tax treatment of these municipal securities should be similar to that of municipal bonds with only in-state investments receiving favorable tax treatment.

With tax parity, plan features, such as investment choices, performance, and fees, become more salient, and state plans will be forced to compete on non-tax dimensions. Further, plan-level differences become even more important for those states without an income tax. The following article provides background on 529 plans, explores key differences in state-level and plan-level features of 529 plans, and concludes with a discussion of current federal and state legislation and current regulatory proposals.

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[1] *Investment News* "529 'tax parity' duel pits states against industry" by Charles Paikert April 11, 2005

BACKGROUND ON 529 PLANS

In the late 1980s, Michigan and Florida became the first states to create qualified tuition plans to help parents save for rising tuition costs. Michigan did not impose a state income tax on the plan's investment income and filed a suit on behalf of the program investors for a refund of federal income taxes in 1994 (*State of Michigan and Michigan Education Trust v. U.S.* 74 AFTR 2d 94-6806). The court's initial holding for the IRS was reversed on appeal.

While the lawsuit moved through the courts, several states introduced prepaid tuition plans, and Congress stepped in by codifying prepaid tuition plans and college savings plans under Internal Revenue Code (IRC) Section (§) 529 in the Small Business Job Protection Act of 1996 (P.L. 104-188).[2] College savings plans allow contributors to invest among limited traditional investment options (e.g., mutual funds) and use the investments and earnings for qualified educational expenses at nearly all accredited institutions of higher education. Initially, IRC Section §529 provided that contributions to these plans could grow tax-free but distributions would be subject to federal income tax. The Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) amended the Code to permit "qualified" withdrawals from 529 plans to be exempt from federal income taxes for both the contributor and the beneficiary.

Qualified withdrawals include expenses for tuition, required fees, books, and room and board and may be used for any public or private college, university, graduate school, or trade school. The earnings portion of non-qualified distributions is included in the beneficiary's taxable income and is subject to an additional 10 percent penalty. In the case of the beneficiary's death, disability, or scholarship receipt, no penalty on distribution is imposed. Tax-free rollovers

[2] While IRC §529 applies to both prepaid tuition plans and college savings plans, we limit our analysis to college savings plans. Prepaid tuition plans allow contributors to purchase tuition units redeemable in the future at many U.S. colleges and universities, thereby locking in future tuition costs at today's tuition rates.

are permitted once a year to transfer 529 plan assets to another 529 plan or to another beneficiary.[3]

Section 529 plans are considered completed gifts of a present interest to the beneficiary when the contribution is made. Therefore, investors may contribute up to $11,000 annually per beneficiary ($22,000 for joint spousal gifts) gift-tax free. In addition, the contributor may elect five-year averaging, thereby enabling a $55,000 contribution ($110,000 for joint spousal gifts) to each beneficiary in a single year without gift-tax consequences. Because five years of exclusions are accelerated to year one, additional taxable gifts made during the five-year period would be subject to gift tax. While the gift is complete for tax purposes, the contributor is deemed to be the plan owner and, therefore, retains the right to control distributions and to change plans, beneficiaries, and investment choices, and to transfer ownership. Gift-tax limitations could easily be circumvented under current law if a contributor names a number of beneficiaries, contributes the maximum to each account, and then later changes the beneficiaries of all plans to a single or limited number of persons. No state requires notification to the beneficiary of plan changes.[4] In addition, the contributor is treated as the owner for financial aid purposes. This is important as only 5.64 percent of the 529 plan's account balance is considered for financial aid purposes versus 35 percent if the beneficiary were considered to be the owner.[5]

Roth IRAs and Coverdell Education Savings Accounts (Coverdell ESAs) have many of the federal income tax benefits of 529 plans, but annual contributions to these investment vehicles are limited and are phased out for upper-income taxpayers. For the 2005 tax year,

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[3] Rollovers are generally only allowed to a family member of the beneficiary (IRC §529(e)(2)). This includes the following relations: child or stepchild, sibling or stepsibling, parent or stepparent, ancestor of a parent (only), niece or nephew, aunt or uncle, son- or daughter-in-law, father- or mother-in-law, brother- or sister-in-law, spouses of the previously mentioned individuals, spouse, and any first cousin.

[4] Virginia VEST plan will notify the beneficiary at the account owner's request.

[5] These formulas are subject to change at any time. See Ma (2005) for more detailed information about the impact of 529 plan savings on financial aid.

individuals can contribute a maximum of $2,000 annually per beneficiary to a Coverdell ESA and $4,000 to an IRA or Roth IRA. Phase-out of contributions for married couples filing a joint return begins for IRAs, Roth IRAs, and Coverdell ESAs at adjusted gross incomes (AGIs) of $65,000, $150,000, and $190,000, respectively. Section 529 plan contributions have no income limitations and can be made until the total account balance reaches the state established limit. The contribution limit averages $250,000 nationwide but is as high as $305,000 in several states. Contributors may open accounts in multiple states, and states also allow multiple accounts for multiple beneficiaries to be established. Until states begin to share 529 plan information, account balance limits are likely to be exceeded through ownership in accounts in multiple states.

While codified at the federal level, states retain discretion over designing plan features, such as investment options, fee structures, and distribution methods, as well as the state income tax treatment of contributions and distributions. The next section addresses some of the *state* differences, followed by a discussion of the *plan* differences.

STATE-LEVEL FEATURES

States compete to attract investors to their 529 plan. To discourage investment in out-of-state plans, states reserve certain tax benefits for in-state investment. For example, Alabama, Illinois, Mississippi, and Pennsylvania allow for tax-free withdrawals from in-state plans but tax distributions to residents from out-of-state plans.[6] Pennsylvania also taxes the earnings portions of rollovers from out-of-state plans. Currently, 26 states and the District of Columbia allow for income tax deductions for all or a portion of contributions to their own state-sponsored 529 plan, and California has proposed legislation that would provide a tax deduction to the California

[6] Effective for 2005, Mississippi will conform to the federal income tax exclusion for distributions from non-Mississippi 529 plans.

Scholarshare 529 Plan effective for 2005 contributions.[7] No state, however, allows deductions for contributions to plans in other states.[8]

The annual deduction is generally a function of filing status and the number of beneficiaries. In 2005, the annual deduction ranges from $1,000 in Nebraska and Oregon to $20,000 in Mississippi and Alabama, with six states and the District of Columbia permitting excess contributions to be carried forward.[9] Unlimited deductions are allowed in Colorado, New Mexico, South Carolina, West Virginia, and for certain Virginia taxpayers.[10] In some states, deductions may be taken by someone other than the contributor. Virginia, for example, permits the plan owner to take the deduction, even if he or she did not contribute the funds. Table 1 summarizes the range of deductions permitted among states.

Table 1
State Tax Deduction Ranges

Deduction Limitation[11]	# of States (including DC)
Less than $5,000	8
$5,000 - $10,000	9
More than $10,000	5
Unlimited	5

[7] See California SB30.
[8] Legislation has been proposed in California, Missouri, Illinois, Wisconsin, and Rhode Island to allow for a deduction/credit for 529 plan contributions to both in-state and out-of-state plans. This legislation has been voted down in Virginia, Maryland, Iowa, and Colorado in prior sessions.
[9] Oregon has a four-year carryforward, Oklahoma, the District of Columbia and West Virginia have five-year period, and Idaho permits a 10-year carryforward. Unlimited carryforwards are permitted in Ohio, Rhode Island, and Virginia.
[10] Contributors over age 70 are allowed an unlimited deduction in Virginia. Other contributors are allowed $2,000 per year per contributor per account. Thus, a contributor would have to establish 10 accounts at $2,000 each to deduct $20,000. Beginning in 2005, deductions are limited to $10,000 each year per contributor.
[11] We assume a filing status of married filing joint, two beneficiaries, and one account per beneficiary.

Several states offer other tax incentives to attract investors to their plan. These range from matching grants to eligibility for in-state tuition. Major incentives as of this writing are described in Table 2.

Table 2
Other State Incentives

State	Description of Incentive
Kentucky	Beneficiaries with eight years of program participation and at least $2,400 in total contributions who move out of state remain eligible for resident tuition rates at Kentucky public institutions.
Louisiana	Louisiana provides an earnings incentive ranging from 2 percent to 14 percent (depending on income) of an in-state participant's contributions when the account is used for qualifying expenses.
Maine	Residents with AGI of $50,000 or less in the prior year may apply for an annual $100 matching grant.
Michigan	Michigan residents with AGI of $80,000 or less and a beneficiary under 7 years old may apply for a one-time matching grant of up to $200.
Minnesota	A matching grant of up to $300 may be available for qualifying families.
New Jersey	New Jersey beneficiaries are eligible for a scholarship of up to $1,500 at any New Jersey college or university.
Pennsylvania	Pennsylvania low-income families may be eligible to have their contributions matched.
Rhode Island	The state will match up to $500 in contributions from low and moderate income Rhode Island residents for accounts opened for beneficiaries under age 11.
Utah	Participation by a Utah beneficiary for eight years vests the beneficiary with resident status for tuition if the beneficiary later leaves Utah.
Utah	Low income Utah participants may qualify for a $300 match per year for four years.

Source: Savingforcollege.com

Currently, 21 states have more than one 529 plan. Of the 14 states that offer two 529 plans, 11 states have a plan available by direct investment (i.e., without a broker) to residents only.[12] In Alaska, Nebraska, and Oregon, three plans are available; Arizona, New Mexico, and

[12] In December 2004, North Carolina discontinued the advisor-sold plan offered to non-residents and now allows both residents and non-residents to participate in the lower fee, direct-sold plan.

West Virginia offer four; and Nevada has five 529 plans. In addition Arizona will add a fifth plan to be managed by Fidelity later this year.

State residency is also an important consideration for many plans. Louisiana is the only state that does not have a plan available to non-residents; the Louisiana START Savings Program requires the account owner or beneficiary to be a resident at the time of enrollment. The Kentucky Education Saving Plan Trust is not available to most non-residents, as it requires the owner or beneficiary to have "Kentucky ties," meaning currently or formerly residing or working in the state, or having a family member with a current or former residence in the state. Finally, corporations may also promote education savings by arranging enrollment and payroll deduction of contributions; however, corporations must comply with various state laws regarding the deduction and transmission of funds to the 529 plan.

PLAN-LEVEL FEATURES

Until recently, traditional ranking resources (e.g., Morningstar) did not cover 529 plans, and historical return information was not available. Therefore, until widespread investment performance data became available in 2003, investors could evaluate plans only on features that might affect returns (e.g., fees, investment options, etc.) but with no clear data on the actual results. Furthermore, even if performance data was available, the dramatic increase in the number of plans following the 2001 tax act meant that most plans would have been too new to have a meaningful record.

For investors, the water is still muddy. The vast difference between 529 plans' investment options makes comparing plans based on the limited performance data difficult even today. For example, assume that a contributor is undecided between an age-based option, a "static" option, or a self-directed plan (discussed further below). How does an investor compare

the performance of the age-based option available in Tennessee with the past performance of self-directed fund options available in Virginia? To be meaningful, the potential investor must first select a "basket" of self-directed mutual funds comparable in every respect to the asset-class composition of the age-based option – an extremely difficult task. This paper concentrates on plan options that are easily compared across plans. As performance data becomes more available and as plans develop a meaningful investment history, performance will take a more important role in choosing among plan options.

Purchasing Methods

Methods of purchasing 529 plans vary by plan. Currently, 19 plans must be purchased through a broker. Twenty-one plans offer direct investment to all investors, while 11 plans make direct investment available to in-state residents only. Finally, 32 plans have both direct investment and advisor options for both in-state and out-of-state residents. A summary of these purchasing methods is provided in Table 3.

Table 3
Summary of Purchasing Options

Purchase Option	Description	Number of Plans
Advisor Only	Both in-state and out-of-state residents must purchase investments through an advisor.	19
Direct Investment (in-state only)	In-state residents may purchase investments directly; out of state residents must use an advisor.	11
Direct Investment (in-state and out-of-state)	Both in-state and out-of-state residents must purchase investments directly from the state.	21
Advisor with direct option	Both in-state and out-of-state residents can choose to purchase their investment directly or use an advisor.	32

Investment Options

Both the number and type of investment options offered by the plans differ. States, plan distributors, and/or investment managers decide on both the type of plan (i.e., age-based, static, and/or self-directed), as well as the underlying mutual funds within each plan type. All plans offer age-based portfolios, static portfolios, self-directed investments, or a combination of the three. Nineteen plans offer all three portfolio types. Of the 30 plans providing a self-directed option, 26 also have an age-based portfolio and 29 have a static portfolio. It is interesting to note that broker-sold shares represent approximately 62 percent of total 529 plan assets, and approximately 68 percent of assets are invested in age-based portfolios where investment choices are automatic (College Savings Foundation). These options are summarized in Table 4.

Table 4
Summary of Investment Options

Portfolio Types	Description	Person making Investment Choices / Changes	Number of Plans[13]
Age-based	Investments vary depending upon the participant's age and become more conservative as the participants get older.	Plan Manager	56
Static	Contributions are allocated to a single fund or several funds and remain fixed unless the annual option to change allocations is exercised.	Investor	59
Self-directed	Investor selects from a basket of mutual funds, similar to a 401(k) plan.	Investor	30

[13] 16 plans did not report the information.

As the name suggests, investments in an age-based portfolio vary depending upon the participant's age. As the participants get older, the plan manager adjusts the portfolio to hold less stock and more bond and cash-equivalent mutual funds. This progression is designed to automatically reduce risk as the student approaches college age. Twenty-four plans offer age-based investments with options based upon the investor's risk tolerance. For example, Colorado's Scholar's Choice Savings Plan offers seven age-based portfolios (e.g., 0-3, 4-6, 7-9, ...19+). When the participant is under the age of 4, investments are allocated with 76 percent invested in stocks, 18 percent in bonds, and 6 percent in cash. By age 19, investments are allocated with 9 percent invested in stocks, 53 percent in bonds, and 38 percent in cash.[14] Nebraska's TD Waterhouse 529 College Savings Plan offers four age-based programs, including aggressive, conservative, balanced, and growth, with allocations to suit a variety of risk levels.

Plans with static investment options allow investors to allocate all or a portion of the investment to a single fund or several funds. For example, Virginia's College American 529 plan offers 21 different mutual fund portfolios with more than 70 underlying stock funds and 35 bond funds. The investor, therefore, can combine these portfolios to best meet investment goals and risk tolerance. Minnesota's College Savings plan only offers two different portfolios: (1) an equity-only option with investments in the market-cap spectrum, real estate, and foreign stocks and (2) a guaranteed option. Unlike the age-based investment in which stock and bond allocations are annually adjusted by the fund manager, static investments remain the same unless the investor exercises the annual option to change allocations.

Self-directed plans resemble the typical 401(k) plan in many ways. The state and plan manager offer a selection of typical mutual funds that might include several domestic stock

[14] Colorado's Scholar's Choice also offers a years-to-enrollment portfolio, which is built around the number of years until the student enters college (e.g., 6-8, 9-11,...19+)

funds, bond funds, and/or foreign funds. Investors then simply select from these available options. The number of single-fund portfolios offered within the plans ranges from two in the Utah Educational Savings Plan trust to 22 in Nebraska's TD Waterhouse 529 College Savings Plan.

Plan Fees

Some plans charge commissions and fees high enough to attract the attention of regulators and legislators. Of the products available to retail investors, Mary Schapiro, NASD vice chairman and president, stated that she is most concerned about the sales practices of 529 plans and variable annuities (NASD Conference 5/3/04). In response to 529 plan sales practice concerns, the NASD is investigating 20 broker-sold funds with unusually high amounts of non-resident sales. The Securities and Exchange Commission (SEC) has established a task force to examine 529 plan fees and disclosures. Both houses of Congress have held hearings to examine whether brokers have recommended plans based on commissions, while ignoring important state tax benefits that are lost when investors choose out-of-state plans. Dyrnarski (2004) finds that 529 plan fees are higher on average than those for mutual funds, IRAs, or Coverdell ESAs. Also, Alexander and Luna (2005) find some evidence that investors are choosing plans with higher plan fees and not choosing plans with favorable state tax consequences.

Typical fees include initial enrollment fees, annual maintenance fees, account management fees, and fees for the underlying funds. Only eight plans charge an enrollment or application fee, ranging from $10 to $85. While most plans do not charge these fees, several plans' contributions may be subject to an initial or contingent sales charge depending on the share class. For example, Rhode Island Class A shares have a 4.25 percent sales charge, and Class B shares have a potential deferred sales charge of up to 4 percent.

Annual account maintenance fees are common and vary across plans. The annual fees range from $10 to $50 and are often waived for residents or when an account balance reaches a specified threshold. For example, the Arkansas GIFT College Investing Plan charges $25 annually on accounts less than $20,000 but waives the annual fee for Arkansas residents, regardless of the account balance. The Montana Pacific Funds 529 College Savings Plan (direct-sold version) does not charge an annual fee; however, the advisor-sold version charges $25 annually for accounts with $25,000 or less. This fee is waived for accounts with automatic contributions.

In addition, most plans charge an annual asset-based program fee, which varies dramatically among plans. Some plans charge the fee on the total asset value, plus each share class (i.e., A, B, C) has its own expense structure. Fees range from a low of 0.15 percent in the DC 529 College Savings Program to a high of 2.42 percent in the Arizona Waddell & Reed InvestEd Plan for Class B and C shares.

Fees for the underlying funds range from less than 0.35 percent (e.g., Maryland College Investment Plan) to 2.1 percent (e.g., Arizona Family College Savings Program).[15] The plans with a direct-investment option generally have lower underlying fees. Many broker-sold plans also charge a front or deferred load as high as 5.75 percent of the initial investment. In 2002, loaded products represented 20 percent of 529 plan assets and grew to 64 percent in 2003 (Korn 2003).

Taken as a whole, the fees vary tremendously from plan to plan. If an investor includes all of the various charges, and amortizes the sales load over five years, total expenses range from approximately 0.8 percent to over 3 percent per year. At a time when domestic stocks have been

[15] Some plans include this fee in the asset-based management fee.

returning no better than 7 percent per year, some 529 investors are paying much of their annual investment returns to the state and plan managers.

Minimum Contributions

Investors with limited means must consider the initial minimum contribution required by a particular plan. While the vast majority require an initial investment of less than $500 (see Table 5 below), at least 17 require an initial commitment greater than $1,000. Some plans will accept substantially lower initial contributions if the investor enrolls in an automatic investment program offered by many plans.

Table 5
Summary of Minimum Contributions

Dollar Amount	Number of Plans
≤ $100	29
$101 - $500	35
$1,000	11
$2,000	1
$2,500	2
$3,000	3
Not Available	2

Plan Managers

Each state contracts with one or more mutual fund families to provide plan investment options. Currently, 47 plans create investment portfolios from mutual funds managed by a single fund family, while the rest invest with multiple fund managers. For example, Allianz AG

distributes South Dakota's College Access 529 Plan and provides investment portfolios containing 23 underlying funds from eight different mutual fund families. New Hampshire only offers Fidelity funds.

Plan features vary across plans with the same plan manager. For example, TIAA-CREF manages 14 plans in 12 states. Management fees, expense ratios, and investment options all vary among the plans it manages. None of the TIAA-CREF funds charge a load; however, the low-cost manager charges investors in Oklahoma's College Savings Plan's a 0.55 percent annual fee (one of the lowest around) and investors in Georgia's Higher Education Savings Program 0.85 percent per year. Of course, these TIAA-CREF plans vary on many other dimensions. California's Golden State ScholarShare is the only TIAA-CREF plan that offers a socially responsible fund. The Georgia Plan is the only plan that offers two age-based options: aggressive and moderate portfolios.

Fidelity also manages multiple plans across states, including the New Hampshire Unique Plan (direct sold) and the New Hampshire Advisor Plan (advisor only). While the advisor-sold plan offers plenty of investment options and flexibility, offering 13 static portfolios, fees make this plan less attractive when compared to the Unique Plan. The management fee for both plans is a reasonable 0.3 percent. However, the Advisor Plan also comes with a sales charge ranging from 2.5 percent to 5.75 percent and an expense ratio ranging from 0.42 percent to 1.11 percent. The Unique Plan is a no-load plan and expense ratios are under 0.81 percent, but it only offers three static options: aggressive, moderate, and conservative portfolios.

Smallest and Largest Plans

According to the College Savings Foundation, as of March 31, 2005, investments in 529 plans totaled $55.4 billion, an increase of 38.6 percent from a year earlier and 6 percent from the

beginning of the year.[16] That balance is expected to grow to $400 billion by 2010 through additional investments and investment appreciation (Figure 1). The smallest and largest plans are presented in Tables 6 and 7 for comparison purposes. A brief analysis shows that a plan's size has little to do with the range of fees charged.

Table 6
Smallest Plans (Assets Under $24 Million as of April 30, 2005)

Plan Name	Assets (in millions)	Inception Date	Program Manager	Direct Investment Available	Program Manager %	Expense Ratio %
WV SMART 529	7.0	09-15-04	The Hartford Insurance Co.	Yes	0.07-0.35	0.2-0.48
MS Affordable College Savings	5.0	10-15-02	TIAA-CREF	No	0-0.7	0.08-0.2
AZ Family College Savings Program	7.6*	6-29-99	SM&R	Yes	None	Not Available
WY College Achievement	16.6**	9-24-01	Mercury Advisors	Yes	Not Available	Not Available
HI Tuition EDGE	23.7	5-10-02	Delaware Investments	Yes	0.95	None

*Assets as of 3-31-05 as reported by Morningstar
**Assets as of 9-30-04 as reported by Morningstar

Table 7
Largest Plans (Assets Above $3.0 Billion as of April 30, 2005)

Plan Name	Assets (in millions)	Inception Date	Program Manager	Direct Investment Available	Program Manager %	Expense Ratio %
Virginia CollegeAmerica	10,577.1	2-15-02	American Funds	No	None	0.62-2.27
Rhode Island College Bound Fund	5,475.7	10-26-00	Alliance Capital Mgmt.	Yes	None	0.5-1.65
	3,360.0	10-01-00	Putnam	No	0-1.35	0.53-1.37

[16] http://www.collegesavingsfoundation.org.

Ohio Putnam CollegeAdvantage			Investment Management			
New York 529 College Savings	3,483.2	11-17-03	Vanguard UPromise	Yes	0.42-0.52	0.08-0.18
Maine NextGen College Investing Plan	3,024.6*	8-05-99	Merrill Lunch	Yes	0-1	0.61-1.77
New Hampshire UNIQUE College Investing Plan	3,037.6	7-01-98	Fidelity	Yes	0.3	0.55-0.81

*Assets as of 3-31-05 as reported by Morningstar

CURRENT FEDERAL LEGISLATION

On the federal front, legislation has been proposed to close many of the estate and gift-tax loopholes that currently exist with 529 plans.[17] As discussed earlier, donors can currently claim the gift-tax exclusion for contributions to 529 plans even though they retain control over the assets, can change beneficiaries, or can liquidate the account entirely. For other similar transfers, the annual exclusion is not available because the donor retains control over the assets. In addition, 529 plan assets are generally not included in the estate of the donor, account owner, or the beneficiary. The proposed legislation would bring the treatment of 529 plans in line with that of other assets under current law.

Although the rules are somewhat complex, the result is that gift-tax exclusions would only be available when the donor irrevocably relinquishes control over the account. Otherwise, the gift occurs only upon distribution for the benefit of the beneficiary. The designated beneficiary can be changed but only under very restrictive circumstances--most importantly that the beneficiary reaches the age of 18 and either will not attend college, has sufficient scholarship money to pay for college, or cannot attend college because of death or a learning disability. In the latter case, the assets could be transferred only to another family member of the same

generation. If the account owner retains control over the assets and can freely change beneficiaries, as under current law, the entire balance is included in the estate of the account owner at his or her death.

The law enabling tax-free withdrawals from 529 plans is set to expire in 2010. The Bush Administration's 2006 revenue proposals have called for removing sunset provisions. If the law is not extended or made permanent, 529 plan distributions would again be taxable, even if used for educational purposes. The state tax treatment of 529 plans would also change in states that conform to federal law. This introduces uncertainty because conforming states would have to choose whether to enact law to allow for tax-exempt withdrawals at the state level and the effective date of such change. Thus, confusion and complexity for federal and state income tax planning is again increased.

Current legislation also proposes the creation of Lifetime Savings Accounts (LSAs), where individuals could contribute up to $5,000 per year regardless of wage income to save for any purpose, including retirement, health care, emergencies, and education. In addition, individuals could transfer up to $50,000 in existing 529 plan assets to their LSA.

Finally, the Bush Administration has also called for reform of 529 plans. Proposed reforms include the following:

1. Each 529 account could have only one contributor.
2. Non-qualified distributions would be subject to a 20 percent penalty if the withdrawal is made to the contributor more than 20 years after the account was created.

[17] Refer to the Joint Committee on Taxation's "Options to Improve Compliance and Reform Tax Expenditures" (January 27, 2005).

3. Non-qualified distributions in excess of $50,000 ($150,000) would be subject to a 35 percent (50 percent) excise tax to a beneficiary who is not the initial beneficiary of the account.
4. Only direct trustee-to-trustee rollovers would be permitted.

The proposal would be effective for 529 accounts established after the changes are enacted. Furthermore, additional contributions to existing plans would be prohibited unless the plans elect to comply with the new rules.

CURRENT STATE LEGISLATION

States offer different approaches to 529 plan investment. The 26 states offering a contribution deduction and other resident-only benefits are targeting in-state residents. Other states team up with program managers to attract investors nationwide. For example, Virginia's CollegeAmerica plan can only be purchased through a financial advisor with Class A shares having a front-load sales charge of 5.75 percent, yet within one year of operation, this plan was the largest in the nation.

Recent inquiries by Congress, the SEC, the GAO, and the NASD have shed some light on 529 plan sales practices. Most recently, in December 2004, Edward D. Jones & Co. made a $75 million settlement with the SEC after disclosing that the company had accepted tens of millions of dollars in secret fees from seven mutual fund groups. Included were payments for 529 plan investments in which American Funds and Putnam made revenue-sharing payments to Edward D. Jones brokers directing clients to these plans. Further, regulators are concerned that investment advisors are not disclosing state-tax benefits available for investing with the in-state plan.

Sixteen large investment firms, including Merrill Lynch, Strong, Fidelity, and AIM, have formed the education and lobbying group called College Savings Foundation, with a primary mission to promote tax equity. One key concern includes promoting the need for state tax policies that provide equal treatment to all 529 plan savings programs.

Missouri is considering legislation where contributions to 529 plans would receive the same tax treatment regardless of whether they invest in the Missouri 529 plans or any other 529 plan.[18] Two other states – Wisconsin and Rhode Island – have bills to extend tax credits to residents using out-of-state 529 plans. Missouri Sen. Delbert Scott (R) is also working on a proposal that would extend Missouri state deductions to the 529 plans of states that offer similar tax deductions to non-residents who invest in the Missouri plan. Currently, Missourians receive a state-tax deduction for contributions up to $8,000 per year to the Missouri Saving for Tuition Program (MO$T). The proposed legislation would level the playing field among 529 plans. In addition, it would place 529 plans on the same level as IRAs as investors would be free to choose among a large variety of investment options without regard to the state tax treatment of their choice.

This radical departure from current rules would create a number of winners and losers. The biggest winners, of course, would be investors/donors. Instead of weighing the potential income tax deduction for an in-state plan versus better investment options elsewhere, the investor would choose a plan based on various criteria, including investment objectives, investment options, risk level, performance returns, and fees -- without regard to taxes. Mutual fund companies that offer a superior product are also winners, as the potential drawback (i.e., loss of state tax deduction) would be eliminated.

[18] Missouri S.B. 324

With tax parity, not all states, taxpayers, and investors benefit equally. Specifically, those states without an income tax or without a state income tax deduction for contributions may find that non-resident investment declines. Also, states with high deduction levels may fair worse under tax parity agreements, because tax parity would remove the golden handcuffs of state tax deductions. Taxpayers currently unwilling to consider out-of-state plans because of the loss of a state tax deduction may (and should) change their investment criteria. Taxpayers in states approving tax parity legislation may be indirectly subsidizing out-of-state investment in two ways. First, taxes are lost with the deduction without a correlated increase in state plan assets. Second, 529 plan management fees will be shared with another state.

Tax parity will make some investors much better off than others. Residents of states with tax parity will have better after-tax returns than other investors, and investors in states without tax parity may be charged higher fees, thus earning lower returns. For instance, as plan managers in states without tax parity find it increasingly difficult to attract clients, additional advertising expenses coupled with fewer investors to share fees may lead to current plan investors being charged higher fees.

CURRENT REGULATORY PROPOSALS

The Municipal Securities Rulemaking Board (MSRB) has released a proposal for uniform disclosures of plan- and state-level features and called for advisors to present a comparison of 529 plans to investors. In Notice 2005-25 (May 19, 2005), the MSRB cites the complexity of 529 plan investments and seeks comments on the feasibility of a centralized webpage that provides material features in a uniform manner.

In addition, the MSRB has proposed disclosure requirements in Notice 2005-32 (June 2, 2005) for advertisements for municipal securities (which includes 529 plans) to be consistent

with mutual funds. For example, if advertising includes performance data, the data must be current up to the most recent month end, or alternatively, the advertisement must include a toll-free phone number or website address from which current data may be obtained. The MSRB also proposed that fee and expense disclosures be made consistent with rules currently being considered by the SEC for mutual funds.

CONCLUSION

This paper provides some significant 529 plan differences that may be most salient to the majority of investors, such as state tax and other benefits, plan fees, and performance information. State policymakers support 529 plans, because saving for education is good policy. Minimizing 529 plan complexities and adopting uniform disclosures will reduce investor confusion and benefits college savers by enabling them to make informed decisions with or without the aid of a paid financial advisor.

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CSF
CollegeSavings
FOUNDATION

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September 13, 2004

Mr. Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
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Re: Notice 2004-16

Dear Mr. Lanza:

I am writing to you today on behalf of the College Savings Foundation ("CSF"). CSF is a 501(c)(6) organization dedicated to the advancement of 529 college savings programs. CSF's mission is to help American families achieve their education savings goals by working with public policy makers, media representatives and financial services industry executives in support of education savings programs. CSF's members include many of the country's leading financial services firms, and collectively manage approximately $10 billion in savings-type qualified tuition programs, representing over one-third of the dollars in such programs. CSF also includes associate members that are governmental and non-profit agencies and individuals who support CSF and its mission.

CSF serves the education savings industry as a central repository of information and an expert resource for its members and for representatives of state and federal government, institutions of higher education and other related organizations and associations. The primary focus of CSF is building public awareness of and providing public policy support for 529 plans - an increasingly vital college-savings vehicle.

This letter is in response to MSRB Notice 2004-16 (the "Notice"), which requests comments on proposed amendments to Rule G-21, which addresses advertisements, and Rule G-17, which addresses conduct of municipal securities activities. CSF supports the principles of improved disclosure set forth in the Notice but believes that a few of the specifics of the proposals in the Notice warrant comment.

General Disclosures in Advertisements

MSRB Website Reference

The Notice seeks comment on whether the proposed general disclosure language required for 529 advertisements should include a specific reference to information about 529 programs maintained on the MSRB's website, and if so, to what extent the information currently provided there should be included, modified, supplemented or deleted.

We commend the MSRB's willingness to undertake the work that would be involved in maintaining information on its website, but we do not believe it is advisable or practical in a 529 advertisement to include a reference to information on the MSRB website, for several reasons.

First, many issuers and program administrators maintain extensive consumer websites, which contain 529 product, industry, and educational information.

Second, the 529 marketplace has several third-party websites that provide consumers with an abundance of industry and program information.

Third, if dealers are expected to furnish information to the MSRB to populate its website, the administrative burdens on dealers (and perhaps issuers) is likely to be substantial, particularly if such information is to be updated simultaneously with changes in 529 programs.

Fourth, for the most part, 529 advertisements are in print and are subject to space limitations. Television and radio advertisements are even more constrained. Advertisements are and will continue to be subject to lengthy disclosure requirements, and the addition of this item would further diminish the ability of an advertisement to communicate substantive information.

For all the foregoing reasons, we respectfully request that this proposal be withdrawn.

Disclosures Modeled on SEC Rule 482

The Notice proposes that 529 advertisements include lengthy general disclosure requirements modeled upon the requirements found in Rule 482 of the U.S. Securities and Exchange Commission. We support this concept but respectfully note that there simply would not be enough time to include all of the required disclosures in a radio or television advertisement, with the practical consequence that there would quite possibly be no more 529 radio or television advertisements.

We note that it is not possible to purchase directly from a radio or television advertisement, and that before purchase, a consumer would be presented with appropriate information and disclosures. Therefore, we suggest that for radio and television advertisements that mention a 529 program by name but do not contain such content as to raise the advertisement to the level of an offer under federal securities laws, abbreviated general

disclosures should be acceptable. We believe that presenting the member firm's name and address, the name of the 529 program, the name of the state that establishes and maintains the program, and an abbreviated form of the offering legend that refers consumers to the Official Statement should be sufficient.

Nature of Issuer and Security

The Notice proposes that a 529 advertisement that identifies a specific municipal fund security include the name of the issuer, presented in a manner no less prominent than any other entity identified in the advertisement, and not imply that a different entity is the issuer of the municipal fund security.

We believe that the purpose of the proposal is to make it clear that a state, state agency or state instrumentality is the issuer, not any private sector administrator that may be hired to provide services to the program, and we believe that any communications should say so. However, providing the name of the legal issuer may not help consumers understand this point, and indeed may result in additional confusion. The legal issuer is often an obscure state trust, whose name is not mentioned outside of some descriptive material in the Official Statement for the program. Further, the same issuer may be involved in more than one program. We submit that it would be more helpful to identify the program by marketing name, together with the name of the state that establishes and maintains the program.

Consider, for example, the two programs established and maintained by the State of New Hampshire. Each program consists of a number of investment portfolios grouped under a marketing name, but the portfolios are all part of the same issuer, a special purpose trust established by the State for the purpose of segregating the program's assets from other dollars the State may handle. Providing consumers with the name of the trust will not help them understand which program they are being offered although identifying the program and the State would help.

We note further that there are situations, such as in New Hampshire, where the issuer itself does not have a logo, but the program does, and we suggest that in any advertisements or other materials it be the program's logo, not the issuer's, that should appear at least as prominently as the member's logo.

Capacity of Dealer and Other Parties

The Notice proposes that an advertisement soliciting purchases of municipal fund securities that would be effected by any party other than the dealer that publishes the advertisement must clearly state which entity would effect the transaction.

Many 529 programs are intermediary sold programs. For some programs, transactions are effected through several hundred dealers. It would be very onerous and impractical to identify each selling institution in a print advertisement, and impossible to do so in a radio or television advertisement. We suggest that the entities required to be identified under this

proposal be limited to dealers that are affiliates of the dealer publishing the advertisement and, if applicable, the issuer itself.

Tax Consequences and Other Features

The Notice contains proposed modifications to Rule G-21 and draft interpretive guidance under Rule G-17, which we discuss together here because they share a common subject matter, the information to be provided to consumers concerning the consequences under state laws of choosing to invest in the program of one state rather than another.

The Notice would require 529 advertisements to include statements regarding the nature of tax or other benefits offered under state or federal law, and proposes to broaden the existing Rule G-17 point-of-sale disclosure to include reference to other potential benefits offered solely in connection with investments in an in-state 529 program. As part of the Rule expansion, the Notice states that the point of sale obligation to disclose the state benefits available to consumers only through an investment in an in-state 529 program would be satisfied if it is included in an offering statement in a manner reasonably likely to be noted by an investor.

We have concerns about the proposals contained in the Notice, both from a content standpoint and a procedural standpoint.

Content

The area of variations in state treatment is full of complexity. We believe the Notice may lead to firms' providing disclosure in advertisements and at the point of sale that may be less than complete, and indeed might possibly be misleading. We believe that a better approach would be to remind the public to carefully review the Official Statements of their home-state programs.

We also believe that it is crucial for the public to understand that not all differences in state treatment will be of benefit to an individual who invests in the program established and maintained by the state where they reside. Thus, we feel that the phrase "state tax or other benefits" should be changed to "different tax or other consequences".

There are a number of ways in which investing in a home-state program may be disadvantageous. For example, one state that provides a substantial tax deduction to its residents only if they invest in the state's own program also provides that rollovers to other states' programs will be treated as taxable distributions under state law, notwithstanding the fact that federal law would treat the rollover as tax free. This state and others also recapture state tax deductions previously taken if an account holder rolls over to another 529 program. Matching grants and scholarships may also be taken back by states as the result of leaving the home-state program. It may be prudent for an individual to choose an out-of-state program, and thus forego a tax deduction or other benefits offered by their home state, rather than be locked into a program that may impose a financial penalty on the individual should they later move to another, possibly more suitable, program. Portability may be particularly important for parents of younger

children, who are more likely to move from one state to another before their children reach college age.

Another factor to be considered is whether benefits may be available only in connection with a program that is not offered by the state in which the account owner resides. For example, consider an account where the owner resides in State A, and the beneficiary ultimately attends school in State B. State B may have a matching grant program that is available only to beneficiaries of the 529 program of State B, so consideration of where the beneficiary may ultimately attend school may outweigh any advantages of the program offered by State A, particularly if, as noted above, State A places tax burdens on rollovers to the program offered by State B.

Given the complexity in today's environment, we suggest that any requirement concerning tax and other benefits reflect the concept that not all consequences of investment in an in-state program are necessarily favorable. We also suggest that while it is appropriate to suggest to consumers that they seek help from their own advisor, it is not appropriate to suggest that they seek help from the state in which they reside. For one thing, such a suggestion may result in liability to a dealer if the home-state program (or its service provider) provides information that is not entirely complete and accurate. For another, it may result in a situation where the consumer is presented with a sales pitch rather than disinterested information. Finally, the home state may not be aware of potential disadvantages to the consumer that will result from investment in the home-state program.

Additionally, we are concerned about the language in the Notice that says "the advertisement must make clear the nature of such benefits". Benefits of investing in a home-state program may currently include one or more of the following: two-tiered investment pricing, i.e. a less expensive class of units or shares for in-state individuals, and a more expensive class for out-of-state individuals, but both investing in the same underlying pool of assets; lower administrative fees; deductibility of contributions; favorable income tax treatment upon distribution; protection from creditors (which might be only during bankruptcy proceedings, or in wider circumstances); availability of matching educational grants; special status under financial aid statutes; and preferential Medicaid treatment. There may be additional current benefits of which we are unaware, and states may add other benefits in the future.

If all that would be required is a general statement that tax and other benefits may be available only through the home-state program, the guidance should so state. Some Official Statements of programs distributed by CSF members already contain such statements. One reads "Some states offer favorable tax treatment or other state benefits to their residents only if they invest in their own state's plan. Before making any investment decision, you may want to consult with a qualified adviser to learn more about the benefits or consequences of investing in a plan offered by your own state". Another reads "By investing in a 529 plan outside of the state in which you pay taxes, you may lose any tax benefits offered by that state's plan". We believe that such simple statements are sufficient to put individuals on notice that they should learn more.

If a laundry list of all potential aspects of differing treatment is required, we are concerned that such a list could not practically be updated to account for all new state laws, and that even if it could, space limitations would make it impractical or impossible to achieve compliance. The outcome, even from efforts made with the best of intentions, is likely to be investor confusion and inaccurate, incomplete or misleading disclosure. Consider, for instance, an individual who values one ancillary benefit, perhaps creditor protection, as being extremely valuable. If the description of creditor protection provided to that individual is less than comprehensive and completely accurate, the individual may make a decision that they later come to regret.

Finally, we are very concerned that an overemphasis on state variations may detract from more fundamental considerations, including whether a qualified tuition program is the right way for an individual to save for college, and whether the investments offered through a particular program are suitable for the individual. The more detail about state variations that an individual sees, the more likely they are to believe that state variations are more important than other factors.

Procedure

The Notice provides that a dealer may meet its obligation to disclose information about the consequences of investments in a home-state program if appropriate disclosure appears in the Official Statement in a location "reasonably likely to be noted by an investor". We note that typically consumers are required to certify that they have read the entire Official Statement before executing an application, and believe that there should be a presumption that placement anywhere in the Official Statement should constitute acceptable notice. One can only imagine the potential conflicts among hundreds of dealers, each pressuring an issuer to place disclosure in its preferred place in the Official Statement, if the proposal contained in the Notice is adopted. We respectfully request that there be no requirements concerning the location of this information in the Official Statement. We do not mean to suggest that obscuring such information is acceptable, only to suggest that it should be a matter for each dealer to determine whether the issuer's choice in placement of such information is sufficient. We also suggest that the draft interpretive guidance under Rule G-17 be modified in light of the foregoing.

We thank you for your efforts in drafting the Notice and for the opportunity to present these comments. I would be happy to discuss with you the comments above and any other issues related to the Notice. Please do not hesitate to call me at 817-474-8298 if you believe we can be of further help.

Sincerely,

David J. Pearlman

CollegeSavings
FOUNDATION

1101 17th Street, NW

Suite 703

Washington, DC 20036

July 29, 2005

Mr. Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street
Suite 600
Alexandria, VA 22314-3412
703.797.6700

Re: Notice 2005-28

Dear Mr. Lanza:

I am writing to you today on behalf of the College Savings Foundation ("CSF"). CSF is a 501(c)(6) organization dedicated to the advancement of 529 college savings programs. CSF's mission is to help American families achieve their education savings goals by working with public policy makers, media representatives and financial services industry executives in support of education savings programs. CSF's members include many of the country's leading financial services firms, and collectively manage more than $25 billion in savings-type qualified tuition programs, representing nearly one-half of the dollars in such programs. CSF also includes associate members that are governmental and non-profit agencies and individuals who support CSF and its mission.

CSF serves the education savings industry as a central repository of information and an expert resource for its members and for representatives of state and federal government, institutions of higher education and other related organizations and associations. The primary focus of CSF is building public awareness of and providing public policy support for 529 plans - an increasingly vital college-savings vehicle.

This letter is in response to MSRB Notice 2005-28 (the "Notice"), which requests comments on proposed changes to interpretations of conduct and suitability rules governing the sale of 529 college savings programs. CSF appreciates the opportunity to comment on the Notice and appreciates the MSRB's continuing dialogue with the 529 industry in refining the regulation of the sales of 529 plans.

With regard to the elements in the Notice concerning increased dealer obligations, particularly comparisons of plans of different issuers, and with regard to the proposed

establishment of a centralized website for dealers to reference information about all the plans in existence, we believe that the Notice, although well-intentioned, would have unintended and unfortunate consequences for potential 529 college savings plan investors if adopted, and therefore urge that the Notice be withdrawn, for the reasons stated below.

CSF has not seen evidence of abuses in the sale of 529 plans, nor does the Notice indicate that any such abuses are taking place. We are aware of no NASD or other enforcement actions concerning 529 plan sales, and do not believe that a change in the current guidance governing 529 plan sales is warranted. The current scheme requires dealers to be conversant with the plans they sell, and to advise prospective investors that their home state plan may offer state-based benefits not available through the purchase of an out of state plan.

We note that CSF has encouraged and led efforts to help reduce the complexity faced by prospective 529 investors. CSF members have been involved in the development of the disclosure principles adopted by the College Savings Plan Network. CSF maintains an active media outreach effort to build public awareness and understanding of 529 programs. CSF also issues periodic press releases containing 529 market data. CSF is also active in state legislatures, urging them to provide equal tax treatment for investments in home state and out of state programs, to make it easier for prospective investors to compare programs.

The Notice proposes that with respect to every potential sale of interests in a 529 college savings plan in a situation where the purchaser or designated beneficiary is not a resident of the state whose program is being offered, the dealer would have to inquire whether "realizing state-based benefits is an important factor in the customer's investment decision". We submit that requiring dealers to pose this question would be inappropriate, for two reasons. First, as a matter of securities law, it would impose a burden on dealers not present with respect to any other security. Second, as a practical matter, a prospective purchaser will generally not know the answer to this question until he or she understands the magnitude of any such potential benefits and the potential negative consequences of an investment in the program offered by the state of residence. Depending on the programs involved, potential negative consequences may include the recapture of all previously taken state tax deductions, penalties on withdrawals, poor program investment performance or service, and unfavorable treatment for financial aid, insolvency, Medicaid or other state law purposes. Even after consideration of all these factors, it may be impossible for a prospective investor to know whether state-based benefits are sufficiently important to them that such benefits outweigh other factors relevant to an investment decision.

The Notice would appear to have the practical effect of requiring dealers to keep current with all state-based benefits, including state tax treatment, for every plan in every state in which they offer one or more 529 plans, since the Notice further states that state-based benefits would be "one of many appropriately weighted factors that have an ultimate bearing on the relative strengths of a particular investment." Since, as is observed in the Notice, it is quite unlikely that issuers will include information about every 529 plan in their offering materials, each firm would have to compile a matrix of state benefits and analytical tools that could be used to decide whether one 529 plan is likely to be more suitable for a particular investor than another.

There might well be aspects of investing in a particular 529 plan other than state-based benefits that are of critical importance to a particular investor, and such factors could vary from person to person. Some factors might be purely financial, others non-financial. Examples of financial considerations could include the level of program fees, investment management fees, and withdrawal penalties. How to evaluate these factors might be far from clear, and might require the dealer to obtain information, which may not be disclosed by all issuers, concerning such things as how long a state's contract with a program administrator is scheduled to last, and whether the state reserves the right to raise fees in the future. It may also require the dealer to engage in sheer speculation as to the state of residence of a 529 account investor or beneficiary a decade or two into the future, what state a beneficiary might attend school in, whether a beneficiary might receive a scholarship or require financial aid, or a host of other things.

Some financial factors can't be viewed in the context of a single security or a single transaction. The amount and nature of other college funding assets held now or planned to be created in the future may be important. It may be important to plan the order in which college funding assets are used, for tax, scholarship, loan or other purposes. For these sorts of issues advisors can play an invaluable role, but nothing in the Notice acknowledges that the purchase of a particular security exists in the context of the investor's overall situation. Advisors serve other valuable functions as well. Advisors regularly evaluate investment managers. They have the ability to consolidate all of an individual's holdings in a comprehensive account, thus facilitating overall financial planning. Ease of recordkeeping may have other benefits, such as increased efficiency in preparing tax information for income tax returns, or working with estate planning experts. Again, none of these factors is easily quantifiable in analyzing whether a particular security may be more or less suitable than another for a particular investor.

In many situations relevant factors would include things that have both a financial and non-financial element, such as whether purchase of an interest in a particular 529 program could help qualify the investor for a discount under a wrap fee program or breakpoints. It might be wise to forgo the potential for state-based benefits, particularly those that may be of nominal value or may not be realized because they are scheduled to occur far in the future and thus are subject to change before being used, in return for a discount in a wrap fee program or a reduced sales charge based on a more favorable breakpoint schedule. The fee discount or breakpoints might be available only if an out of state program is the one invested in, since investment in the home state program might require that the customer purchase through a firm other than the one in which the customer's wrap fee program or other mutual fund or brokerage accounts are maintained.

It appears from the Notice that the analysis would have to incorporate every aspect of every 529 plan, not merely those related to state-based benefits and the drawbacks that may accompany them. Such a requirement may be financially burdensome for some, if not all, dealers, may expose them to liability based on the provision of tax advice for a security they cannot offer, and would be unlike any regulatory requirement imposed on broker-dealers of other securities in the marketplace. In addition, dealers may not feel comfortable making representations about plans for which their firms do not have selling agreements. The only way for a dealer to become comfortable with its analysis of such plans may be to seek to interact directly with the issuers or the primary distributors for such plans to obtain the same materials and information available to firms that do have selling agreements. It is questionable whether the plans or primary distributors

would even be willing to take on such a burden. If the issuers and primary distributors are not willing to do so, non-selling firms may decide that their only course of action is to sell no 529 plan in such a state. If the issuers and primary distributors do take the time to interact with the non-selling dealers, the scheme proposed in the Notice may have the perverse effect of overburdening the issuers and distributors of such plans, leaving them even less time to spend on the maintenance and distribution of their plans.

Plugging all these factors into an algorithm that is designed to determine whether one 529 program is more suitable than another would be an extremely daunting task, even if all the relevant information about every 529 plan were unchanging and readily available.

With regard to program information availability, the Notice suggests that increasingly standardized disclosure and a centralized website are the way to go. There is no indication of what body would maintain such a website and how quickly such a site might be updated in response to changes in programs, regulations, and the laws (whether state or federal) that affect the wisdom of investing in them. Regardless of whether a private or governmental entity would be responsible for maintaining such a website, there would likely be financial as well as practical issues to be solved, as the Notice acknowledges when it raises the issue of whether to impose fees under MSRB Rule A-13. Such costs would ultimately be borne by all investors in the programs, while providing little, if any, benefit that cannot already be realized by the use of existing websites.

Program information will continue to grow and evolve over time. Today, there are approximately seventy programs, all of which are dynamic. To stay current with program information, the compliance department at every selling firm would have to continually monitor the programs of every state in which it sells even one program. Every time a program makes a change, the compliance algorithms comparing all programs would have to be rerun to see if the changes tip the scales in favor of one program over another. This burden, needless to say, could be quite substantial, and its results perhaps misleading to investors.

If, after plugging in all relevant factors, the dealer determines that under all reasonable scenarios an investment in the home state plan not offered by the dealer would be superior to investment in an out of state plan offered by the dealer, the Notice would require that the customer be informed of this determination, and the dealer would be permitted to effect a transaction in the out of state plan only if (1) an investment in the out of state plan could be considered suitable under traditional analysis, and (2) the customer nonetheless directs that the dealer effect the transaction after being informed of the dealer's determination.

This aspect of the Notice is problematic in several respects. Selling firms have long been under a regulatory regime where comparisons to other securities have been disfavored by securities regulators. Indeed, it is a very, very rare occurrence for a dealer to compare one security to another security it does not offer, principally because of the high standards to which comparisons are held under NASD rules. There is no distinction in the Notice based on degree of difference between economic and non-economic factors. Consider, for example, a situation in which two otherwise identical programs each offers a single investment option, based on the S & P 500 index. Program A, the home state program of the investor charges X basis points, while Program B charges X plus one. Program A also offers a minimal state income tax deduction. It is

clear that under the proposal, the dealer will have to inform the prospective customer that Program A is more suitable if suitability is purely an economic analysis. We hope that this is not the case, and that if adopted, it will be clear that non-economic factors may be considered in making the comparative suitability determination. We note also that for investments other than those tied to an index, even purely economic comparisons analysis must necessarily be based on guesswork about future investment performance, yet predicting performance is not permitted under the securities laws. Finally, it is unclear what course of action is open to a dealer that makes a good faith determination that a plan it does not offer is more suitable than those it does offer, or what happens if the dealer cannot make a good faith determination, based on the information available, that one plan is more or less suitable than the other. Should it refer the prospective investor to the issuer of a plan it does not sell? Will the dealer then be held responsible for having recommended the plan it does not sell, and liable to the investor if the investor purchases an interest in a plan that performs poorly or does not provide the state-based benefits that appeared available at the time of purchase?

There is an additional problematic consideration when the investor chooses to direct the dealer to effect a transaction in an out of state program. Many 529 programs require that a customer's account be held directly with the program, not via an account at the selling institution. For customers making periodic investments, the selling firm would be required to obtain renewed instructions annually, yet the customer data may reside solely with the issuer. Dealers in such circumstances would need to obtain periodically personal customer information from the issuer, creating a further burden on both dealer and issuer. If for some reason an issuer decides not to share such information, it would be impossible for dealers to comply with this part of the proposal.

The upshot of the proposals in the Notice is that many firms may decide that the additional regulatory requirements are overly burdensome. As a result they may cease to sell some or all of the 529 plans they currently offer. For direct sold plans, which are typically offered by a single dealer, the problem could be particularly acute. Many customers of financial institutions who are accustomed to relying on their financial advisors may have little choice but to make their own investment decisions, perhaps less wisely than if they worked with their advisor. Many customers who might otherwise purchase suitable 529 plan interests may well purchase none at all.

Federal securities regulation has never been premised on the concept that a dealer is obligated to determine the most suitable investment of a particular type for any customer, and we see no reason to place upon the 529 college savings plan industry the unprecedented burdens contained in the Notice. We respectfully urge that the Notice be withdrawn.

Please do not hesitate to call me at 817-474-8298 if you believe we can be of further help.

Sincerely,

David J. Pearlman
Chairman

CollegeSavings
FOUNDATION

1101 17th Street, NW

Suite 703

Washington, DC 20036

February 13, 2006

Mr. Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314-3412
703.797.6700

Re: Notice 2005-28

Dear Mr. Lanza:

I am writing to you today on behalf of the College Savings Foundation ("CSF"). CSF is a 501(c)(6) organization dedicated to the advancement of 529 college savings programs. CSF's mission is to help American families achieve their education savings goals by working with public policy makers, media representatives and financial services industry executives in support of education savings programs. CSF's members include many of the country's leading financial services firms, and collectively manage more than $30 billion in savings-type qualified tuition programs, representing nearly one-half of the dollars in such programs. CSF also includes associate members that are governmental and non-profit agencies and individuals who support CSF and its mission.

CSF serves the education savings industry as a central repository of information and an expert resource for its members and for representatives of state and federal government, institutions of higher education and other related organizations and associations. The primary focus of CSF is building public awareness of and providing public policy support for 529 plans - an increasingly vital college-savings vehicle.

This letter is in response to MSRB Notice 2005-28 (the "Notice"), which requested comments on proposed changes to interpretations of conduct and suitability rules governing the sale of 529 college savings programs. CSF submitted a comment letter on July 29, 2005. In light of subsequent events we think it appropriate to offer some additional thoughts.

As you are well aware, the College Savings Plan Network ("CSPN") has committed to enhancing its website so that consumers will be better able to compare the expenses, investment performance and features of all 529 college savings plans. We fully support the development of the enhanced website and have promised our support to CSPN. Pending implementation of the enhanced website, we respectfully request that the MSRB defer any action on the portions of Notice 2005-28 that relate to increased suitability obligations on selling dealers.

Please do not hesitate to call me at 817-474-8298 if you believe we can be of further help.

Sincerely,

David J. Pearlman
Chairman

September 15, 2004

Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street – Suite 600
Alexandria, Virginia 22314

Re: Notice 2004-16 (June 10, 2004) Request for Comments on the Amendments to Advertisements of Municipal Fund Securities and Draft Interpretative Guidance on Disclosure in Connection with Out-of-State Sales of College Savings Plan Shares

Dear Mr. Lanza:

The College Savings Plan Network ("CSPN"), the national organization of states that establish and administer Section 529 Plans, respectfully submits the following comments in response to the captioned Notice, released by the Municipal Securities Rulemaking Board ("MSRB") on June 10, 2004 (the "Notice"). In these comments, proposed additions to language appearing in the Notice are shown as underscored and proposed deletions are stricken through.

1. The Notice specifically requests comments on the proposed method of calculating performance to appear in advertisements as set forth in the proposed new Rule G-21(e)(ii). CSPN strongly supports the effort to develop a uniform method of calculating performance.

To assure that the methodology for calculating performance is consistent across Section 529 college savings plans, CSPN suggests that the MSRB consider establishing the following assumptions to be used when calculating returns for a Section 529 college savings plan investment:

a) That the distribution will be used for qualified higher education expenses;

b) That the distribution is tax exempt with a footnoted acknowledgement that the distribution will be taxable and the after-tax return would differ, if the current law sunsets.

Additionally, since the purpose of Section 529 college savings plan investments is to save for qualified higher education expenses which would be eligible for tax-free distributions under current law, CSPN suggests that proposed Rule G-21(e)(ii) should clarify that an after-tax return for a Section 529 college savings plan investment does not need to be

presented in accordance with SEC Rule 482/Form N-1A , which anticipates a taxable investment.

2. Proposed new subsection G-21(e)(i)(A)(1) fails to take into account that many state programs offer specific benefits to both the investor and the account designated beneficiary. CSPN proposes that the referenced subsection read:

> 1) " If the advertisement relates to municipal fund securities issued by a qualified tuition program[1] under Internal Revenue Code Section 529, a statement that advises an investor to consider, before investing, whether the investor's or designated beneficiary's home state offers any state tax or other benefits that are only available for investments in such state's qualified tuition program."

3. In addition to the specific proposed subsection G-21(e)(i)(A)(1), the Notice asks for comment on whether the proposed language should require a reference in advertisements of qualified tuition plans to a web site maintained by the MSRB for more information, and, if so, what information should be required. CSPN believes that it is not necessary to require advertisements to include a reference to the MSRB web site for additional information. Currently, the CSPN web site includes links to the web sites of all qualified tuition programs, where each state issuer can maintain appropriate information. CSPN plans to enhance its current web site to invite state issuers to include program materials directly on the CSPN web site. CSPN believes that voluntary placement of materials prepared by the state issuers is the most appropriate manner of creating a general information center for these materials. CSPN does not believe, even when such a site is fully operational, that it will be appropriate to mandate a reference to that site in advertisements.

4. Proposed new Subsection Rule G-21(e)(i)(C) requires that the disclaimers required by Subsections (e)(i)(A) and (B) be included in radio and television advertisements and given equal emphasis to and placed in close proximity to the performance data. CSPN requests that the MSRB consider the brief run time (15 – 30 seconds) of radio and television advertisements and allow advertisers to include disclaimers that take into account the time the advertisement will run and allow adequate disclaimers consistent with the proposed rule.

5. Proposed new Subsection (e)(v) appears to impose a significant disclaimer burden on what may be minimal language referring in a general way to a state tax or other benefit offered by a college savings program. CSPN believes that for general statements of benefits, general statements of limitation are appropriate, provided that the investor is

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[1] Although the proposed Subsection references a qualified tuition program, CSPN understands that the Interpretive Guidance and rule proposals in the Notice would be applicable only to college savings programs and not prepaid programs, which are not municipal fund securities. CSPN requests that this understanding be made explicit in the definition of a municipal fund security.

directed to the applicable disclosure document for additional information. CSPN also notes that some state benefits may not be specifically created under state law, but implemented by the state entity administering the college savings program under a general grant of authority. CSPN suggests the following modifications to the second section of proposed Rule G-21(e)(v):

> "In the case of an advertisement that includes statements regarding tax or other benefits offered ~~under state or federal law~~ by a qualified tuition program, the advertisement must make clear ~~the nature of such benefits and~~that the availability of such benefits may be materially limited based upon residency, purpose for or timing of, ~~share redemption~~ withdrawals, or other factors, as applicable, and must refer the investor to the official statement for full descriptions of, and any limitation on, the receipt of such benefits, which reference ~~limitations~~ must be ~~described in the advertisement and~~ presented in close proximity to, and in a manner no less prominent than, the reference to ~~description of~~ such benefits. "

6. The Notice seeks comment on a Draft Interpretive Guidance on Disclosure of In-State Benefits under Rule G-17. CSPN has addressed the concern raised by the Draft Interpretive Guidance in its Voluntary Disclosure Principles Statement No. 1, released in draft form in May 2004 ("CSPN Disclosure Principles"). We believe that the formulation with regard to tax or other benefits set forth in the CSPN Disclosure Principles is an appropriate standard to include in the Draft Interpretive Guidance. CSPN urges the adoption of the language previously proposed in the comment submitted by *Hawkins, Delafield & Wood LLP* on this point, and also suggests that the first sentence of the first paragraph of the Interpretive Guidance be revised to read:

> "In the case of sales to a customer of out-of-state college savings plan interests, Rule G-17 requires a dealer to disclose, at or prior to the time of trade, that college savings plan interests offered by other states may offer tax or other benefits to taxpayers or residents of those states that are not available with regard to the offered interest in the out-of-state college savings plan and that taxpayers or residents of those states should consider such state tax treatment and other benefits, if any, before making an investment decision." ~~that depending upon the laws of the customer's home state, favorable state tax treatment for investing in a college savings plan or other benefits offered under state law in connection with investing in college savings plans may be available only if the customer invests in a college savings plan offered by the customer's home state.~~

7. The second paragraph of the Draft Interpretive Guidance is tantamount to prescribing what must be included in an Official Statement, as well as where and how it must be placed. While the Draft Interpretive Guidance acknowledges that the MSRB has no authority to mandate inclusion of any particular items in an Official Statement, the Draft Interpretive Guidance language effectively does that. CSPN objects to the inclusion of language in the Interpretive Guidance specifying any requirement in the Official Statement.

Thank you for your consideration of these comments. Representatives of CSPN would be pleased to elaborate on, or discuss with you, any matters raised in these comments or in the Notice.

Sincerely,

Diana F. Cantor
Chair, College Savings Plans Network
Executive Director, Virginia College Saving Plan

CSPN

College Savings Plans Network

July 29, 2005

Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: Comments Concerning MSRB Notice 2005-28
Draft Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans

Dear Mr. Lanza:

The College Savings Plans Network (CSPN), on behalf of its State members, is pleased to have this opportunity to comment on MSRB Notice 2005-28, Draft Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans issued May 19, 2005 (the "Interpretive Notice"). CSPN appreciates the Board's continuing provision of guidance to assist investors seeking to purchase 529 College Savings Plans. As your reference to the College Savings Plans Network's Disclosure Principles Statement No. 1 reflects, CSPN is very concerned with assuring that investors have appropriate, consistent information to assist in their investment in 529 College Savings Plans ("529 Plans"). The CSPN would like to offer comments on three (3) aspects of the Interpretive Notice.

1) The feasibility of creating one or more centralized websites providing summary information on the material features of 529 plans.

The Interpretive Notice seeks comment on the feasibility of creating one or more centralized websites to provide summary information of the material features of 529 Plans, together with direct links to all 529 Plan offering materials and related information. The Interpretive Notice specifies that the goal of the online site would be to provide summary information that is sufficiently complete and understandable to permit dealers to fully rely on the website to meet the obligations to review established industry sources.

a) Creation by the MSRB of a centralized website is unnecessary

At this time, CSPN maintains a website found at www.collegesavings.org ("CSPN Website") which provides both municipal securities dealers and investors with easily navigable, free access to the information that the Notice identifies. The CSPN Website includes a 529 Locator in which an individual enters any State name or clicks on its profile on a national map and is instantly linked to details about that State's program(s). In addition to providing a link to the offering materials for that State's program, the landing page for each State provides a summary of certain details including, if applicable:

- Whether there is a residency requirement;
- State tax incentives;
- Other State incentives;
- Some pages also provide a section for updated Program News.

Thus, CSPN has already created an easy to use on-line source for information and offering materials voluntarily provided directly by State issuers. This website more than adequately enables dealers to obtain both summary and detailed information with regard to the 529 Plans they offer. The site also gives every 529 Plan investor a centralized clearinghouse for 529 Plan information. Indeed, CSPN believes that the existing CSPN website both substantively achieves the goals specified in the Interpretive Notice for a centralized website and provides a level of access to information with regard to a particular type of investment vehicle is unprecedented both in the municipal and private markets. In addition, CSPN is concerned that establishment of by the MSRB of an additional centralized website would unnecessarily risk investor confusion, as discussed in more detail in the following section.

b) The creation by the MSRB of a centralized website with summary information is not mandated by current law.

CSPN is strongly opposed to any regulatory body, including the MSRB, creating a centralized website on which it provides summary information about 529 Plans. Any such action would be contrary to the policy of Section 3(a)(2) of the Securities Act of 1933 (the "Securities Act"), s. Section 2(b) of the Investment Company Act of 1940 (the "Investment Company Act") and Section 202(b) of the Investment Advisers Act of 1940 (the "Investment Advisers Act"), which each provide that States are exempt from the registration and reporting provisions of the federal securities laws. In order to effectuate a centralized website, the MSRB would effectively be requiring every State issuer of Section 529 Plan interests (whether or not the 529 Plan is offered by a broker/dealer or other regulated entity) to provide its offering materials to the MSRB. CSPN strongly objects to any regulation that either directly or indirectly regulates the offering materials of State issuers. CSPN views any such regulation to be a violation of the

policy embodied in Section 3 of the Securities Act, Section 2(b) of the Investment Company Act and Section 202(b) of the Investment Advisers Act. In this connection, we note as well that Section 529 of the Internal Revenue Code clearly evinces Congressional intent for States to be primarily responsible for all aspects of the administration of their 529 Plans.

CSPN is additionally concerned with the aspect of the proposal that would authorize the MSRB or other website provider to provide summary information of the offering materials provided to the website provider. In this way, the MSRB or another website provider would be determining which portions of a State issuer's offering materials are the most significant or material, a determination which is best made by the State issuer of the 529 Plan. Each 529 Plan is unique. For a centralized entity to be responsible for distilling the information that is the most significant or material and properly interpreting and summarizing that information will require significant effort and diligence and has a strong likelihood of providing inaccurate information or highlighting information that is not as significant or relevant to one or more 529 Plans. Further, such a distillation is directly contrary to the MSRB's long-held view that the Official Statement is the definitive disclosure document and that purchasers should not be encouraged to rely on any other information. CSPN would view any regulatory maintenance of such information to be contrary to the policy embodied in Section 3 of the Securities Act, Section 2(b) of the Investment Company Act and Section 202(b) of the Investment Advisers Act.

As noted in the Interpretive Notice, CSPN has proactively addressed general 529 Plan disclosure concerns through the promulgation of its Disclosure Principles Statement No. 1 ("DP1") to provide guidance and consistency in the drafting of offering materialsDP1 has been widely implemented by 529 Plans. CSPN wishes to advise you that it has recently developed and submitted for approval by the National Association of State Treasurers its Disclosure Principles Statement No. 2 ("DP2"), which is anticipated to include the an expanded locator concept, which will assist investors in finding similar information in the offering materials prepared by various State issuers, while still using only the materials authorized by that State issuer. CSPN strongly believes that this expanded locator as well as other aspects of DP2 and the useful information available on the CSPN website, will be the most effective and appropriate approach to enhancing investor accessibility to pertinent 529 Plan information.

2) Proposed increased suitability requirements for out-of-state sales are excessive.

Notice 2005-28 would require that broker/dealers would need to take steps in addition to the traditional suitability analysis to establish the existence of reasonable grounds for recommending the

offered 529 Plan to the customer based on information about that security and a comparative analysis of the customer's home State 529 Plan with the out-of-state 529 Plan being offered.

Such additional suitability analysis is not required for the sale of any other securities, (including, of course, state and local government debt and securities that offer state as well as federal tax benefits) and should not be established with respect to 529 Plans offered by the States, setting them apart from every other investment vehicle available. In offering such exempt securities, or mutual funds registered under the Investment Company Act, notwithstanding that such debt securities or funds may offer particular tax benefits to residents of a certain State or any number of other characteristics that the Investment Advisor may deem appropriate for that customer, the dealer is not required to specifically ascertain and document that the customer does not want the fund with particular tax or other advantages. The Interpretive Notice appears intended to require municipal securities dealers to become fully familiar with the terms of all 529 Plans before offering any such 529 Plan. CSPN believes this extraordinary burden to be unprecedented and likely to significantly discourage the marketing of 529 Plans. This would defeat the Congressional and state purposes in establishing these programs. CSPN wholeheartedly supports the need for each 529 Plan to advise potential investors of the various tax and other benefits that may be available through that investor's home State 529 Plan. In fact, both DP1 and DP2 specifically require such disclosure in each member's 529 Plan disclosure materials.

3) Requirement that a Dealer Determine that the Issuer has provided all Material Information

Another aspect of Notice 2005-28 of concern to the State issuer members of CSPN, is the requirement that a dealer determine whether or not "the issuer has not included the material information that the dealer is required to disclose under G-17, or if such information is not presented in the program disclosure with adequate prominence, the dealer would remain obligated to disclose such information separately to the customer under G-17…". This raises the possibility that a single dealer may determine that a State issuer's offering materials do not include all materially relevant information, thus calling the issuer's determination to include or omit particular information or even the placement of particular information within the offering materials into question. This would create a constant second-guessing aspect as to the validity of offering materials created and distributed by State issuers. Once again, CSPN views any regulation which would require a third-party determination as to the suitability of a State issuer's disclosure materials to be, contrary to the policy embodied, Section 3 of the Securities Act, Section 2(b) of the Investment Company Act and Section 202(b) of the Investment Advisers Act and Section 529 of the Internal Revenue Code.

Thank you for this opportunity to comment on the Interpretive Notice. If we can provide any further information on our comments, please contact the undersigned at (859) 244-8175 or Elizabeth Bordowitz, Esq. At (207) 623-3263 or Mary Anne Busse O'Donnell, Esq. At (410) 576-6462.

Very truly yours,

Tim Berry
Chair, College Savings Plans Network &
Indiana State Treasurer

cc: Elizabeth Bordowitz, Esq., Chair, CSPN Lawyer's Committee
Mary Anne Busse O'Donnell, Esq., Chair, CSPN Disclosure and Governance Committee

COLLEGE SAVINGS PLANS OF MARYLAND

August 10, 2005

Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, Virginia 22314

RE: MSRB Notice 2005-28, Draft Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans

Dear Mr. Lanza:

On behalf of the College Savings Plans of Maryland (CSPM) and its Board, I would like to take the opportunity to comment on the above-referenced Notice. CSPM is an independent agency of the State of Maryland and administers two 529 College Savings Plans – the Maryland Prepaid College Trust and the Maryland College Investment Plan.

As fiduciaries of account holders in each of our plans, we view excellent, thoughtful disclosure as one of our key responsibilities. We take great care in ensuring that CSPM representatives deliver plan information to investors and potential investors in a fair and efficient manner. In fact, we were one of the first States to adopt the College Savings Plans Network (CSPN) Disclosure Principles Statement No. 1 and will be incorporating Disclosure Principles Statement No. 2 into our enrollment materials this fall.

In support of excellent 529 plan governance, we respectfully submit our concurrence and support of the comments made to you by CSPN in its letter of July 29, 2005.

Thank you for the opportunity to comment on this matter. If you have any questions or if we can provide further information, you may contact Mary Anne Busse O'Donnell, Esq. at (410) 576-6462 or Joan Marshall, Executive Director of CSPM at (410) 767-3225.

Very truly yours,

Nancy K. Kopp

Nancy K. ~~Kopp~~
Treasurer, State of Maryland and
Chair, College Savings Plans of
Maryland

cc: Mary Anne Busse O'Donnell
Joan Marshall
Tim Berry, Indiana State Treasurer and
Chair, College Savings Plans Network

COLLEGE SAVINGS PLANS OF MARYLAND
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www.collegesavingsmd.org | mpct@choosemaryland.org

December 7, 2005

Mr. Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street
Suite 600
Alexandria, VA 22314-3412
703.797.6700

Re: Notice 2005-28

Dear Mr. Lanza:

The Fidelity Investments group of companies, which includes municipal securities dealers offering 529 college savings plans, would like to add its voice to the discussion of the proposed changes to interpretations of conduct and suitability rules governing the sale of 529 college savings programs set forth in MSRB Notice 2005-28 (the "Notice"), and to express its concern about current NASD examination and enforcement activities relative to dealers' suitability obligations under MSRB rules.

Fidelity concurs with the comment letter submitted by the College Savings Foundation on July 29, 2005. Fidelity does not believe that a deviation from well settled principles of suitability under securities law is warranted in the context of 529 plans. Fidelity believes that a requirement for dealers to perform plan comparisons before making recommendations will be viewed by selling dealers as overly burdensome. We also believe that selling dealers will find the concept of comparative suitability to be one that is so risky they will simply abandon the sale of 529 plans in states that provide more than minimal benefits conditioned on participation in the home state plan. We believe that the result of adopting the proposals in the Notice would be that in a significant number of states, consumers will be left with a stark choice; participation in the home state plan, or participation in no 529 plan at all.

We are already receiving anecdotal evidence that some selling dealers are withdrawing from the 529 market in response to current activities. We are particularly troubled by the fact that the NASD appears to be incorporating the proposals contained in the Notice into its enforcement posture, and request that you remind the NASD that the Notice is a proposal, not a statement of the current state of the law.

Federal securities regulation has never been premised on the concept that a dealer is obligated to determine the most suitable investment of a particular type for any customer, and we see no reason to place upon the 529 college savings plan industry the unprecedented burdens contained in the Notice. Fidelity respectfully urges that the Notice be withdrawn.

Sincerely,

David J. Pearlman
Senior Vice President and Deputy General Counsel
Fidelity Investments

cc: Barbara Z. Sweeney
Senior Vice President and Corporate Secretary
National Association of Securities Dealers

FINANCE AUTHORITY OF MAINE

Business & Education at Work for Maine

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E-mail: info@famemaine.com URL: www.famemaine.com FAX: 1-207-623-0095 TTY: 1-207-626-2717

September 13, 2004

Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street – Suite 600
Alexandria, Virginia 22314

Re: Notice 2004-16 (June 10, 2004) Request for Comments on the Amendments to Advertisements of Municipal Fund Securities and Draft Interpretative Guidance on Disclosure in Connection with Out-of-State Sales of College Savings Plan Shares

Dear Mr. Lanza:

The Finance Authority of Maine (the "Authority"), an independent agency of the State of Maine responsible for the administration of numerous commercial and education finance programs including the Maine College Savings Program which is known as the NextGen College Investing Plan®, respectfully submits the following comments in response to the captioned Notice, released by the Municipal Securities Rulemaking Board ("MSRB") on June 10, 2004 (the "Notice"). In these comments, proposed additions to language appearing in the Notice are shown as underscored and proposed deletions are stricken through.

1. The Notice specifically requests comments on the proposed method of calculating performance to appear in advertisements as set forth in the proposed new Rule G-21(e)(ii). The Authority strongly supports the effort to develop a uniform method of calculating performance.

To assure that the methodology for calculating performance is consistent across Section 529 college savings plans, the Authority suggests that the MSRB consider establishing the following assumptions to be used when calculating returns for a Section 529 college savings plan investment:

a) That the distribution will be used for qualified higher education expenses;

b) That the distribution is tax exempt, with a footnoted acknowledgement that the distribution will be taxable and the after-tax return would differ, if the current law sunsets.

Additionally, since the purpose of Section 529 college savings plan investments is to save for qualified higher education expenses which would be eligible for tax-free distributions under current law, the Authority suggests that proposed Rule G-21(e)(ii) should clarify that an after-tax return for a Section 529 college savings plan investment does not need to be presented in accordance with SEC Rule 482/Form N-1A, to the extent that it anticipates a taxable investment.

2. Proposed new subsection G-21(e)(i)(A)(1) fails to take into account that many state programs offer specific benefits to both the investor and the account designated beneficiary. The Authority proposes that the referenced subsection read:

> 1) " If the advertisement relates to municipal fund securities issued by a qualified tuition program[1] under Internal Revenue Code Section 529, a statement that advises an investor to consider, before investing, whether the investor's or designated beneficiary's home state offers any state tax or other benefits that are only available for investments in such state's qualified tuition program."

3. In addition to the specific proposed subsection G-21(e)(i)(A)(1), the Notice asks for comment on whether the proposed language should require a reference in advertisements of qualified tuition plans to a website maintained by the MSRB for more information, and, if so, what information should be required. The Authority believes that it is not necessary to require advertisements to include a reference to the MSRB website for additional information. Currently, the CSPN website includes links to the websites of all qualified tuition programs, where each state issuer can maintain appropriate information. The Authority understands that CSPN plans to enhance its website to invite state issuers to include program materials directly on the CSPN website. The Authority believes that voluntary placement of materials prepared by the state issuers is the most appropriate manner of creating a general information center for these materials. The Authority does not believe, even when such a site is fully operational, that it will be appropriate to mandate a reference to that site in advertisements.

4. Proposed new Subsection Rule G-21(e)(i)(C) requires that the disclaimers required by Subsections (e)(i)(A) and (B) be included in radio and television advertisements and given equal emphasis to and placed in close proximity to the performance data. The Authority requests that the MSRB consider the brief run time (15 – 30 seconds) of radio and television advertisements and allow advertisers to include disclaimers that take into account the time the advertisement will run and allow adequate disclaimers consistent with the proposed rule.

5. Proposed new Subsection (e)(v) includes references to "shares" that are not appropriate for many qualified tuition programs. The Authority also notes that some state benefits may not be specifically created under state law, but implemented by the state entity administering the college savings program under a general grant of authority. The Authority suggests the following modifications to the second sentence of proposed Rule G-21(e)(v):

> "In the case of an advertisement that includes statements regarding tax or other benefits offered ~~under state or federal law~~ by a qualified tuition program, the advertisement must make clear ~~the nature of such benefits and~~ that the availability of such benefits may be

---

[1] Although the proposed Subsection references a qualified tuition program, the Authority understands that the Interpretive Guidance and rule proposals in the Notice would be applicable only to college savings programs and not prepaid programs. The Authority requests that this understanding be made explicit in the definition of a municipal fund security.

materially limited based upon residency, purpose for or timing of, ~~share redemption~~ withdrawals, or other factors, as applicable, which limitations must be described in the advertisement and presented in close proximity to, and in a manner no less prominent than, the reference to ~~description of~~ such benefits. "

6. The Notice seeks comment on a Draft Interpretive Guidance on Disclosure of In-State Benefits under Rule G-17. CSPN has addressed the concern raised by the Draft Interpretive Guidance in its Voluntary Disclosure Principles Statement No. 1, released in draft form in May 2004 ("CSPN Disclosure Principles"). The Authority believes that the formulation with regard to tax or other benefits set forth in the CSPN Disclosure Principles is an appropriate standard to include in the Draft Interpretive Guidance. The Authority urges the adoption of the language previously proposed in the comment submitted by *Hawkins, Delafield & Wood LLP* on this point, suggesting that the first sentence of the first paragraph of the Interpretive Guidance be revised to read:

> "In the case of sales to a customer of out-of-state college savings plan interests, Rule G-17 requires a dealer to disclose, at or prior to the time of trade, that college savings plan interests offered by other states may offer tax or other benefits to taxpayers or residents of those states that are not available with regard to the offered interest in the out-of-state college savings plan and that taxpayers or residents of those states should consider such state tax treatment and other benefits, if any, before making an investment decision." ~~that depending upon the laws of the customer's home state, favorable state tax treatment for investing in a college savings plan or other benefits offered under state law in connection with investing in college savings plans may be available only if the customer invests in a college savings plan offered by the customer's home state.~~

7. The second paragraph of the Draft Interpretive Guidance is tantamount to prescribing what must be included in an Official Statement, as well as where and how it must be placed. While the Draft Interpretive Guidance acknowledges that the MSRB has no authority to mandate inclusion of any particular items in an Official Statement, the Draft Interpretive Guidance language effectively does that. The Authority objects to the inclusion of language in the Interpretive Guidance specifying any requirements in the Official Statement.

Thank you for your consideration of these comments. I would be pleased to elaborate on, or discuss with you, any matters raised in these comments or in the Notice.

Sincerely,

Elizabeth L. Bordowitz
General Counsel

cc: John C. Witherspoon, CEO

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July 28, 2005

Ernesto A. Lanza
Senior Associate General Counsel
MSRB
1900 Duke Street, Suite 600
Alexandria, VA 22314

RE: Request for Comments on Draft Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans.

Dear Sir or Madam:

1st Global Capital Corp. ("1st Global") is a fully disclosed retail broker-dealer registered to conduct business in all domestic jurisdictions, with over 1200 Registered Representatives offering securities services through nearly 600 branch and non-branch locations.

This letter is being written pursuant to your request for comments on the draft interpretation on customer protection obligations relating to the marketing of 529 College Savings Plans. 1st Global's comments are provided below.

I. Centralized Source of Information

The MSRB sought comment on the feasibility of creating one or more centralized websites (or enhancing existing web-based resources) that would provide on-site summary information to allow dealers and customers to make meaningful comparisons of the features of 529 plans. 1st Global supports this proposition. Obviously, a centralized data source reduces the complexity of gathering the necessary information required for disclosure. In addition, the goal of providing *free* access to information to dealers and investors is consistent with the spirit of disclosure rules. Furthermore, a website sponsored by the MSRB would alleviate dealer and customer concerns regarding complete and accurate information. A centralized source of information would alleviate the problems associated with using multiple sources, which includes inconsistent information.

II. Disclosure Obligations

The MSRB sought comment on the mechanics of the proposed point of sale disclosure obligations relating to the marketing of 529 plans. 1st Global proposes that these disclosure obligations could be met by supplementing current disclosures with a web address containing all necessary information at the point of sale (plan disclosure document). Currently, 1st Global requires its Registered Representatives to disclose all material information relating to the 529 plan being offered. In addition to providing his or her customer with the plan disclosure document, 1st Global requires its Registered Representatives to review and complete the attached Mutual Fund/529 Plan Disclosure Form with each customer. 1st Global believes that the most efficient way to meet the proposed disclosure obligations would be to supplement its current procedures by requiring the disclosure of a central website

1st Global is opposed to a point of sale disclosure form in the format previously proposed by the Securities and Exchange Commission. Requiring a detailed point of sale disclosure form in addition to the plan sponsors disclosure document would only overwhelm customers with an abundance of information. The plan sponsors disclosure document already contains the necessary information relating to that particular plan. Supplementing this information with a web site containing links to all other plans (particularly home state plans) provides a simplified approach to the requisite disclosure requirements.[1]

Thank you for the opportunity to submit comments on the issues raised in the above-referenced publication. If you have any questions regarding the information provided above, please do not hesitate to contact me at (214) 378-0376.

Sincerely,

Judith A. Wilson
Compliance Attorney

Enclosure

[1] The NASD supported the website disclosure format its letter dated May 4, 2004 to the Securities and Exchange Commission.

1st GLOBAL

Mutual Fund / 529 Plan Disclosure

Client Name:_____

O Brokerage O Retail Direct

If existing brokerage account, please list account #:_____

If existing retail direct account, please list account #:_____

It is important that you understand the risks, costs and potential benefits of any securities products that you purchase.

Risk of Investing 1

The value of my shares may go up or down. At the time I redeem my shares, I may receive more or less than I paid for them. Past performance of these funds is no guarantee of future results. I understand that dollar-cost averaging does not assure a profit and does not protect against loss in declining markets.

Cost to Purchase 2

I understand that:

I will pay a sales fee for Class A shares when I purchase them up front. The amount of the up front fee I pay is based on my total payment amount. The maximum front-end sales fee is typically 5.75% (but may be as high as 8.5%). My investment in Class A shares may also be subject to ongoing fees, i.e. distribution/12(b)(1) fees (fees used to pay for a fund's advertising and distribution costs). The distribution/12(b)(1) fees for "A" shares are typically between .25% and .35% of share class assets. **I understand I can obtain fee discounts for larger purchases ("breakpoints"), through agreements to make additional purchases over a set period of time ("letter of intent"), or by telling my financial advisor about the other amounts I and/or my family members have invested with a particular fund company ("right of accumulation").** I have told my financial advisor about such investments and/or included any related 1st Global brokerage and/or advisory accounts on the 1st Global Household Relationship Form so that they can be appropriately linked for sales fee discount purposes.

My investment in Class B shares will not be subject to an initial sales fee, but I will pay higher ongoing distribution/12(b)(1) fees than Class A shares (see above) every year I hold Class B shares. The distribution/12(b)(1) fees for Class B shares are typically 1% of the share class assets. I understand that the larger the amount I invest the more likely it is that it will be less expensive for me to purchase "A" shares due to breakpoints that reduce the front-end load and the lower internal costs associated with "A" shares. **Class B shares are not no-load funds.** Due to the ongoing higher distribution/12(b)(1) fees associated with Class B shares, the potential cost savings of investing in Class A shares may be significant. For this reason, several mutual fund companies do not allow investors to purchase more than $50,000 in a Class B mutual fund and most of the remaining companies do not allow investments in excess of $100,000. I may pay a sales fee for Class B shares when I sell them at the back end. The fee varies with both the value of the shares I sell and the length of time I hold them. The back end sales fee is typically set at 5% for the first year in which the Class B shares are held. Thereafter, it decreases in units of 1 percentage point, reaching 0% in the sixth or seventh year in which the shares are held. After six to eight years, Class B shares typically convert to Class A shares, lowering the level of the ongoing distribution/12(b)(1) fee to that of Class A shares.

My investment in Class C shares will be subject to an annual ongoing distribution/12(b)(1) fee that is typically 1% of the share class assets. The 12(b)(1) fees associated with Class C shares will be higher than the distribution/12(b)(1) fees associated with Class A shares (see above). Class C shares do not typically convert to Class A shares. **For these reasons, a long-term investment in Class C shares will likely be more expensive than an investment in Class A or Class B shares.** I may pay a sales fee for Class C shares if I sell my shares within the first year of purchase. The back end sales fee is typically set at 1%.

Detailed information concerning fees and charges is contained in the mutual fund prospectus. I understand I should review that information before authorizing any purchase.

Purchases into Multiple Fund Families 3

Recommendations to utilize multiple fund families are made with the objective of achieving greater diversification of management style. I/We acknowledge that such a strategy may result in higher initial sales charges (if "A"shares are purchased) or higher ongoing expenses (if "B" or "C" shares are purchased instead of A shares) when compared to a strategy utilizing a single fund family.

Investment Time Horizon 4

I/We understand that my advisor makes recommendations based on his/her understanding of my/our investment horizon. I/We realize that even the most conservative investment requires a minimum commitment of time to remain invested since fluctuating values during a down market and the inability to delay a sale may result in a loss or larger losses. Accordingly, the more aggressive my investments the longer my investment time horizon needs to be.

Risk Factors 5

I/We understand that investments in technology, emerging markets, international or non-diversified funds entail greater potential volatility and can pose greater risk to my principal, as described in the prospectus.

Replacement of Previously Owned Mutual Fund 6

I/We understand that it is not 1st Global's policy to recommend the sale and purchase of securities unless my/our investment or personal objectives can be better served. My/Our Financial Advisor has outlined the differences between this mutual fund(s) and my previous mutual fund(s) and I/we are comfortable with the decision to change. I/we feel that the change (including any tax consequences) has been explained in terms I/we understand. There will be a contingent deferred sales charge of_____% ($_____) to redeem the current mutual fund which was purchased approximately_____ years ago and

- if "A" shares are being purchased, a new sales charge which was disclosed in Section 2 will apply. I understand that this sales charge can be avoided by exchanging within the same family of funds, OR
- if "B" or "C" shares are being purchased, a new contingent deferred sales charge which was disclosed in Section 2 will begin.

I/We have chosen this new product over our current product for the following reason(s): (check the appropriate reason)

- ○ My objective has changed from_____ _____ (objective of the original investment) to _____ (objective of the new investment).
- ○ Poor short, mid and long term performance by the fund when compared to its peer group and benchmark index.
- ○ Other. Please explain:_____ _____

529 Savings Plans 7

I understand that depending on my state of residence and the state of residence of the beneficiary, an investment in a Section 529 plan other than my state's own 529 plan may not afford me or my beneficiary certain state tax benefits (like a state income tax deduction). In addition to state tax benefits, I understand that some states offer some or all of their residents, if they invest in their in-state college savings plan, other benefits such as scholarships to in-state colleges, matching grants into their college savings plan accounts, or reduced or waived program fees. In some cases, the value of these other benefits can be considerably higher than the state tax benefits.

Detailed information regarding investment objectives, risks, fees, and expenses of the Section 529 plan is contained in the issuer's official statement. I understand that I should review that information before authorizing any purchase.

Signatures 8

I/we understand the features and risks of this product and after reading the prospectus and discussing the potential risks and rewards with my/our Financial Advisor, I/we feel that this product meets our investment objectives and risk tolerance.

_____
Client Signature Date

_____
Client Signature (if joint account) Date

_____
Financial Advisor Name Date

_____
Financial Advisor Signature

PRINCIPAL'S SIGNATURE OR STAMP

1st GLOBAL

OPS04330102

Office of Treasury and Fiscal Services

200 Piedmont Avenue, Suite 1202, West Tower
Atlanta, Georgia 30334-5527

W. DANIEL EBERSOLE
DIRECTOR

(404) 656-2168
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August 4, 2005

Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: CSPN Comments Concerning MSRB Notice 2005-28 (Draft Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans)

Dear Mr. Lanza:

I am writing on behalf of the Georgia Office of Treasury and Fiscal Services and the Georgia Higher Education Savings Plan, Georgia's Section 529 college savings plan, to express our strong support of the College Savings Plans Network comments regarding MSRB Notice 2005-28.

The intent of the United States Congress in enacting Section 529 of the Internal Revenue Code was clear: the States are to "establish and maintain" Section 529 Plans and the states are the issuers of Section 529 Plan interests. I strongly believe that, despite some anecdotal reporting in the media to the contrary, the state role brings great value to these programs. I would make the following points regarding the state role:

- The states have a vested interest in bringing higher education opportunities to our families; in fact, the original college savings plans were created by states before there was a Section 529.
- The states have established program features such as age-based investment options that meet the needs of less-sophisticated investors.
- The states have leveraged their experience as major institutional investors to establish low-cost, direct-sold college savings investment options within these programs.

Perhaps most importantly, the states have worked individually and collectively through CSPN to bring substantial levels of consumer protections to program participants. This work is evidenced by the successful development and implementation of the CSPN Disclosure Principles, and by CSPN's on-going efforts to revise and extend those Disclosure Principles.

The states and CSPN are committed to full and usable disclosure materials for 529 plans. Over the relatively short life of these programs, we have made substantial progress in bring uniformity to program offering documents, and we plan to continue this important effort.

I am enclosing a document that details the value added by the state role in administering Section 529 plans. I hope you will find this information useful in explaining our commitment to college savings plans. Our goal has been, and will continue to be, to serve the families of our respective states.

Sincerely,

W. Daniel Ebersole, Director
Office of Treasury and Fiscal Services

Attachment

College Savings Plans and Public Policy

The state administered Section 529 college savings programs are unique investment vehicles, specifically designed to achieve a number of public policy goals. These goals relate to the special challenges states face in ensuring and increasing access to higher education and building a better-educated workforce. In this perspective, the programs are inextricably linked to, and are an important component of, the overall higher education policies of the states. At their core, these programs are entities of the states, with a different purpose and different set of goals than private sector investment vehicles. This fundamental aspect of the state administered college savings plans must be kept in mind when examining the operation, oversight, and performance of the state plans.

What lies behind the development of the state plans? Over the past 30 years, college tuition rates have consistently increased by two to three times the rate of inflation each year. During this same period of time, federal financial aid funding has shifted away from student grants to providing access to guaranteed student loans. Today, nearly 60 percent of all federal financial aid is in the form of loans, substantially increasing the number of college graduates who are faced with the burden of repaying enormous student loan debt upon entering the workforce.

Concerned by the mounting financial strain placed on young families, states began to develop innovative programs designed to help families and students save for their college education. The original plans were created by states such as Florida, Michigan, Ohio and Wyoming in the late 1980's. Since the incept of these programs, over 8 million children have become beneficiaries of 529 accounts with assets of more than $67 billion dedicated to their future higher education. Additionally, nearly 475,000 students nationwide have used their assets in these programs to help pay for their college education.

Although states created Section 529 plans more than 15 years ago to encourage their citizens to save for college, the movement started to gain momentum in 1994 with Michigan's victory in the Sixth Circuit Court of Appeals. As a result of this court decision, the Michigan Education Trust prepaid tuition plan was declared to be nontaxable as an instrumentality of the state.

Following the court decision, the Internal Revenue Service declared its intention to contest the tax status of each plan on a case-by-case basis, which prompted the states to increase their efforts in Congress to clarify the federal tax treatment of the existing state programs and to implement income tax benefits to encourage families to save for higher education. In 1996, U.S. Senator Bob Graham of Florida, where a prepaid plan was well established, and U.S. Senator Mitch McConnell of Kentucky, which had a savings trust program, led a bipartisan effort to provide federal tax relief for all plans, resulting in the creation of Section 529 of the Internal Revenue Code (IRC).

The adoption by Congress of IRC Section 529 and the resulting federal tax treatment (taxes deferred on the earnings when used for higher education) spurred the development of college-savings plans nationwide. From 1996 to 2000, 30 states developed and launched a Section 529 plan, dramatically increasing the opportunities for families to save for the rising costs of higher education.

The enactment of the Economic Growth and Tax Relief Reconciliation Act on June 7, 2001, provided further congressional support for the state-run Section 529 college savings plans. The 2001 tax act exempted the earnings of Section 529 plans from federal taxation when used for higher education, further solidifying the partnership between the federal government and the states in the promotion of college savings, rather than asking families to rely on loans to fund their children's education.

By working to promote saving for college, states have provided leadership and innovation to improve educational and economic opportunities for all Americans. In an era of increasing concern over corporate governance activities and expanded governmental regulations in the markets, Section 529 college savings plans are an excellent example of what can be achieved by a public/private partnership administered through a state mandate.

What benefits do states bring to these plans?

The principal focus of the state programs, which are directly linked to the overall higher education policy of the states, is to encourage families to save for the growing expense of a college education. A key goal of the programs is to target middle- and lower-income families to save. This unique feature of the state programs points out the vital role the states play in the college savings market. Without this focus, it is unlikely that the 529 market would be so vibrant, and these families would be underserved.

Many low- and moderate income families are not sophisticated investors. Additionally, they are not a target market for financial firms, financial planners and investment advisors. These families typically do not have much discretionary income to invest or save. These are the families the state administered college savings plans are designed to help. For example, most savings plans offer age-based investment options that automatically re-balance assets depending on the age of the beneficiary, making it very easy for families to save in 529 plans. Additionally, state oversight of these programs ensures that families have access to low-fee options that are sold directly from the program, allowing families to participate without having to pay a sales commission or load. These programs also offer low monthly contribution minimums making it very easy for low- and moderate income families to participate in a program.

In setting up 529 plans, the states leverage their experience as major institutional investors to establish low-cost, low-fee college savings investment options for their residents. Many investments, such as mutual funds, require initial investments and subsequent minimum investments that are too high for most low- and moderate-income families to meet. In negotiating agreements with investment fund managers, states have typically insisted that these investment minimums be reduced so that families of all income levels can participate. Without this state involvement, financial firms would have little interest in marketing Section 529 plans to these important demographic groups. The history prior to the state establishment of the plans bears this out. The private sector had done little to establish targeted college savings initiatives. The states saw a need and moved forward to establish these innovative and highly successful programs.

Furthermore, the states' role in the selection of financial service firms or investment managers through state-regulated competitive procurement processes assures participants that they receive

better pricing and account servicing than they could obtain independently. States have been able to contract with the private sector to secure a lower fee structure for participants in the plans than those participants would receive were they to invest in the very same mutual fund through a broker or dealer.

In the absence of a requirement that Section 529 plans be established and maintained by a state, it is likely that the Section 529 market place would become much more confusing and that the confusion would deter families from saving. More investment firms would create and offer programs. Choosing the "right" program would be a more daunting task and many families would be frozen in inaction. State involvement gives the small, unsophisticated saver the confidence to invest.

Sophisticated investors have the wherewithal to start with their home state program but investigate other options and choose what is best for them. But the vast majority of low- to moderate-income families can count on their state to have done its homework, giving those families confidence to invest that they would not have otherwise. States have protected these investors by providing direct-sold, low-cost products. Where there is anecdotal evidence of overly high fees and unsuitable sales practices, it has generally been when broker/dealers sell a state's plan to residents of another state, sometimes at high costs and/or without regard to suitability for the investor.

Few, if any, private sector mutual fund firms or other investment firms actively market to low- and moderate-income families. The realities of the investment world are that larger dollar accounts are more profitable and small dollar accounts are costly to manage. State involvement in Section 529 plans, however, ensures that the marketing will reach those segments of the population not typically targeted by private-sector investment firms. In contracting with their private-sector partners, states insist on targeting marketing to all segments of the population.

Moreover, because Section 529 plans are state plans, many more outreach avenues are available to the entire population of the state. The following are a sampling of the Section 529 outreach that takes place in the states that would not be available if these were not state programs: Low-cost public service radio and television advertising; inserts placed in automobile licensing notices sent to every resident renewing a license; inserts sent with each birth certificate for a newborn or newly adopted child; outreach mailings and presentations to elementary, middle, and high school parents throughout a state; statewide workshops given to elementary and middle school guidance counselors; and contact by members of a state's legislature to their constituents through public service television shows, newsletter, and other outreach events.

Many states have appropriated millions of dollars from general tax revenues for marketing their Section 529 plan to a broad spectrum of families. These funds allow programs to purchase advertising through more traditional avenues, such as television and radio, which reach the entire state population. Additionally, the college savings programs in many states include placing employees throughout the state whose primary job responsibility is to educate families about the state's Section 529 program. None of this extraordinary outreach would occur if Section 529 plans were not state sponsored.

The states provide an essential additional layer of consumer protection for program participants. This role further distinguishes Section 529 plans from other private-sector investment vehicles available to use for college savings. In fact, we believe that the substantial level of state involvement brings more focused, and stronger investment protections to families who save for their children's college education.

All the benefits state involvement brings to Section 529 plans do not significantly increase the costs associated with these plans. Some but not all states receive funds from the program managers to cover their costs in establishing and maintaining their program. For most states, the fees actually received by the state are quite small. In most states, the bulk of the fees associated with the Section 529 plan are used to pay for investment, administrative, marketing, and operational management costs.

Most of the fees associated with Section 529 plans are no different than those associated with the mutual fund industry in general. Typically there is one additional fee, the Section 529 administrative fee, which does not otherwise exist in the general mutual fund industry. This fee is analogous to plan sponsor fees in 401(k) or 403(b) plans. They cover such functions as complex tax reporting, intensive investor customer service, management of the "fund of funds" structure, special confirmations and statements, and systems management costs. In the 401(k) or 403(b) retirement plan arena, the plan sponsor fee is often paid by the employer. Since most state programs must be self-sufficient (meaning that they are not supported by state tax dollars and participants must bear the costs of the program), the states must pass these costs on to the account owners of Section 529 plans. We are aware of no state that commingles this fee with their general fund.

Section 529 college savings plans have been extremely successful in motivating parents to invest and save for a child's higher education expenses. An estimated $70 to $100 billion more is expected to flow into Section 529 plans over the next five years. For millions of American children, the prospect of a brighter future is becoming a reality through the efforts of states and their private sector partners who operate the programs and the families who participate in them.

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August 20, 2004

Ernesto A. Lanza
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Re: Notice 2004-16 (June 10, 2004) Request for Comments on Draft Amendments Relating to Advertisements of Municipal Fund Securities and Draft Interpretive Guidance on Disclosure in Connection with Out-of-State Sales of College Savings Plan Shares

Dear Mr. Lanza:

The following comments in response to the captioned Notice released by the Municipal Securities Rulemaking Board on June 10, 2004 (the "Notice") are respectfully submitted by Hawkins Delafield & Wood LLP. Our firm regularly acts as counsel to state and local governments and their instrumentalities with respect to securities, tax and contractual matters in connection with public programs involving the issuance of securities or application of public funds. In this capacity, we have represented public entities in several States in connection with the establishment and administration of their respective college savings plans. We have also represented public entities in a number of States who administer, invest in or borrow from local government pools. In these comments, proposed additions to language appearing in the Notice are shown underscored and proposed deletions are shown within square brackets.

1. The proposing notice requested comments on whether disclosure language for advertisements of college savings plans should be required to include a reference to a website maintained by the Municipal Securities Rulemaking Board ("MSRB"). The College Savings Plan Network ("CSPN") maintains a website which includes links to the official websites of each State-administered qualified tuition program. We understand that CSPN is currently undertaking to modify this website to permit it to make directly available to users current disclosure documents as provided to CSPN by State administrators with respect to their respective programs. We question whether any required reference to the MSRB or the CSPN website is necessary. Moreover, any such required reference should be phrased to advise investors of the respective types of information available on the CSPN, as well as the MSRB, websites. The value of including such a reference in advertisements must be evaluated in light of the limited

verbal capacity of most advertisements. In view of the other statements required to be included in college savings plan advertisements, taking into account the other proposals included in the Notice, it may be impractical to include a complete and accurate reference within most advertisements.

2. The following comments refer to the draft interpretive language included in the Notice under the caption "DRAFT INTERPRETIVE GUIDANCE ON DISCLOSURE OF IN-STATE BENEFITS UNDER RULE G-17".

(a) The first sentence of the first paragraph appears to be based upon implicit assumptions that: (i) the State in which the out-of-State customer resides or pays taxes offers tax or other benefits as inducements to participation in that State's qualified tuition program; and (ii) the out-of-State customer is aware of, and has been induced to participate in a college savings program in part on the basis of, his or her awareness of these benefits. As proposed, the requirement appears to address only the possibility that the out-of-State customer may be mistaken in assuming that he or she will receive all benefits offered by his or her home State in connection with his or her participation in another State's college savings plan. In contrast, the formulation included in Section 3(B) of the CSPN Voluntary Disclosure Principles Statement No. 1 (the "CSPN Principles") would clearly advise the out-of-State customer both of the possibility that such home State sponsored benefits exist and of the further possibility that they may be offered only with respect to participation in the home State's program. We would respectfully suggest that the MSRB should adopt the CSPN Principles formulation and that the first sentence of the first paragraph should be revised to read:

> *In the case of sales to a customer of out-of-state college savings plan interests, Rule G-17 requires a dealer to disclose, at or prior to the time of trade, that college savings plan interests offered by other states may offer tax or other benefits to taxpayers or residents of those states that are not available with regard to the offered interests in the out-of-state college savings plan and that taxpayers or residents of those states should consider such state tax treatment and other benefits, if any, before making an investment decision [that, depending upon the laws of the customer's home state, favorable state tax treatment for investing in a college savings plan or other benefits offered under state law in connection with investing in college savings plans may be available only if the customer invests in a college savings plan offered by the customer's home state].*

(b) Because no generally recognized standard of qualification for advisers who might assist customers in assessing non-tax benefits exists, it would be preferable for dealers to suggest that customers contact the programs with respect to such benefits. We would respectfully suggest that the second sentence of the first paragraph should be revised to read:

> *The dealer also must suggest to such customer that he or she consult with a qualified adviser or contact his or her home state's*

college savings plan to learn more about state tax [or other] benefits that might be available in conjunction with an investment in that college savings plan and contact that college savings plan to learn more about other benefits that might be available in conjunction with such an investment.

(c) The proposed specification of the manner in which disclosure of the potential availability of tax or other benefits through participation in the customer's home State's program must appear in a college savings plan disclosure document in order to permit dealers to satisfy this disclosure obligation through timely delivery of the disclosure document is both overly rigid and unnecessarily intrusive with respect to the development by State entities of tuition savings program disclosure. Additionally, it would result in unnecessary repetition of a formulaic legend. In contrast, Section 3(B) of the CSPN Principles recognizes as an acceptable qualified tuition program issuer disclosure practice the inclusion in disclosure documents of a statement in bold type addressing this point, but does not attempt to determine the precise location or frequency of inclusion of the statement in the disclosure document. We would respectfully suggest that the second sentence of the second paragraph should be revised to read:

A presentation of this disclosure in the official statement in close proximity to and with no less [and with equal] prominence than [to] the first presentation of substantive information regarding other federal or state tax-related consequences of investing in the college savings plan[,] and the inclusion of a reference to this disclosure in close proximity to and with no less [and with equal] prominence than [to] each other presentation of substantive information regarding state tax-related consequences of investing in the college savings plan, would be deemed to satisfy this requirement.

(d) It would be preferable to define the phrase "have reason to know", as used in the third paragraph, in order to render compliance more ascertainable. We would respectfully suggest that this paragraph be modified through the addition, following the existing language, of a new sentence reading:

A dealer would be deemed to have reason to know facts concerning benefits offered by different states if in the ordinary course of due diligence, including review of the applicable official statement, the dealer would have discovered such facts.

3. The following comments refer to the draft amendment to Rule G-21.

(a) As proposed, the new Section (e) of Rule G-21 would generally apply to all dealer advertisements with respect to interests in local government investment pools as well as to advertisements with respect to interests in college savings plans and assumes the existence of an official statement, with the apparent result that dealers would not be able to advertise these securities unless an official statement was prepared by the issuer.

This seems anomalous with respect to local government investment pools. Typically, investment in these pools is open only to governmental entities and, we believe, no official statement is typically prepared. We would respectfully suggest that the section be revised to apply solely to dealer advertisements with respect to interests in college savings plan.

(b) As proposed, new Subsection (e)(i)(A)(1) of Rule G-21 appears to be based upon the implicit assumption that all municipal fund securities arising under college savings plans are offered and marketed on an interstate basis. This, however, is not always the case. We would respectfully suggest that this Subsection should be revised to read:

> (1) If the advertisement relates to municipal fund securities issued by a qualified tuition program under Internal Revenue Code Section 529, except for advertisements for municipal fund securities that are distributed, whether by print or broadcast media, only within the state that has authorized the issuance of the municipal fund securities and that relate only to municipal fund securities that are offered exclusively to residents of that state, a statement that advises an investor to consider, before investing, whether the investor's home state offers any state tax or other benefits that are only available for investments in such state's qualified tuition program.

(c) As proposed, new Subsection (e)(v) would appear to require any dealer advertisement with respect to interests in college savings plans that refers in any manner to tax or other benefits to include a detailed description of the nature of, and of limitations applicable to receipt of, such benefits. Again, the value of invariably including such a detailed description in advertisements must be evaluated in light of the limited verbal capacity of most advertisements. In view of the other statements required to be included in college savings plan advertisements, taking into account the other proposals included in the Notice, and in view of the nature and variety of such college savings plan benefits and of the limitations applicable to such benefits, it may be impractical to include such a detailed description within most advertisements without resulting in potentially misleading or incomplete statements. We would respectfully suggest that the MSRB should permit the inclusion in dealer advertisements of general references to college savings plan benefits that are accompanied by references to the applicable disclosure document for detailed information concerning such benefits and their applicable limitations and that the second sentence of this Subsection should be revised to read:

> In the case of an advertisement that includes statements referring to [regarding] tax or other benefits offered under state or federal law, the advertisement must make clear [the nature of such benefits and] that the availability of such benefits may be materially limited based upon residency, purpose for or timing of withdrawals [share redemptions], or other factors, as applicable, and must refer to the applicable official statement for full descriptions of the nature of, and any limitations upon the receipt of, such benefits, which reference [limitations] must be

> [described in the advertisement and] presented in close proximity to, and in a manner no less prominent than, the reference to [description of] such benefits. If the advertisement includes substantive descriptions of any such benefits, the advertisement must make clear the nature of the benefits described and must make clear the nature of any limitations upon the receipt of such benefits, which description of limitations must be presented in close proximity to, and in a manner no less prominent than, the description of the benefits.

Thank you for your consideration of these comments. We would be happy to have the opportunity to discuss with you any of the issues raised or to be of any other assistance to you in connection with the matters addressed in the Notice.

Very truly yours,

HAWKINS DELAFIELD & WOOD LLP

Kenneth B. Roberts

KBR/jy

INVESTMENT COMPANY INSTITUTE

September 10, 2004

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Re: MSRB Notice 2004-16 Relating to Advertising of Municipal Fund Securities and Guidance on Disclosure in Connection with Out-of-State Sales of 529 Plan Shares

Dear Mr. Lanza:

The Investment Company Institute[1] appreciates the opportunity to express its views in support of the proposals set forth in Municipal Securities Rulemaking Board Notice 2004-16.[2] The MSRB's Notice proposes to: (1) provide greater consistency between the MSRB's advertising rule, Rule G-21, with the rule of the Securities and Exchange Commission applicable to mutual fund performance advertisements; and (2) revise and update the interpretive guidance the MSRB issued in 2002 on the application of MSRB Rule G-17, relating to fair dealing with customers, to sales of 529 plan securities to out-of-state investors.[3]

Tailoring the MSRB's advertising rule to provide for consistency of regulation of performance advertising between 529 plan securities and mutual fund shares will better serve the investing public and municipal securities dealers. Investment company securities and municipal fund securities share many common features in their offer and sale, including in the manner in which they are advertised to investors. Subjecting these common features to similar standards of regulation reduces both the confusion to investors that might result from disparate

[1] The Investment Company Institute is the national association of the American investment company industry. More information is available about the Institute at the end of this letter.

[2] *See* MSRB Notice 2004-16, *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* (June 10, 2004) (the "MSRB's Notice").

[3] *See Rule G-21 Interpretation – Application of Fair Practice and Advertising Rules to Municipal Fund Securities* (May 14, 2002) (the "MSRB's 2002 Interpretive Guidance").

regulation as well as the burdens that conflicting regulatory requirements would impose upon persons offering and selling both types of securities. Moreover, inasmuch as the NASD is charged with inspecting securities firms for compliance with the rules of the MSRB and the SEC, including the advertising rules, uniform standards should facilitate the NASD's ability to conduct such inspections. As such, the Institute again commends the MSRB for its efforts to revise its rules governing the offer and sale of municipal fund securities to be consistent with the regulation applicable to the offer and sale of registered investment company securities under the Federal securities laws, to the extent practicable.

To provide even greater consistency between the MSRB's rules and those applicable to mutual fund performance advertisements, we recommend, as discussed in detail below, that the MSRB further revise Rule G-21 to protect investors from inappropriate reliance on stale performance information. In the interest of consistency of regulation, we also recommend that the MSRB conform its interpretation of any provisions added to Rule G-21 to relevant SEC interpretations. As regards the compliance date for the revised rule, we recommend that the MSRB provide an appropriate transition period for compliance with any revisions adopted to Rule G-21. With respect to the proposed Interpretive Guidance, for the reasons set forth below, we recommend that its discussion relating to the location of disclosure of state tax and other benefits in an issuer's Official Statement be revised to avoid unduly redundant disclosure.

I. PROPOSED REVISIONS TO MSRB RULE G-21, RELATING TO ADVERTISING

The MSRB has proposed to substantially revise Rule G-21 as it applies to municipal fund securities. In particular, the MSRB has proposed to supplement the rule's general anti-fraud standard with specific disclosure standards. These new standards, which are largely based on the MSRB's 2002 Interpretive Guidance and consistent with Rule 482 under the Securities Act of 1933,[4] would add to the rule more specific standards governing the computation, disclosure, and display of performance information in advertisements.[5] The new standards are intended to provide enhanced information to investors and greater uniformity in the computation and display of performance information for municipal fund securities, thereby addressing concerns with the lack of comparability of this information.

For the reasons noted above, the Institute is pleased that the MSRB's proposed revisions to Rule G-21 seek to track the requirements of Rule 482. As recognized in the MSRB's Notice, certain items of information that exist in the mutual fund industry – such as the information disclosed in a mutual fund's registration statement, prospectus, or statement of additional information – do not exist for municipal fund securities. Accordingly, it was necessary for the MSRB's proposal to make certain modifications to the provisions of Rule 482 when incorporating its substance into Rule G-21. The MSRB's Notice requests comment on these proposed modifications. In our view, the proposed modifications satisfactorily address any

[4] As discussed in the MSRB's Notice, Rule 482 governs advertisements by investment companies, including those containing performance information.

[5] According to the MSRB's Notice, if the amendments to Rule G-21 are adopted, the MSRB would expect to withdraw the portions of the 2002 Interpretive Guidance relating to advertisements. The Institute supports such withdrawal.

disparities that should be taken into account in incorporating the provisions of Rule 482 into Rule G-21. We therefore support the MSRB's proposed changes to Rule G-21.

A. Currentness of Performance Information

There is one area of Rule 482 that the MSRB Notice has not proposed to incorporate into Rule G-21. In particular, Subsection (g) of Rule 482 requires an advertisement that includes performance data to provide a website or toll-free or collect telephone number where an investor can obtain more current month-end information. Such website or telephone number must provide the investor performance information on the security advertised that is current to the month ended seven business days prior to the date of use of the advertisement. This provision was added to Rule 482 to address concerns that advertisements containing performance information that was current as of the most recent quarter end before the advertisement was submitted for publication could confuse or mislead investors, particularly if the fund's performance had declined significantly since the period reflected in the advertisement.[6] Adding this new requirement to Rule 482 was intended to ensure that investors who view advertisements highlighting a mutual fund's performance would be alerted to the fact that the fund's current performance may differ from that advertised and have ready access to performance data that is current to the most recent month-end.[7]

The Institute supported the addition of this requirement to Rule 482.[8] We believe the same concerns it was intended to address also exist in the context of municipal fund security performance advertisements. Therefore, the Institute strongly encourages the MSRB to revise Rule G-21 to require advertisements subject to the rule that include performance information to provide a source where investors may obtain, at no charge, performance information current to the month ended seven business days prior to the date of use of an advertisement. Not only would this ensure that investors contemplating a transaction in a municipal fund security have access to more current performance information, it would also provide for even greater uniformity between the MSRB's advertising requirements and those imposed on mutual funds under Rule 482.

B. Consistency of Implementation of Advertising Regulation

Along the lines of providing greater consistency between the advertising requirements of the MSRB and those of the Commission, the Institute recommends that the MSRB conform its interpretation of any provisions added to Rule G-21 based on Rule 482 to relevant SEC

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[6] *See Proposed Rule: Proposed Amendments to Investment Company Advertising Rules* SEC Release Nos. 33-8101, 34-45953, and IC-25575 (May 17, 2002) at p. 7.

[7] *See Final Rule: Amendments to Investment Company Advertising Rules,* SEC Release Nos. 33-8294, 34-48558, and IC-26195 (Sept. 29, 2003) (the "SEC's Adopting Release") at p. 7.

[8] *See* Letter from Amy B.R. Lancellotta, Senior Counsel, Investment Company Institute, to Mr. Jonathan G. Katz, Secretary, SEC, dated July 31, 2002. As noted in the Institute's comment letter, the Commission's proposal was largely consistent with recommendations the Institute submitted to the Commission in July 2001. *See* Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Mr. Paul F. Roye, Director, SEC Division of Investment Management, dated July 18, 2001.

interpretations. The MSRB should clarify in the notice adopting the revisions to Rule G-21 that a municipal securities dealer advertising a municipal fund security may rely upon any guidance provided by the SEC (*e.g.*, in its release adopting the amendments to Rule 482) or by the National Association of Securities Dealers relating to the implementation of Rule 482.[9]

C. Disclosure of Source Containing Generalized Information

As proposed to be amended, Rule G-21(e)(i)(A)(1) would require an advertisement for a municipal fund security to include a statement that advises an investor to consider, before investing, whether the investor's home state offers any state tax or other benefits that are only available for investments in that state's qualified tuition program. The MSRB's Notice seeks comment on whether this disclosure should also include a reference to an MSRB-maintained website where generalized information on municipal fund securities would be provided and, if so, the extent to which the information currently provided on the MSRB website should be included, modified, supplemented, or deleted. The Institute recommends that the disclosure not be required to include such a reference. We believe that there is sufficient information available in the marketplace concerning 529 plan securities to enable an investor contemplating an investment in such securities readily to obtain both general information and information about specific features of individual states' programs. As such, we do not believe it necessary that advertisements also be required to disclose a source where generalized information about such securities can be obtained. We note that we are not aware of any other investment product whose advertisements are required by law to include a source where generalized information about the type of investment product can be obtained.

II. DRAFT INTERPRETIVE GUIDANCE ON DISCLOSURES RELATING TO OUT-OF STATE PLANS

As mentioned above, in addition to proposing amendments to Rule G-21, the MSRB has proposed to enhance its 2002 Interpretative Guidance relating to the application to municipal fund securities of Rule G-17, which governs fair dealing with customers. In particular, the MSRB proposes to require a municipal securities dealer to disclose that, "depending upon the laws of the customer's home state, favorable state tax treatment for investing in a college savings plan or other benefits offered under state law in connection with investing in college savings plans may be available only if the customer invests in a college savings plan offered by the investor's home state."[10] The interpretive guidance would also require the dealer to "suggest" that the customer consult with a qualified adviser or contact his or her home state's

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[9] For example, as revised, Rule 482 requires that mutual fund advertisements include: (1) a statement that past performance does not guarantee future results; (2) a statement that current performance may be lower or higher than the performance data quoted; and (3) a toll-free or collect telephone number or website where an investor may obtain more current performance information. Although not expressly stated in the Rule, the SEC's Adopting Release clarifies that an advertisement may combine these required statements in a single sentence provided that each of the required disclosures is "clear and easy to understand." *See* SEC Adopting Release at p. 11.

[10] Examples cited in the MSRB's Notice of these non-tax benefits include "lower fees, matching grants, scholarships to state colleges, and other financial benefits." MSRB Notice at fn. 14.

college savings plan to find out more about such benefits.[11] As proposed, this disclosure would be required to be provided to an investor "at or prior to the time of trade."[12]

The Institute supports the MSRB's proposed enhancements to the 2002 Interpretive Guidance. We agree that it is important to alert investors to benefits that may only be provided to them by their home state's college savings plan program. The proposed disclosures should help ensure that an investor contemplating the purchase of an out-of-state plan makes an investment decision on the basis of more complete information. We recommend, however, that a minor revision be made to the language in the Interpretive Guidance relating to the location of the disclosure of state tax and other benefits in an issuer's Official Statement. As proposed, the Interpretive Guidance would deem the disclosure obligations of Rule G-17 to be satisfied if this disclosure appears in an Official Statement "in close proximity and with equal prominence" (1) to the first presentation of information regarding other federal or state-tax related consequences of investing in the college savings plan *and* (2) to each other presentation of information regarding state-tax related consequences. While we fully support (1), with respect to (2), we recommend that the Official Statement not be required to incorporate this disclosure in every mention of the state-tax consequences of investing in the plan. Instead, such disclosure should only be required where it would be relevant to the issue being discussed.

III. TRANSITION PERIOD

The Institute recommends that the MSRB provide an appropriate transition period for compliance with the revisions to Rule G-21. The proposed revisions to Rule G-21 will require substantial changes, not only to advertisements, but to phone systems and websites,[13] each of which will necessitate the expenditure of considerable time and resources to ensure compliance with the new requirements. We note that when similar changes were made to Rule 482 by the SEC in 1988, the Commission's proposed compliance date of 90 days from adoption was extended to 210 days to accommodate the changes necessitated by the revised rule. We believe the process municipal securities dealers will have to go through to achieve full compliance with the proposed revisions to Rule G-21[14] will be comparable to that experienced by mutual funds

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[11] While the dealer would not be required to provide the investor specific information about state tax or other benefits available to an out-of-state investor, to the extent the dealer does so, it must ensure that the information is not false or misleading.

[12] Under the MSRB's proposal, though this requirement could be satisfied if the disclosure is included in an official statement provided to the investor prior to the trade. If the disclosure is included in the official statement, it must appear in a manner that is reasonably likely to be noted by the investor, as discussed in more detail in the proposed revisions to the guidance.

[13] This is particularly true if the MSRB adopts the Institute's recommendation to require that investors have access to more current performance information.

[14] While the rule only applies to advertisements by municipal securities dealers, due to the nature of the 529 plans, it is likely to expect the state issuers of such plans to be involved with any advertisements placed by the dealer advertising the plan, which adds complexity to this process that does not arise in connection with mutual fund advertisements.

when Rule 482 was substantially revised in 1988.[15] Therefore, we recommend that the MSRB provide a 210-day transition period prior to enforcing compliance with the revised rule.

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The Institute appreciates having the opportunity to provide these comments on the MSRB's proposal. If you have any questions concerning these comments, please do not hesitate to contact the undersigned by phone at (202) 326-5825 or by e-mail at tamara@ici.org.

Sincerely,

Tamara K. Salmon
Senior Associate Counsel

cc: Jill C. Finder, Assistant General Counsel

[15] We additionally note that, when the revisions to Rule 482 were adopted by the Commission in September 2003, the Commission provided a compliance date of March 30, 2004, approximately 180 days after adoption.

About the Investment Company Institute

The Investment Company Institute's membership includes 8,600 open-end investment companies ("mutual funds"), 630 closed-end investment companies, 135 exchange-traded funds and 5 sponsors of unit investment trusts. Its mutual fund members manage assets of about $7.351 trillion. These assets account for more than 95% of assets of all U.S. mutual funds. Individual owners represented by ICI member firms number 86.6 million as of mid 2003, representing 50.6 million households. The Investment Company Institute is the national association of the American investment company industry. Many of the Institute's investment adviser members render investment advice to both investment companies and other clients. In addition, the Institute's membership includes 231 associate members, which render investment management services exclusively to non-investment company clients. These Institute members and associate members manage a substantial portion of the total assets managed by registered investment advisers.

INVESTMENT COMPANY INSTITUTE

July 29, 2005

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1900 Duke Street, Suite 600
Alexandria, Virginia 22314

Re: MSRB Notice 2005-28 Relating to Draft Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans

Dear Mr. Lanza:

The Investment Company Institute[1] appreciates the opportunity to express its concerns with the MSRB's proposed guidance regarding the obligations of municipal securities dealers in connection with selling out-of-state 529 college savings plans ("529 plans").[2]

The Institute strongly supports efforts to provide potential purchasers of 529 plans with ample information to make informed investment decisions. With respect to the purchase of out-of-state plans, informing investors, through prominent disclosure, that they may be forgoing home-state tax benefits is sufficient.[3] The MSRB's proposed interpretive guidance would go well beyond this, however, and impose on dealers[4] selling out-of-state 529 plans burdensome requirements that do not apply to sales of any other investment product, including in-state 529 plans. We are concerned that, if the proposed guidance is adopted, either many dealers will cease selling out-of-state 529 plans or the costs to investors associated with such plans will

[1] The Investment Company Institute is the national association of the American investment company industry. More information is available about the Institute at the end of this letter.

[2] *See* MSRB Notice 2005-28, *Request for Comments on Draft Interpretive Guidance on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans* (May 19, 2005) (the "Notice").

[3] *See* Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Diane G. Klink, Esquire, General Counsel, MSRB, dated April 1, 2002, in which the Institute recommended that the MSRB require municipal securities dealers to provide concise and understandable written disclosure to all customers alerting them that the customer's home state may only offer favorable tax treatment for investing in a plan offered by that state. The MSRB subsequently adopted such a requirement. *See Application of Fair Practice and Advertising Rules to Municipal Securities*, MSRB (May 14, 2002).

[4] As used in this letter, the term "dealer" refers to those persons that are municipal securities dealers subject to the MSRB's jurisdiction; the term "broker-dealer" refers to those persons, such as full-service broker-dealers, that are subject to the NASD's jurisdiction under the Securities Exchange Act of 1934.

increase. Neither of these outcomes is in the best interests of investors. For these reasons, and as discussed below, the Institute recommends that the MSRB refrain from pursuing this proposal further.

The interpretive guidance imposes a series of unique, unprecedented and unreasonable obligations on dealers that sell out-of-state 529 plans. First, it requires a dealer to affirmatively seek information from the customer in all transactions involving the offer or sale of out-of-state 529 plans, including unsolicited transactions.[5] To our knowledge, no such sweeping duty of inquiry applies to dealers or broker-dealers in any other context. Instead, MSRB and NASD rules require dealers and broker-dealers, respectively, to inquire about a customer's financial status, tax status, and investment objectives only when *recommending* a security to that customer.[6]

Second, the guidance requires a dealer to be familiar with securities that are not the subject of the particular transaction, and that the dealer may not even offer. This obligation is inconsistent with the MSRB's longstanding interpretation of MSRB Rule G-17, which requires a dealer to disclose material information solely about the transaction being effected for the customer.[7] It also will require every dealer selling an out-of-state 529 plan to be knowledgeable about every state's laws governing such plans and the plans themselves. Not only is this requirement patently unreasonable, but also it discriminates inappropriately against dealers selling out-of-state 529 plans compared to dealers and broker-dealers selling other securities products.

For example, in the municipal securities market, preferential tax treatment often is limited to residents of the state that issued the security. Yet, the MSRB has never proposed to require dealers selling municipal securities to be knowledgeable about each state's tax treatment of such securities before selling state municipal bonds to an out-of-state investor.

Third, if a dealer recommends an out-of-state 529 plan to a customer, the guidance requires the dealer to conduct a "comparative analysis" between the recommended security and any 529 plan offered by the customer's home state to ensure that the 529 plan sold to the customer is the most suitable security for the customer. A dealer that has conducted the required comparative analysis may sell a less suitable out-of-state 529 plan to the customer

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[5] If, through this proposed inquiry, the dealer determines that the customer is not a resident of the state whose plan is being offered to the customer, the Notice would require the dealer to inquire whether realizing state-based benefits is an important factor in the customer's investment decision. If it is, the dealer would then be required "to disclose material information available from established industry sources about state-based benefits offered by the home state of the customer or designated beneficiary for investing in [the home-state] plan" and whether such benefits are available to a customer who purchases an out-of-state plan. Notice at p. 10. The dealer also would have to suggest that the customer consult with his or her financial, tax, or other adviser to learn more about the home state's plan and inform the customer that he or she may want to contact the home state plan to learn more about any state-based benefits or limitations.

[6] *See* MSRB Rule G-19 and NASD Rule 2310.

[7] *See, e.g.*, Rule G-17 Interpretive Letters – *MSRB Interpretations of March 4, 1986* and *May 13, 1993*, which state that "the Board has interpreted [Rule G-17] to require that a dealer *must disclose*, at or before the sale of municipal securities to a customer, all material facts *concerning the transaction*, including a complete description *of the security*, and must not omit any material facts that would render other statements misleading." (Emphasis added).

provided the dealer (1) maintains records of the customer's direction to buy the less suitable security, (2) has a principal promptly review and approve the transaction, and (3) confirms such direction at least annually if the customer makes periodic investments in the 529 plan.[8] Again, this onerous requirement is completely unprecedented. In no other instance is a dealer or broker-dealer selling a security to a customer required to determine whether it is the "most suitable" security for the customer.

The comparative analysis requirement also raises a host of practical issues. For example, if the customer or beneficiary is in the military or otherwise likely to relocate his or her residence on a regular basis, it is not clear which residence would be relevant for the comparative analysis. Also, in this situation, it is not clear whether a comparative analysis made by the dealer could continue to be used if the customer or beneficiary moves to a new state. If not, and the new comparative analysis of the customer's or beneficiary's home state indicates that the new home state's plan is more suitable than the existing plan, it is not clear whether the dealer would be required to recommend that the customer open a new account, thereby perhaps forfeiting any breakpoint or rights of accumulation advantages that result from having a single account. It is not clear whether the new comparative analysis must take issues such as these into account in order for the dealer to satisfy its obligations under Rule G-19. Because each state's 529 plan has unique features, benefits, tax treatment, etc., it is not clear which particular plan features the dealer must consider in its comparative analysis.

Moreover, before conducting such analysis, a dealer would have to consider what liability it has under state or federal securities laws for disclosures it makes to a customer about a product that the dealer does not sell but that it must include in its comparative analysis. A dealer also would have to consider whether the tax analysis included in the comparative analysis may be construed as providing tax advice – which may be beyond the purview of the dealer's expertise. If the customer's home state 529 plan is only sold via a competing dealer, dealers likely would be concerned with having to contact a competing dealer to obtain the information necessary to conduct the comparative analysis.

This requirement might also impede the ability to effect a transaction requested by the customer inasmuch as, before the dealer can execute the trade, it must gather sufficient information about other 529 plans to enable it to conduct the comparative analysis. Dealers also would be concerned with how current the comparative analysis must be. For example, if the dealer's analysis is a month, six months, or one year old, will it be considered current? Moreover, in the event the customer purchases the out-of-state 529 plan through a periodic investment plan, the dealer would need to consider how often its analysis must be updated after the initial transaction.

Also, a dealer that sells a customer an out-of-state plan after conducting a comparative analysis would be concerned with whether Rule G-19 would require the dealer to notify the customer who purchases such plan of any subsequent changes to the customer's home state

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[8] According to the Notice, for those dealers that determine that the customer's home state plan is *more* suitable than any of the 529 plans offered by the dealer, the dealer "may wish to contact the 529 plan or its primary distributor (if any) to gain such authorization and to sell the home state 529 plan interest to the customer. The MSRB recognizes that this . . . option may not always be available." We believe that it will rarely, if ever, be available, thereby resulting in the dealer having to refer its customer elsewhere to purchase the securities.

plan that might alter the comparative analysis. If so, the dealer would have to consider the consequences for itself and the customer if the revised comparative analysis indicates another state's security may be more suitable for the customer.

These are just some of the many issues that would need to be resolved before the guidance could be implemented. The number and scope of these issues exacerbate our concern that the proposed guidance will be unworkable.

Also, the guidance places inordinate focus on state benefits associated with an in-state plan, while ignoring the fact that there are myriad reasons why an investor might choose to purchase an out-of-state plan, even in the absence of such home state benefits. Based on the foregoing, the Institute is concerned that the proposed guidance will adversely affect investors.

By applying disproportionately burdensome requirements to sales of out-of-state 529 plans, the guidance will discourage dealers from offering these securities. As a result, investors wishing to invest in 529 plans may have to do so directly with state issuers. Unlike dealers, however, that are subject to the MSRB's regulatory requirements and jurisdiction, state issuers are not subject to *any* disclosure, suitability, or other regulatory requirements, apart from the general antifraud provisions of the federal securities laws. Nor are states subject to the MSRB's jurisdiction.

Further, to the extent some dealers choose to continue offering 529 plans, the proposed requirements will increase their costs. It is likely that at least some of the additional cost will be passed through to investors.

The costs and burdens that the proposed guidance entails, in addition to being discriminatory, are unwarranted. The Notice provides no evidence of abuses in the offer or sale of out-of-state 529 plans to support the proposed onerous requirements. Nor does it explain why existing requirements – including disclosure that the customer's home state may only offer favorable tax treatment for investing in a plan offered by that state and suitability requirements – are insufficient to address potential abuses.[9] And, it provides no policy basis for singling out the offer and sale of out-of-state 529 plans and subjecting dealers to higher standards for this product than for any other.

The Institute continues to believe, as we recommended to the MSRB in 2002, that alerting customers, through prominent disclosure, of the potential loss of state tax advantages is sufficient to enable them to make an informed decision regarding the purchase of an out-of-state 529 plan. For this reason, and to avoid the adverse unintended consequences outlined above, we strongly urge the MSRB to withdraw the proposed guidance.

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[9] To our knowledge, and notwithstanding the fact that the NASD as the enforcer of the MSRB's rules has been looking at this issue for some time, there have been no enforcement proceedings commenced against dealers or broker-dealers that have alleged sale practices abuses or fraud in connection with the sale of out-of-state 529 plans (*e.g.*, sales of unsuitable securities or omissions of material facts) to customers. Given this, we question the basis for the proposed interpretive guidance to address alleged – but unsubstantiated – abuses in connection with the sale of these plans.

* * *

The Institute appreciates the opportunity to explain its significant concerns with the proposed interpretive guidance. If you have any questions concerning these comments or would like additional information regarding the proposed impact of the MSRB's proposal on dealers and the 529 plan market, please do not hesitate to contact the undersigned at (202) 326-5825.

Sincerely,

Tamara K. Salmon (by dd)

Tamara K. Salmon
Senior Associate Counsel

Attachment

cc: Ghassan Hitti
Assistant General Counsel

THE INVESTMENT COMPANY INSTITUTE

The Investment Company Institute (ICI) is the national association of the American investment company industry. ICI members include 8,521 open-end investment companies (mutual funds), 651 closed-end investment companies, 144 exchange-traded funds, and 5 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately $8.036 trillion (representing more than 95 percent of all assets of US mutual funds); these funds serve approximately 87.7 million shareholders in more than 51.2 million households.

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Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Ste 600
Alexandria, VA 22314

Re: Comments Concerning MSRB Notice 2005-28
Draft Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans

Dear Mr. Lanza:

As state treasurer and administrator of Iowa's 529 plan, *College Savings Iowa*, I am pleased to have this opportunity to comment on MSRB Notice 2005-28. I am writing to you regarding the letter dated July 29, 2005, from the College Savings Plan Network. I support the position outlined by the Network and would ask that you give the comments strong consideration.

Since Iowa created *College Savings Iowa* in 1998, I have had the opportunity to see how 529 plans have helped not just Iowans, but people across the nation, save for their children's futures. When we began the program, we hoped for modest investments and participation. What we discovered was there was a great demand for opportunities to save for college and earn tax breaks.

Today, *College Savings Iowa*, a direct sold 529 plan, has over $1 billion in assets with over 100,000 accounts. I have families continuously thanking me for helping them find a way to save for college and overcome the hurdle of trying to find the best way to save.

These plans have become a vital tool for families to make college available to the next generation. My goal, along with the members of Network, is to ensure that all families become aware of these plans and save for college. I believe that the Board plays a vital role in ensuring that families have adequate information when deciding the best way to save and I would ask that the Board consider the Network's comments.

Thank you for the opportunity to comment on the Interpretive Notice. If I can provide any further information, please contact me at 515-281-5368 or Karen Austin at 515-281-7677.

Sincerely

Michael L. Fitzgerald

Michael L. Fitzgerald
State Treasurer of Iowa

John Hancock Financial Services

U.S. College Savings

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Diana Scott
Senior Vice President
General Manager

July 28, 2005

VIA Fax : 703-797-6700

and Overnight Mail

Ernest A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: MSRB Notice 2005-28
Draft Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans

Dear Mr. Lanza:

Thank you for the opportunity to comment on MSRB Notice 2005-28 Draft Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans ("the Interpretive Notice" or "Notice"). John Hancock Freedom 529 is a national college savings plan distributed by John Hancock Distributors LLC ("JHD"), through other broker/dealers appointed by JHD. The Plan is offered by the Education Trust of Alaska ("Trust") and T. Rowe Price Associates, Inc. ("T. Rowe Price") is the Program Manager.

In its capacity as Program Manager, T. Rowe Price selected JHD to distribute the Plan through financial consultants by providing marketing and wholesaling services on behalf of the Plan. Specifically, JHD secures selling agreements with various broker-dealer organizations and/or financial institutions, and provides wholesaling services to the registered representatives or selling agents associated with these organizations. Additionally, JHD and its affiliates (collectively, "John Hancock") assist with the design and branding of the Plan, including the multi-managed investment approach to the Plan. T. Rowe Price selected John Hancock to perform these services, recognizing John Hancock's expertise in the design and distribution of third party sold financial savings vehicles. The Plan is designed for national distribution through financial consultants who will provide investment advice and recommendations for their client, the Account Holder.

T. Rowe Price Associates, Inc. is the investment advisor for the Plan. The Plan's underlying investments are offered and managed by T. Rowe Price or by the third party investment managers with whom it has entered into agreements for the purchase of shares offered by such third party managers. Although decision-making authority resides with the advisor, John Hancock does provide input to decisions regarding selection, oversight and changes to the Plan's underlying investments or managers. Subject to review and approval of the Program Manager and the Trust, John Hancock develops all Plan sales literature and marketing materials as well as the Plan Disclosure Documents.

As a general matter, John Hancock appreciates any and all initiatives aimed at educating and providing any prospective investor comprehensive information in connection with any investment, including a 529 Plan investment. In October, 2004, the Plan Disclosure materials for John Hancock Freedom 529 were revised to comply with the Voluntary Disclosure Guidelines adopted by College Savings Plan Network ("CSPN"). John Hancock supports such efforts to standardize the presentation and content of plan disclosure information to the extent such standardization facilitates meaningful comparison across like types of plans (ie. direct versus Intermediary sold; national versus in-state plans). In addition, we applaud efforts designed to assist with the conduct of recommending suitable and appropriate products, including 529 Plans, to an investor.

With respect to the Interpretive Notice, we offer the following specific thoughts and comments for your consideration:

Creation of a Centralized Website

The MSRB has proposed the creation of a centralized website which would serve as the established "industry source" to which dealer would be required to consult in fulfillment of their obligation under Rule G-17 to provide full and fair disclosure of all material facts at the point of sale and upon which the obligations of suitability described later in the Interpretive Notice may depend. As stated in the Notice, the objective of this website is to provide summary information for all available 529 plans presented in a manner to allow dealers and customers to make meaningful comparisons of the material features of 529 plans together with direct links to all 529 plan disclosure documents and related information. Savingforcollege.com, and CSPN currently maintain websites that include general information about 529 Plans as well as links to specific plans. In addition, Savingforcollege.com rates the individual Plans. Each of these sites seem to adequately provide the appropriate level of information to allow dealers and customers to make meaningful comparisons. In fact, the Notice acknowledges the MSRB's view that these websites currently operate as established "industry sources." Therefore, it appears that the goal of creating yet an additional website as a new industry source is to require that information is presented in a standardized manner and perhaps a means of dictating disclosure standards akin to registered securities for securities that are exempt from registration. Nevertheless, the first obvious question is who would establish and maintain such a website and how would the materials be summarized? The disparities of product design, features, and individual state treatments will make parallel information across all programs, direct sold and Intermediary sold, nearly impossible. As a wholesaler of a national plan, we are concerned that the provision of materials to a centralized source for purposes of presenting in a summary manner may, in fact, omit material information or otherwise portray such information inaccurately. In addition, as discussed below, the accuracy and reliability of the content of such a website will be critical given that the dealers Rule G-17 obligations must be fulfilled by consulting such industry sources.

Disclosure and Suitability Considerations in Connection with Availability of State-Based Benefits

The Interpretive Notice proposes a new disclosure requirement that the dealer disclose, at the point of sale, that the availability of state tax or other benefits offered by the state in connection with the investment in the 529 plan may be available only if the customer invests in a 529 plan offered by the home state of the customer or designated beneficiary. In order to fulfill this disclosure requirement the MSRB has indicated that the dealer may rely on the Plan Disclosure materials however, if the customer is interested in, and the dealer is recommending investment in an out of state plan, the dealer has an affirmative duty to make inquiries beyond the those traditionally associated with suitability and to compare the in-state plan with the recommended plan. If, after such suitability comparison is made the customer wants to invest in the out of state plan, the dealer must document why a customer did not invest in the in-state plan despite the tax or other benefits offered by the in-state plan (of the customer or

the designated beneficiary). We have several concerns with this proposal. First, we share the MSRB's stated view that state tax issues are and properly should be one of several considerations when selecting a 529 Plan. Other considerations should also include a review of investment options, investment performance and fees. However, to impose heightened suitability with respect to state tax issues seems to contradict this view as the state tax issue then becomes the primary consideration in the overall suitability assessment. Second, with respect to Intermediary sold plans, the proposal effectively forces an Intermediary to be versant in every 529 plan on the market, direct and Intermediary sold. Presumably, such knowledge is to be to gained from, among other sources, industry sources such as the aforementioned website and should the in-state plan which was not initially recommended be inaccurately or incompletely portrayed, liability under Rules G-17 and 10b-5 could be imposed with respect to the in-state plan. In addition, it appears from the Notice that proposed expanded point-of sale obligation under Rule G-17 to disclose in-state benefits is required in every instance and there does not seem to be any distinction for unsolicited transactions.

Where the investor seeks to invest in any out of state plan, the Notice would require the Intermediary to become versant on the in-state plan. MSRB Rule G-17 which requires fair dealing and the prohibition from engaging in any deceptive, dishonest or unfair practice has been reasonably interpreted to require, among other things, the obligation to notify a customer of potential state benefits available only by investing in the in-state plan. However, to go beyond that standard and apply an affirmative duty to research and present a security that is not necessarily even being recommended or sold goes beyond the scope of the Rule and imposes a standard that is not currently imposed in connection with the sale of any other type of security. Such heightened suitability effectively requires a broker to determine that the 529 plan is not merely suitable for this customer based on obtaining information concerning the customer's financial status, tax status and investment objectives, as well as any other information reasonable and necessary in making the recommendation, but is *the* most suitable 529 plan. By forcing compliance with a set of rules not applicable to other securities, including municipal securities, unduly burdens the Intermediary in the 529 market. We fear that the unintended consequence of such requirements will be to discourage Intermediaries from selling 529 Plans altogether and providing valuable assistance to those customers who need and prefer to engage the services of Intermediaries.

We very much appreciate the opportunity to provide comments on the Interpretive Notice. Should you have any questions, feel free to contact me at 617-663-2308.

Sincerely,

Diana L. Scott

Diana Scott
Senior Vice President and General Manager
U.S. College Savings

Mary L. Schapiro
Vice Chairman, NASD
President, Regulatory Policy and Oversight

September 9, 2004

Mr. Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street Suite 600
Alexandria, VA 22314

Re: 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 (MSRB Notice 2004-16) (June 10, 2004) ("MSRB Notice")

Dear Mr. Lanza:

I am writing on behalf of the NASD staff to express our views concerning the above-referenced proposal. The comments provided in this letter are solely those of the NASD staff; they have not been reviewed or endorsed by the Board of Governors of NASD or by the Board of Directors of NASD Regulation.

1. Summary of the NASD Staff's Comments

The NASD staff appreciates the opportunity to comment on the MSRB's proposed revisions to its advertising rule, Rule G-21, and the MSRB's proposed interpretive guidance on point-of-sale disclosure.[1] We strongly support the goals of the MSRB's proposals, to ensure that investors receive adequate disclosure concerning 529 plans, including disclosure about the mutual funds available through 529 plans.

As the MSRB is aware, 529 plans commonly use mutual funds as their primary investment vehicle.[2] While 529 plans do carry specific benefits associated with their status as municipal securities, investors may perceive a 529 plan as a mutual fund with a municipal security "wrapper." In fact, 529 plans present all of the potential suitability, disclosure and other sales practice issues as mutual funds. Moreover, their very benefits, such as in-state tax deductions and fee reductions, present additional disclosure and other

[1] In light of the Securities and Exchange Commission's proposed new Rules 15c2-2 and 15c2-3, the MSRB recently withdrew a proposed interpretive notice concerning point-of-sale disclosure in the workplace. MSRB Notice 2004-25 (August 2, 2004). However, we understand that the MSRB has not withdrawn the proposed point-of-sale disclosure guidance in the MSRB Notice that is a subject of this comment letter.

[2] In this letter, the terms "529 plan" and "municipal fund security" are intended to refer to college savings plans established under Section 529(b)(A)(ii) of the Internal Revenue Code of 1986 as "qualified tuition programs." The terms are not intended to include pre-paid tuition plans or local government pools.

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sales practice issues. For that reason, every SEC and NASD sales practice standard that applies to the distribution of mutual funds to retail investors also should apply to the sale of mutual funds through 529 plans, and these standards should be supplemented by additional sales practice requirements to address the unique characteristics of 529 plans.[3]

As to the MSRB's specific proposals, the NASD staff generally supports the proposed amendments to Rule G-21. In particular, we support the requirement that any advertisement for an underlying mutual fund comply with the SEC and NASD advertising rules.

With respect to the advertisement of the municipal fund securities themselves, the MSRB's proposal would emulate various provisions of the SEC and NASD advertising rules. We support this approach, but recommend that whenever possible, Rule G-21 should use precisely the same language as the pertinent provisions of the SEC and NASD advertising rules. The proposed amendments contain several differences that may cause unnecessary confusion. In addition, the MSRB should clarify that SEC and NASD interpretations of our advertising rules would apply to the similar provisions of Rule G-21. This clarification would better ensure that the SEC, NASD and MSRB consistently apply the rules and that mutual fund investors receive full protection from sales practice abuse – whether they purchase their funds through 529 plans or through other distribution channels.

The NASD staff also supports the objectives of the proposed amendments to Rule G-17 – but we recommend that the MSRB go even farther. In particular, we recommend that the MSRB mandate point-of-sale disclosure concerning the fees and expenses associated with a 529 plan and the forms of compensation that dealers receive in connection with the sale of such a plan. We have enclosed a proposed disclosure statement that would effect our recommendation.

Part 2 of our letter presents our comments to the proposed amendments to Rule G-21, concerning advertising, and Part 3 presents our comments to the proposed interpretative statement on Rule G-17, concerning point-of-sale disclosure.

2. *Proposed Amendments to Rule G-21*

A. The NASD Staff Generally Supports the Proposed Amendments

The NASD staff generally supports the proposed amendments to Rule G-21. As the MSRB is aware, NASD is responsible for enforcing compliance with Rule G-21 with respect to our members. Moreover, in Special Notice to Members ("NtM") 03-17, NASD

[3] In a separate letter to the MSRB, we support the MSRB's decision to take a similar approach with respect to non-cash compensation arrangements. **[CITE]**

clarified the treatment of sales material for municipal fund securities, including Section 529 college savings plan securities. In NtM 03-17, we clarified the following points:

- Sales material for municipal fund securities must comply with NASD and SEC advertising rules to the extent that the sales material refers to certain key aspects of an underlying investment company.

- Members must file with NASD municipal fund security sales material that refers to the underlying investment company securities, just as members must file any sales material concerning registered investment companies.

- Sales material for municipal fund securities also must comply with applicable MSRB rules.

The MSRB's proposed amendments to Rule G-21 appear to take a similar approach to the regulation of the sales material for municipal fund securities. In particular, proposed Rule G-21(e)(vi) would provide 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 presentation of the details must comply with the SEC and NASD advertising rules.

We support the proposed approach. The MSRB's proposal recognizes that Section 529 plans often market the underlying mutual fund securities. Investors who are the subject of such marketing efforts deserve the same level of protection as other mutual fund investors.

B. Whenever Possible, MSRB Should Rely Verbatim on SEC and NASD Rule Language

The proposal also would provide specific standards applicable to the advertisement of the municipal fund securities themselves. We understand that these provisions would only apply to the portion of sales material that promotes the municipal fund security. As discussed above, we understand that the portion of the sales material concerning the underlying mutual funds would be subject to SEC and NASD advertising rules.

Several provisions of the proposal emulate the SEC and NASD advertising rules. We appreciate that restating applicable provisions, with some modification, may be necessary because those rules regulate the advertisement of mutual funds rather than municipal fund securities. Nevertheless, to the extent possible, the MSRB should adopt verbatim the language in the applicable provisions of the SEC and NASD advertising rules -- even as to the advertisement of municipal fund securities. In addition, the MSRB should clarify that SEC and NASD interpretations of our advertising rules would apply to the similar provisions of Rule G-21. This approach will better ensure that the SEC, NASD and

MSRB consistently apply the rules and that mutual fund investors receive full protection from sales practice abuse.

The proposal presents several inconsistencies with applicable provisions of the SEC and NASD advertising rules. For example:

- Paragraph (e)(i)(B)(1) of the MSRB's proposal attempts to restate Rule 482 (b)(3)(i), word for word. Yet the restatement does not include the recently adopted language in Rule 482(b)(3)(i) concerning month-end performance data. Consequently, investors would not have ready access to current performance data for municipal fund securities, while they would have access to such data for mutual funds whose sales material is subject to Rule 482(b)(3)(i).

- Paragraph (e)(ii)(C) of the MSRB's proposal attempts to restate Rule 482(d)(3)(ii). Yet the provisions are different in at least one important respect. Rule 482 requires that performance data "be current to the most recent calendar quarter ended prior to the submission of the advertisement for publication." The MSRB's proposal would require that performance data "be calculated as of the most recent calendar quarter ended prior to submission of the advertisement for publication *for which such performance data, or all information required for the calculation of such performance data, is reasonably available to the broker, dealer or municipal securities dealer . . .*" (emphasis supplied). The proposed language appears to give dealers latitude as to the end date that they use for calculation of standardized returns. This latitude may undermine the ability of investors to compare different municipal fund securities programs, or even the same program offered by different dealers who impose varying end dates for their performance calculation. At a minimum, the disparity between the language in Rule 482 and the MSRB's proposal would create confusion for broker-dealers that must comply with both provisions.

- Paragraph (e)(iv) of the MSRB's proposal would require that an advertisement that relates to or describes services "indicate the entity providing those services" and that an advertisement that solicits the purchase of municipal fund securities "clearly state which entity would effect the transaction." This provision resembles, but is not identical to our Rule 2210(d)(2)(C), which generally requires that all sales material prominently disclose the name of the member and, if it includes other names, reflect which products or services are being offered by the member. The differences between the two provisions would cause confusion concerning whether compliance with Rule 2210(d)(2)(C) would constitute compliance with the paragraph (e)(iv) of the MSRB's proposal.

We strongly recommend that the MSRB, whenever possible, use precisely the same language as the SEC and NASD advertising rules, and clarify that our interpretations of

those rules would similarly apply to the interpretation of the Rule G-21 amendments. We are available to assist the MSRB staff in this effort.

3. Proposed Amendments to Rule G-17

A. NASD Staff Supports the Objectives of the MSRB Proposal

The MSRB has interpreted Rule G-17 to require a dealer to disclose to its customers at point of sale all material facts concerning the transaction and the security known by the dealer. The MSRB proposes interpretive guidance to broaden the existing Rule G-17 point-of-sale disclosure requirement, to include reference to all potential benefits offered solely in connection with in-state investments. The guidance would provide that disclosure made through the official statement of the municipal fund securities issuer would suffice if the official statement is provided to the customer by the time of trade and the disclosure appears in the official statement in a manner that is reasonably likely to be noted by an investor.

The NASD staff supports the requirement that dealers disclose the fact that certain benefits are offered only to in-state customers. Failure to make this disclosure may mislead customers concerning the relative benefits of a particular 529 plan.

B. The MSRB Also Should Require Disclosure of Fees and Compensation

We also recommend that the MSRB go farther. In particular, we recommend that the MSRB mandate point-of-sale disclosure concerning all of the fees and expenses associated with a 529 plan, and the forms of compensation that the dealers receive in connection with the sale of such a plan. This disclosure would better inform customers concerning the costs associated with their investment and the potential conflicts associated with the sale of these products. Moreover, a requirement that each dealer provide such a statement with respect to every 529 plan that the dealer offers would facilitate the comparison of different plans.

Such an approach would implement many of the recommendations offered by House Financial Services Chairman Oxley in his July 15th letter to SEC Chairman Donaldson. Chairman Oxley expressed concern about "the lack of consistent transparency of fees" relating to 529 plans. As Chairman Oxley said,

> I strongly believe that if investors are able to discern and compare the fees associated with these plans, market forces will work to reduce those fees – so long as states do not discriminate against investors who would like to select out-of-state plans. Without adequate transparency and uniform treatment the benefits of robust competition will not be realized.

Chairman Oxley therefore urged the development of "a standardized format for describing fees," disclosure of fee amounts in dollar terms as well as percentages, and disclosure concerning the allocation of fees.

We enclose for the MSRB's consideration a prototype disclosure document that would accomplish all of these suggestions. As the MSRB is aware, the Securities and Exchange Commission has proposed Securities Exchange Act Rules 15c2-2 and 15c-3, concerning confirmation and point-of-sale disclosure with respect to investment companies, variable annuities and 529 plans. In commenting on this proposal, the NASD staff submitted a prototype disclosure document that would meet the SEC's objectives while providing concise disclosure to investors.

The enclosed version of this prototype would be especially suitable for 529 plans. This prototype would present the fees and expenses associated with the 529 plan and the forms of compensation to the dealers for the sale of the 529 plans. Moreover, the prototype would state that investment in an in-state 529 plan may provide favorable state tax treatment, reduced plan expenses and other benefits. The prototype would encourage investors to review the official statement for the in-state plan for more information.

We recommend that the SEC and the MSRB consider requiring that all dealers present this disclosure document to investors at point-of-sale, either in writing or by reference to the dealer's Website. This disclosure document would enhance disclosure to investors and help ensure that investors make well-informed investment decisions.

* * *

Thank you again for the opportunity to comment on the MSRB's important proposals. Feel free to contact us if you have any questions.

Sincerely,

Mary L. Schapiro
Vice Chairman, NASD
President, Regulatory Policy and Oversight

Enclosures

cc: Thomas Selman
NASD Investment Companies Reg.

XXX Variable Annuity

What You Pay

This table shows fees and expenses you would pay as a contract owner in the ***XXX Variable Annuity***. Certain charges decline over time. Please see the Annuity's prospectus for more information.

Contract Owner Fees–Paid By You

Maximum Charges ***(per $10,000)***

For Purchases	$XX
For Withdrawals	XX
For Transfers	XX

Annual Contract Expenses
(per $10,000 Investment over 12 months)

Annual Contract Fees	$XX
Mortality & Expense Fees	$XX
Administrative Fees	$XX
Maximum Riders & Guarantees Fees	$XX

Underlying Fund Fee Ranges

Management Fees	XX% - XX%
12b-1 Fees	XX% - XX%
Other Fees	XX% - XX%

What We Receive

This table shows the compensation that we receive when you invest in the ***XXX Variable Annuity*** through XYZ Broker.

Out of the Total Purchase Payments that You Make, We Receive: *(per $10,000 investment)*

- $XX in Sales Commissions at the Time of the Purchase
- $XX of Trail Commissions (over 12 months)
- $XX in Revenue Sharing Payments from the Contract's Issuer
- $XX - $XX in Rule 12b-1 Fees from the Underlying Funds (over 12 months)

Our compensation varies depending upon the underlying funds you choose.
Please note the following:

- Revenue sharing payments are cash payments from the contract's issuer to us, in order to assist us in covering operating expenses and encourage us to bring the variable annuity contract to your attention.
- Your registered representative receives higher compensation for the sale of the XXX Variable Annuity than for the sale of similar variable annuity contracts.
- You may also pay a state premium tax at the time a payment is made, which will vary by state.

Information current as of the contract prospectus dated XXX.
See XYZbroker.com for comparable information about other variable contracts.

State of X 529 Plan – Growth Portfolio

What You Pay

This Table shows the total fees and expenses that you would pay as a unit holder in the ***Growth Portfolio***, including the fees imposed on the underlying mutual funds in the Portfolio. Certain charges decline over time. Please see the disclosure document furnished by the State of X 529 Plan for more information.

Account Holder Transaction Fees–Paid Directly By You

Maximum Charges (per $10,000 contribution)

529 Plan Application Fee	$XX
Purchase Charges	XX
Withdrawal Charges	XX

Annual Account Expenses–Deducted from Account Assets

(per $10,000 contribution over 12 months)

529 Plan Account Maintenance Fee	$XX
529 Plan Program Management Fee	XX
Underlying Fund Fees	
Management Fees	XX
12b-1 Fees	XX
Other Fees	XX

What We Receive

This Table shows the compensation that we receive when you invest in the ***Growth Portfolio*** through XYZ Broker.

Out of the Total Fees and Expenses that You Pay, We Receive:

- XX% of all Maximum Charges
- XX% of Program Management Fee
- $XX in Revenue Sharing Payments (per $10,000 investment over 12 months)
- $XX in Rule 12b-1 Fees from the Underlying Funds (per $10,000 investment over 12 months)

Our compensation varies depending upon which Portfolio you choose.
Please note the following:

- Revenue sharing payments are cash payments from the distributor of the State of X 529 Plan to us, in order to assist us in covering operating expenses and encourage us to bring the Plan to your attention.
- Your registered representative receives higher compensation for the sale of the State X 529 Plan than for the sale of similar 529 plans.
- Investment in an in-state 529 plan may provide favorable state tax treatment, reduced plan expenses, and other benefits. Please review the in-state plan's disclosure document for information.

Information current as of plan disclosure document dated XXX.
See XYZBroker.com for comparable information about other Portfolios in the 529 Plan.

NAST

National Association of State Treasurers

March 20, 2006

Amelia A.J. Bond
Chair
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Dear Ms. Bond:

On behalf of the National Association of State Treasurers, thank you very much for addressing our 2006 Legislative Conference. The state treasurers greatly appreciated your remarks on the Municipal Securities Rulemaking Board's agenda relating to the municipal tax-exempt bond and the Section 529 college savings plan markets.

With the cost of a college education continuing to escalate at a rapid rate, the state college savings programs serve a vital public policy purpose in increasing access to a higher education. NAST and the College Savings Plans Network have adopted two sets of Disclosure Principles the states are implementing to improve and standardize the information that investors have available to determine which Section 529 plan best fits their needs. The principles specify information that should be prominently stated in the offering materials, such as the risks involved in investing in the plans, the need to consider state tax treatment and other benefits, and the availability of other state 529 programs. The principles also provide tables and charts that include clear, concise, and consistent descriptions of fees, expenses, and investment performance.

We believe the principles address all issues raised with respect to disclosure to 529 plan participants, but we commit to working with the MSRB to make sure investors have the full information necessary to make informed decisions when investing in these programs. To this end, NAST and CSPN plan to develop enhancements to the CSPN web site, www.collegesavings.org. The web site enhancements will provide more in-depth program information, investor education, and plan comparisons.

We also applaud the Board's recent decision to modify its interpretation of Rule G-19 on suitability. The May 2005 interpretation would have mandated additional suitability analysis not currently required for the sale of any other securities, which would have substantially increased the burden on states offering the programs and create a disincentive for investments in the plans. We strongly support the need for each 529 plan to advise potential investors of the various tax and other benefits that may be available

SECRETARIAT The Council of State Governments
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E-mail: nast@csg.org Internet: www.nast.org
Office of Federal Relations: 444 N. Capitol St., NW, Suite 401, Washington, DC 20001
(202) 624-8595 Fax: (202) 624-8677
PRESIDENT Randall Edwards, OR State Treasurer, 350 Winter St. NE, Suite 100, Salem, OR 97301-3896
[illegible] MS; Denise L. Nappier, CT; John D. Perdue, WV; Ron Ross, NE;

through that investor's home state 529 plan. The disclosure principles we have developed specifically require such disclosure in each member's 529 plan disclosure materials. As we move forward on the website enhancements and implementation of the disclosure principles, we will work in partnership with the Board to make sure we have the best possible disclosure and information system possible for our participants and potential investors.

Thank you again for your comments.

Sincerely,

Randall Edwards
NAST President
Oregon State Treasurer

Thank you for taking the time to meet with us.

Ghassan Hitti

From: Jackie Williams [Jwilliams@otta.state.oh.us]
Sent: Friday, July 29, 2005 2:19 PM
To: Ernie Lanza; Ghassan Hitti
Subject: MSRB Notice 2005-28

Dear Sirs:
The Ohio Tuition Trust Authority, Ohio's 529 college savings plan, is in complete support of the comments expressed in the College Savings Plan Network (CSPN) letter dated July 29, 2005 to Ernesto A. Lanza regarding the above referenced MSRB Notice. We sincerely hope that MSRB will strongly consider said comments because 529 plans are truly unique.

Sincerely,
Jacqueline T. Williams,
Executive Director

James W. Pasman
Managing Director
Transfer Agency Division
508 871 8755 T 508 871 9720 F
james.pasman@pfpc.com

PFPC

December 12, 2005

Mr. Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314-3412
703.797.6700

Re: Notice 2005-28

Dear Mr. Lanza:

PFPC Inc., as a third party provider of transfer agent recordkeeping services to a number of 529 college savings plans, would like to comment on the proposed changes to interpretations of conduct and suitability rules governing the sale of 529 college savings programs set forth in MSRB Notice 2005-28 (the "Notice"), and to express our concern about current NASD examination and enforcement activities relative to dealers' suitability obligations under MSRB rules.

We agree with the comment letter submitted by the College Savings Foundation on July 29, 2005. PFPC does not believe that a deviation from established principles of suitability under securities law is warranted in the context of 529 plans. PFPC believes a requirement for dealers to perform plan comparisons before making recommendations will be viewed as overly burdensome by selling dealers. We also believe that selling dealers will find the concept of comparative suitability to be one that is so risky they will simply abandon the sale of 529 plans in states that provide more than minimal benefits conditioned on participation in the home state plan. We believe that the result of adopting the proposals in the Notice would be that in a significant number of states, consumers will be left with a stark choice; participation in the home state plan, or participation in no 529 plan at all.

We are particularly concerned the NASD appears to be incorporating the proposals contained in the Notice into its enforcement posture, and request that you remind the NASD that the Notice is a proposal, not a statement of the current state of the law. We expect the premature enforcement action taken by the NASD has discouraged dealers as noted above and thereby restricted consumers from investing in 529 plans that otherwise could benefit their families as they try to save for college expenses.

Federal securities regulation has never been premised on the concept that a dealer is obligated to determine the most suitable investment of a particular type for any customer, and we see no reason to place upon the 529 college savings plan industry the unprecedented burdens contained in the Notice. PFPC respectfully urges that the Notice be withdrawn.

Sincerely,

James W. Pasman
Senior Vice President & Managing Director
Transfer Agent
PFPC Inc.

cc: Barbara Z. Sweeney
Senior Vice President and Corporate Secretary
National Association of Securities Dealers

Securities Industry Association
120 Broadway - 35 Fl. • New York, NY 10271-0080 • (212) 608-1500, Fax (212) 968-0703 • www.sia.com, info@sia.com

September 15, 2004

Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street
Suite 600
Alexandria, VA 22314-3412

Re: Notice 2004-16, 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

Dear Mr. Lanza:

On behalf of the Securities Industry Association, (SIA)[1] we are writing in response to Notice 2004-16, which seeks comments on modifications to the rules governing advertisements and disclosures relating to college savings plans ("529 plans"). SIA is generally supportive of the objective of the subject Notice and we appreciate the opportunity to provide specific comments on potential areas of concern.

Reliance on Official Statements

Notice 2004-16 proposes an expansion to the disclosure requirements related to sales of out-of state 529 plans to other state features, such as special financial aid considerations. Under the proposal, the obligation to disclose the potential loss of state tax benefits could be met if the required disclosure is included in the official statement delivered to the customer, appearing in a manner reasonably likely to be noted by an investor.

[1] The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs 780,000 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift and pension plans. In 2003, the industry generated an estimated $209 billion in domestic revenue and $278 billion in global revenues. (More information about SIA is available on its home page: www.sia.com).

SIA is concerned about the standard "reasonably likely to be noted by an investor" and the potential for an adverse decision if the placement of the disclosure is questioned. SIA believes that there should be a presumption that the placement and adequacy of the disclosure in offering materials is reasonable. Broker-dealers should not be in the position to supplant their judgment over that of the state, particularly since the issuer is a governmental entity. In general, states will have approval over the types of information – including the broker-dealers own marketing material – and will dictate by contract, how this information is delivered to investors. SIA recommends this condition be deleted from the guidance.

MSRB Internet Information

Notice 2004-16 also requests comment on whether the MSRB should require disclosure of Internet-based material maintained by the MSRB. SIA is concerned about mandating this type of disclosure on broker-dealers. SIA applauds the MSRB for putting forward a proposal to enhance investor information and education. However, there are a number of Internet sites that include this type of information and other sites will soon be under development. The Securities and Exchange Commission (SEC) and the National Association of Securities Dealers (NASD) have extensive website information on a variety of products but do not require brokers to disclose the availability of information.

Many SIA members have developed Internet material for their customers and invest significant resources to keep this information current. If broker-dealers are also required to refer to an MSRB website they would bear an added burden to monitor the information on the MSRB website to ensure that it is current and accurate. SIA, however, has no concern if the MSRB moves forward with this proposal but does not require disclosure by member firms. If the MSRB pursues this option, SIA would be pleased to work with you to provide information or other material. SIA maintains extensive information on college savings plan on our investor education website: www.pathtoinvesting.com and has produced a brochure for investors interested in 529 plans.

Enhanced Disclosure With Respect to State Tax "Benefits"

While we appreciate the objectives which MSRB is pursuing, it is not clear that it is in the best interest of investors to elevate disclosure about state tax and other state "benefits" above other significant disclosure issues worthy of investor consideration. But to the extent such disclosure is mandated, one must carefully consider the complexity of the underlying issues so that the disclosure given is meaningful to the investor.

There are countless and rather complex differences in state treatment that may affect investor choice. The complexity of the state variances presents challenges to those attempting to disclose them. The appropriate place for disclosure is in the program description and referring investors to such disclosure may be the best course of action, given the challenges when trying to "summarize" such information. It is not clear whether, due to the complexities, cursory disclosure about these state issues would allow for adequate capture of the considerations that need to be made. Telling an investor about state "benefits," without mentioning at least the existence of potential consequences associated therewith seems inadequate.

To give you a sense for the complexity of summarizing state tax treatment variation, consider the following discussion (which is not intended to be all-inclusive):

States with upfront deductions offer such deductions in various amounts to residents, and in some cases, non-resident, taxpayers. The requirements for these deductions vary. Some deductions are per taxpayer, some are per account, some are per beneficiary and some deductions have differing amounts depending on whether you are filing as a single person or married filing jointly, and some deductions are a combination of these and other requirements.

Further, some states have carry-forward provisions of varying amounts (up to an unlimited amount) that allow investors to spread upfront deductions over a period of years. These deductions are, however, contingent upon an investor having taxable income in the applicable state in the current and following years from which to deduct contributions.

Importantly, states also have provisions that require repayment in full under certain circumstances ("recapture") of 529-related state tax deductions previously taken. New York goes even further and characterizes certain qualified withdrawals as non-qualified, thereby, taxing such withdrawals. Lastly, the tax treatment of qualified withdrawals also varies among states..

In general, we believe that the characterization of state tax treatments solely as "benefits" is misleading. Use of the terms "consequences" or "variances" (vs. "benefits") more accurately describes the true nature of such treatments, and is a fairer and more accurate characterization.

Other State "Benefits"

Other state "benefits" vary greatly as does the population to which they are "available". As with the state tax treatment variances noted above, these variations present challenges to those attempting to "summarize" them. States offer benefits to prospective account owners who are in-state residents, non-resident taxpayers, and in some cases non-residents who have beneficiaries who are residents of the state. These "benefits" include, among other things, fee waivers or reductions, matching grants, eligibility for scholarships and preferential in-state financial aid treatment.

State laws affecting protection of assets vary greatly too. State treatment with respect to creditor protection, divorce, and Medicaid eligibility also vary.

State program rules vary greatly as well and the complexity lies in the details. For example, many states have holding period requirements and all states have maximum investment limits, which vary in amount and style (some programs employ a balance test and others, a contribution test), to determine whether the maximum has been reached.

Other Issues

We are also taking this opportunity to comment on a number of other matters addressed in the proposal. Whenever possible, we identify the particular rule number and/or page of the proposing Notice where the item is addressed:

It should be clarified that "at or prior to the time of sale" refers to the initial sale, and that there is no obligation to provide the disclosure at/or prior to every subsequent investment. SIA would be troubled (due to the number of participants participating in automated systematic contributions and the frequency with which SIA members receive unsolicited additional lump-sum contributions) if disclosure were required each time.

G-17 (point of sale disclosure interpretation): It is difficult for dealers to become familiar with attributes of 529 programs they do not sell. Given the complexities noted above and given the fact that dealers who have not entered into distribution agreements likely would not have current (or any) offering documents from such programs, they may be challenged to provide information or to determine what information needs to be provided. In an attempt to "do the right thing," they may inadvertently provide inadequate disclosure about the "home state" program, doing a disservice to the investor and exposing themselves to liability.

G-21 Required Disclosures (draft section (e)(i)): An abbreviated form of disclosure should be allowed for radio and television ads, as the standard length of most commercials would not permit the required disclosures to be included. Additionally, the requirement for "equal emphasis" for required disclosure would result in the commercial's intended message being lost. It may be sufficient for certain forms of advertising (like short television and radio commercials) to inform an investor to obtain the program description and read it carefully before investing. It could also be required that the state program be named, as well as a source from which to obtain the program description of the program that is being promoted through the ad. It is difficult to meaningfully summarize complex distinctions in an advertisement. The appropriate place for disclosure is in the program description (and the need to obtain and read the program description should be referenced in the ad).

G-21 Capacity of Dealer and other Parties (draft section (e)(iv)); Some 529 programs effect transactions through many broker-dealers. It would be difficult (if not impossible in some cases) to list in an advertisement each dealer associated with a program.

We also believe that the requirement in subsection (e)(iii) of Rule G-21 that advertisements give equal prominence to the name of the issuer is unnecessary, and subject to second guessing. The policy objective of the proposed rule, which is to prevent investor confusion as to who the issuer of the security is, is satisfied by the other requirements set forth in (e)(iii) that the issuer of the security be identified and that the advertisement not imply that another entity is the issuer of the security. Introducing an "equal prominence" rule creates interpretive questions for marketing and compliance personnel that are unnecessary in light of the other requirements in (e)(iii).

The MSRB's Notice, "Application of Fair Practices and Advertising Rules in Municipal Fund Securities", dated May 14, 2002, set forth a similar requirement that a marketing piece

clearly identify the issuer and not imply that another entity is the issuer of the security. However, that Notice did not have an "equal prominence" requirement. There is no evidence of any kind that the existing rule set forth in the May, 2002 Notice is not working, or that investors have been confused as to who the issuers of these securities are.

The attached markup of (e)(iii) is consistent with the approach taken by the MSRB in its prior interpretive notice, and we propose that this modified version be included in any final rule:

"An advertisement for a specific municipal fund security must provide sufficient information to identify such security in a manner that is not false or misleading. An advertisement that identifies a specific municipal fund security must clearly identify the name of the issuer, and must not imply that a different entity is the issuer of the municipal fund security. To the extent an advertisement identifies an entity other than the issuer of the municipal fund security, such advertisement must clearly describe such entity's role with respect to the municipal fund security."

We trust you will find our comments helpful and constructive, and we share your interest is assuring that 529 plan investors receive all appropriate disclosure in a clear and balanced manner. Questions regarding this letter should be directed to either Mike Udoff (212-618-0509) or Liz Varley (202-216-2032) of SIA staff.

Sincerely,

Elizabeth Varley

Michael D. Udoff
Co-Staff Advisers
SIA Ad Hoc 529 Plans Committee

Securities Industry Association

1425 K Street, NW • Washington, DC 20005-3500 • (202) 216-2000 • Fax (202) 216-2119

July 29, 2005

Ernesto A. Lanza, Esquire
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: MSRB Notice 2005-28 – Request for Comments on Draft Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans

Dear Mr. Lanza:

On behalf of the Securities Industry Association[1] (SIA), we are writing in response to the Municipal Securities Rulemaking Board (MSRB) Notice 2005-28, requesting comments on a revised application of Rules G-17 and G-19 to the marketing of 529 college savings plans ("529 Plans"). SIA is pleased to have the opportunity to comment on this important issue. Regrettably, we have significant concerns with the MSRB interpretation and believe that if approved in substantially the same form, it will undermine the ability of broker-dealers to market 529 savings plans to investors.

1. Disclosure Obligations Under Rule G-17

As the MSRB is aware, under current requirements broker-dealers must disclose that favorable state tax treatment for investing in a 529 savings plan may be limited to the investor's home state plan. Notice 2005-28 goes far beyond this current disclosure requirement to mandate that broker-dealers ask clients about the importance of state tax benefits. This approach raises a number of concerns for broker-dealers who market 529 plans.

The practical impact of such a mandate is to require that broker-dealers provide information about every 529 savings plan available. This is an unworkable requirement. It is common practice for broker-dealers to market a limited number of 529 savings plans to their

[1] The Securities Industry Association brings together the shared interests of approximately 600 securities firms to accomplish common goals. SIA's primary mission is to build and maintain public trust and confidence in the securities markets. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2004, the industry generated an estimated $227.5 billion in domestic revenue and $305 billion in global revenues. (More information about SIA is available at: www.sia.com.)

clients. This ensures that broker-dealers understand the products that they are selling as opposed to having only superficial knowledge of dozens and dozens of products. This is a particular concern with respect to 529 savings plans, which even aside from tax considerations, have a multiplicity of other features that add complexity to the process and which vary from plan to plan. These include, but are not limited to, contribution and withdrawal limits, asset allocation, permissible investments, rollover restrictions and fee structures. Essentially, the proposed interpretation of Rule G-17 will have the counter-intuitive result of compromising a broker-dealer's ability to develop in depth expertise regarding the range of investment products it is reasonably capable of servicing.

SIA also believes that the notice goes much further than the requirements that currently apply to similar products such as mutual fund shares where the dealer is permitted to rely on the offering document as containing all material information needed by the client to make a decision. The new interpretation requiring broker-dealers to determine that the information in the offering document is sufficient would likely lead broker-dealers to create their own disclosure documents for use in marketing 529 savings plans. This disclosure would require filing with the MSRB as well as review by the National Association of Securities Dealers (NASD). In addition, if any specific state plan was cited it would also require approval at the state level. Most distribution agreements and program descriptions state that no information (either in contrast to or supplement of) other than that which appears in the official statement can be provided to investors.

2. Suitability Analysis

SIA is also concerned about the new interpretation MSRB would apply to Rule G-19. Rule G-19 imposes a duty on broker-dealers recommending a particular product to ensure that the particular product recommended is suitable. Thus the long-standing review requirement would be extended to essentially require that any 529 savings plan sold is the *most suitable* for the client.

SIA is concerned that the MSRB proposed requirements are inconsistent with the application of the suitability rule to every other product sold by broker-dealers. As stated earlier, broker-dealers universally limit the number of products sold. Firms limit the number of mutual fund companies they recommend because it is too difficult to maintain the level of expertise required to meet the suitability requirements. However, the MSRB would seek to change this long-standing interpretation with respect to 529 savings plans – a product that is complex and raises a number of tax, financial aid, and other considerations for investors. SIA is concerned that broker-dealers will be deemed to offer tax advice to customers if they perform the type of suitability analysis contemplated in the proposed requirements.

While broker-dealers already limit out of necessity the number of 529 savings plans they sell, this requirement would likely reduce the number of broker-dealers willing to market these plans. Suitability analysis is somewhat subjective. It is rare that a broker-dealer would conclude that one product is the "most suitable" for a client.

Finally, SIA is concerned that the MSRB proposed requirements would be difficult to implement from a practical standpoint. The NASD, which must review marketing material used by broker-dealers, has not in the past welcomed the use of comparisons in marketing material.

The MSRB requirement places a premium on being able to compare a number of states' 529 savings plans. However, SIA is aware of situations where NASD has rejected material that compares various 529 savings plans in a comprehensive way. NASD has voiced objections over comparisons because these plans often cannot be compared on an "apples to apples" basis.

3. Summary and Conclusion

Even without considering tax-related issues, 529 savings plans are complex investment vehicles, and the offering of such plans by broker-dealers is a labor-intensive and costly process, particularly considering that most plan investments are modest in size. Nonetheless, broker-dealers have embraced these plans for the same reason that Congress enacted section 529 legislation -- to encourage the funding of the educational needs of future generations. However, there are limits to the cost and regulatory exposure that broker-dealers are willing to endure to offer 529 savings plans. The proposed interpretation poses a significant risk of exceeding that limit.

Regulatory energy would be better directed at addressing the real source of concern regarding tax considerations, which is the lack of uniformity of tax treatment among the states with respect to investments in 529 plans. Applying different tax treatment to state residents depending on the 529 investments they select adds unnecessary complexity for college investors and further, creates an environment which imposes unreasonable and unprecedented additional obligations on broker-dealers attempting to sell these products.

We fully agree that broker-dealers should alert investors that certain 529 plan tax benefits may be limited to in-state plans, but having done so, it should be the investor's responsibility to determine, in consultation with his or her tax adviser, what weight should be given to such benefits. Clearly, the broker-dealer's primary function is to provide investment guidance, not tax advice or analysis.

If you have any questions regarding this letter please do not hesitate to contact SIA staff members Elizabeth Varley at (202) 216-2000 or Michael Udoff at (212) 618-0509.

Very truly yours,

Ira D. Hammerman
Senior Vice President and
General Counsel

CC: Annette L. Nazareth
Mary L. Schapiro

T. ROWE PRICE INVESTMENT SERVICES, INC.

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August 1, 2005

Ernesto A. Lanza, Esquire
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, Virginia 22314

Re: MSRB Notice 2005-28 Relating to Draft Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans

Dear Mr. Lanza:

T. Rowe Price Investment Services, Inc. (**"T. Rowe Price"**) appreciates the opportunity to submit its comments on the above-referenced notice. T. Rowe Price is a registered broker-dealer under the Securities Exchange Act of 1934, NASD member firm, and acts as principal underwriter to the T. Rowe Price family of funds (**"Price Funds"**). As of December 31, 2004, the Price Funds held assets of approximately $145.5 billion, with more than eight million individual and institutional accounts. In addition, T. Rowe Price Associates, Inc. is currently the program manager for four separate Section 529 College Savings Plans for two different state issuers (**"Price Managed 529 Plans"**). T. Rowe Price acts as underwriter and primary distributor for the municipal fund securities of the Price Managed 529 Plans. The Price Managed 529 plans have approximately $2.5 billion in assets and the total number of accounts is approximately 245,000. As a result of these activities, this proposal will significantly impact T. Rowe Price's college savings business.

As a member of the Investment Company Institute (**"ICI"**), we support the comments made by the ICI with respect to this notice. Below we have highlighted areas of particular concern.

RULE G-17: FAIR DEALING WITH CUSTOMERS

Duty to Inquire. Rule G-17 governs a dealer's obligation to deal fairly with its customers. The Notice proposes to enhance a dealer's disclosure obligations in connection with the offer or sale of out-of-state 529 plans in a way that would differ significantly from the MSRB's existing interpretation of this rule. Interpretive guidance published by the MSRB in 2002 under Rule G-17 obligates a dealer that sells an out-of-state 529 plan to a customer to disclose that, depending upon the laws of the customer's home state, favorable state tax treatment for investing in a 529 plan may be limited to investments made in the investor's home state plan. The current Notice,

however, proposes to reinterpret Rule G-17 to require dealers *to* **affirmatively seek information** from the customer. Heretofore, Rule G-17 has not required dealers – regardless of the product sold – to make **any** inquiry of their customers. If, through this proposed inquiry, the dealer determines that the investor is not a resident of the state whose plan is being offered to the investor, the Notice would require the dealer to inquire whether realizing state-based benefits is an important factor in the customer's investment decision. If it is, the dealer would then be required "to disclose material information available from established industry sources about state-based benefits offered by the home state of the customer or designated beneficiary **for investing in [the home-state] plan"** and whether such benefits are available to a customer who purchases an out-of-state plan. The dealer would also have to suggest that the customer consult with his or her financial, tax, or other adviser to learn more about the home state's plan and inform the customer that he or she may want to contact the home state plan to learn more about any state-based benefits or limitations.

This MSRB proposal would obligate municipal fund securities dealers to take affirmative action which, to the best of our knowledge, is not required of any other broker-dealers for any other investment product. Further, for the first time the MSRB proposes to obligate dealers that **do not recommend a 529 plan**, such as T. Rowe Price, to make inquiries that, to date, have only been required in connection with a suitability analysis. T. Rowe Price objects to the MSRB's proposal which discriminates against 529 plan brokers, imposing burdensome additional affirmative responsibilities upon them – requirements not imposed on the dealers of any other investment product in the industry.

Knowledge Requirement.

The proposed interpretation of Rule G-17 would essentially require every dealer selling an out-of-state 529 plan to be knowledgeable about every state's laws governing such plans and the plans themselves. We are not aware of any other provision under the Federal securities laws or under the rules of any self-regulatory organization that imposes a similar requirement upon a broker-dealer selling any other investment product. Imposing such a requirement on dealers selling out-of-state 529 plans isnot only unduly onerous, it is unfair. We do not understand why dealers selling 529 plans would be singled out in the investment industry for such disparate treatment. The likely result of such a burdensome requirement would be for dealers to cease offering 529 plans altogether – not the result intended by Congress when it created Section 529 of the Internal Revenue Code in an attempt to increase college savings.

Unsolicited Transactions.

We question why the MSRB's proposed interpretation has applied these requirements to unsolicited transactions. The rules of the MSRB and the NASD have only imposed a duty to make inquiry of a customer in connection with the recommendation of a security. In particular, MSRB Rule G-19 and NASD Rule 2310 each require dealers and broker-dealers, respectively, to inquire about the customer's financial status, tax status, and investment objectives – when recommending a security to that customer. By contrast, the MSRB's proposal would require, prior to effecting an **unsolicited** transaction, that a dealer selling an out-of-state 529 plan to a customer "inquire whether realizing state-based benefits is an important factor in the customer's investment decision." Such a duty is not required in transactions involving any other investment product in the industry. We do not understand why dealers selling 529 plan securities on an unsolicited basis should be subject to such a disparate and rigorous regulatory requirement.

How T. Rowe Price Distributes 529 Plans.

Typically, the sale of 529 plan interests begins when investors respond to an advertisement or other public information, and contact T. Rowe Price directly, usually by telephone or via the web, to learn more about the investment. When an investor telephones T. Rowe Price, he or she speaks to a telephone representative to whom the call has randomly been routed. Upon request, T. Rowe Price will send out a standard "fulfillment kit." This kit generally contains an application and plan disclosure document. At that point, it is up to the investor to make his or own decision on the appropriateness of the plan for investment and to submit the application, typically through the mail, to the fund's transfer agent. Rarely are accounts opened in a face-to-face interaction with customers. In fact, approximately 65% are opened by mail, 13% over the telephone, 20% via the internet and .02% through face-to-face contact in one of T. Rowe Price's investor centers. This trend is generally consistent across all of our directly-marketed investment products – investors today perform the vast majority of their transactions via the internet, through the mail or over the phone. Among other practical issues, we question how a dealer could satisfy its proposed affirmative obligations under Rule G-17 when an investor elects to purchase a 529 plan security on an unsolicited basis over a dealer's website – an increasingly popular point of contact with investors.

For the above reasons and those detailed by the ICI in its excellent comment letter, we believe the MSRB should reconsider its proposal for Rule G-17. It is our view that imposing such burdensome requirements on dealers selling 529 plans can be expected to dissuade them from continuing to offer 529 plans to investors. Why would a dealer with a choice of products to sell continue to sell 529 plan securities under such rigorous conditions? The ultimate consequence would be the reduction of the number of 529 plan securities available to investors. We believe the MSRB should give serious consideration to the impact on the marketplace of this proposal. To the extent the MSRB determines to proceed with the proposal, we request that it revise its

interpretation to make it consistent with duties traditionally imposed on broker-dealers under the Federal securities laws; and avoid subjecting dealers selling 529 plans to discriminatory treatment vis-à-vis other broker-dealers and the sales of other investment products.

We appreciate the opportunity to comment on the proposed rule. Please feel free to contact Sarah McCafferty (410/345-6638) or Regina Watson (410/345-2163) if you have any questions or need additional information.

Sincerely,

Henry H. Hopkins
Vice President,
Director, and
Chief Legal Counsel

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July 29, 2005

Mr. Ernest A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: Comments Regarding MSRB Notice 2005-28 Draft Interpretations on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans

Dear Mr. Lanza:

I am the associate vice president for finance for the University of Alaska (trustee for the Education Trust of Alaska). I was the principal drafter of Alaska's prepaid college tuition plan in 1991 and have served as executive director of that program and its successor Section 529 college savings program since that time. I am also a founding and currently serving member of the College Savings Plan Network (CSPN) Executive Board, and was one of the active participants in the drafting and promotion of Section 529.

The Education Trust of Alaska offers three college savings plans: (1) the University of Alaska College Savings Plan, a direct-sold national plan marketed only in Alaska, (2) the T. Rowe Price Plan, a direct-sold national plan marketed nationally, and (3) the John Hancock Freedom 529 (formerly Manulife College Savings), a national plan distributed through financial intermediaries. All three of these plans have been rated as high quality plans by Morningstar and/or Joe Hurley (savingforcollege.com).

I have had the opportunity to review drafts of the CSPN and the ICI (Investment Company Institute) comment letters. I concur with the comments included in both letters and respectfully ask that you give serious consideration to them.

In addition, I would like to express a couple of overriding concerns with the MSRB proposals to regulate distribution and sales of Section 529 plans. These concerns are that excessive regulation and alarm over peripheral issues will discourage investment in Section 529 plans and detract from the very purpose of their existence and the intent of Congress in creating these unique programs. I am also concerned about any requirement for brokers or distributors of the Alaska program being required to explain other state program benefits and even more concerned that brokers for other state programs would be explaining the Alaska program provisions to potential participants.

Prior to issuance of this notice, I had not been concerned about MSRB, NASD, or SEC regulation or guidance because I believed it would be helpful to the states, level the playing field by requiring everyone to follow the same rules or principles, and safeguard our participants from abusive practices. The MSRB super-suitability proposals, such as annual reconfirmation of a participant's interest in state tax issues (which are virtually immaterial relative to other issues except for a few states with high tax rates and high deduction limits) will hold sellers and distributors of these programs to standards and requirements which are not reasonable, nor are such standards applicable to other investment products, vehicles, or distributors. The liability associated with being wrong or failure to document compliance will result in sufficient liability exposure for brokers and others to cause them to avoid distribution of tax advantaged college savings investments, "period." The brokers will merely place their clients in other investment vehicles that do not carry such risk for the broker; they will collect their commissions; the investor will be deprived of the federal tax benefits; and the beneficiary will be deprived of educational benefits. The quest for the "best" or even "better" will deprive participants of the benefits authorized by Congress and detract from the basic purpose for which these programs were developed.

Although all states may not fully ascribe to the philosophy that participation in any state college savings program is better than non-participation, most states do. Which state program a participant chooses is not necessarily a critical issue. Most states allow participants to freely transfer to other state programs without penalty. Alaska has no desire to prohibit or restrict in any way other programs from attracting or soliciting Alaska residents into their state programs. Regardless of my opinion that the Alaska plan is the best plan for almost all Alaskans, we welcome anyone who can get our residents to save for college. Our only concern is that the program selected not be fraudulent or abusive and that the sellers inform prospective customers that they should review their home state offerings.

In my opinion, the MSRB and the SEC have a noble purpose, but the proposed cure may be more problematic than the disease. These are new and complex programs for which there has been no guidance and each state has had to develop their own processes, procedures, and disclosures. Some states have been more successful at implementing quality programs than others significant differences in organization and disclosures exist. However, the states and their commercial partners have made tremendous progress in improving the quality of the programs and the disclosures to participants. Almost every state savings program in the country has agreed to conform to the CSPN disclosure principles adopted earlier this year and just this week revised those principles based on

comments from SEC staff and others. The MSRB proposal is attempting to address issues that were identified over a year ago and are adequately being addressed through other venues.

In considering your final proposals, please consider that the purpose of Congress and the states in creating these programs was not to sell securities or compete with other investment vehicles, but to foster and provide financial access to postsecondary education for those that have the potential to fund their education from their own resources. In so doing, most of the state programs partner with commercial entities in order to leverage the expertise and cost efficiency gained from high volumes of activity to support maintenance and marketing to participants that have minimal resources and small accounts that would otherwise be unfeasible to accommodate under a commercial business model. In order to accomplish this mission, one of the inherent goals of every state is to change the family conversation and perception from "if" I go to college to "when" I go to college. You cannot get children to college if they do not have the mindset that they are going to go to college. Nor can they get to college if they have not achieved the basic academic standards. College savings accounts are intended to help change this mindset and encourage higher academic achievement in high school and grammar school. How large of an investment does it take to accomplish this?? Who knows?? It may be only a thousand dollars or $50 per month. And for those that do not go on to college, what is the value of a year or two of more highly motivated academic achievement?? In this arena, even a less than optimal financial investment may have substantial economic and non-economic rewards for the participants and their families.

Thank you for the invitation to respond.

James F. Lynch

THE UNIVERSITY OF NORTH CAROLINA AT WILMINGTON

Mr. Ernesto A. Lanza, Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street Suite 600
Alexandria, VA 22314

September 15, 2004

Re: MSRB Notice 2001-16

Dear Mr. Lanza and MSRB Boardmembers:

Thank you for allowing us to comment on the draft amendments relating to advertisements of municipal fund securities and the draft interpretive guidance on disclosures in connection with out-of-state sales of college savings plan shares.

We would like to bring to your attention the results of a study conducted on the tax and non-tax factors that influence investors' choice of state sponsored §529 college saving plans. We discuss our study below, followed by our recommendations for disclosures of state tax benefits, fees, and historical returns.

Study Overview

We examine investments in state-sponsored §529 plans for quarters ending 12/31/01 through 9/30/03. During this time period, §529 plan investments tripled from $13.6 to $45.8 billion as investors opened an additional 3.7 million accounts. Our results demonstrate that §529 plans with higher fees have more accounts. Surprisingly, the amount of state tax deductions from plan contributions is *negatively* related to number of accounts; the states providing the largest state income tax deduction for residents' contributions are likely to have the smallest number of accounts. These findings are consistent with Congressional concerns that advisor fees are driving investment recommendations, not state income tax benefits or low fees, which should lead to higher expected returns for these investments. No statistically significant results are reported for other plan features such as amount or type of investment choices or for other tax features such as tax treatment upon distribution.

Study Background

Our study tests whether investors are choosing plans offering the greatest estimated return (i.e., lowest fees and greatest tax benefits) or those with lower search costs (i.e., recommended by an

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advisor or part of a well-known fund family). It is well documented that investors make purchase decisions based upon prior returns.[1] However, §529 plan investors relied upon other information as plan returns were not publicly available and traditional investment resources (e.g., Morningstar) did not begin §529 plan coverage until fall 2003. This paper examines the trade-off between tax and non-tax features in a setting in which traditional resources and historical data are absent.

Data

Our empirical analysis is carried out using a panel model with random effects representing each §529 plan across the U.S. over eight quarters. We used information on 77 §529 plans offered to the public for the quarters ending December 31, 2001 through December 31, 2003.[2] For each fund, our database contains the total assets under management, the number of accounts by quarter, and the date established. We supplement this data with state tax information, fees, distribution channels, investment choices and distributors' assets under management.

The absence of return data precludes us from isolating inflows from investment appreciation. Thus, we define our dependent variable as the number of accounts in each §529 plan. We model the demand for the §529 plan by regressing the number of accounts on various characteristics of the plans. In general, investors may choose a plan because of low fees, a favorable impression of the plan manager, the efforts of commissioned sales representatives, tax advantages, and various attractive plan features. We test for each of these and present the major findings on taxes and fees below.

Tax Benefits

§529 plans are touted because unique tax benefits make them desirable investments for many people.[3] At the federal level, they are similar to a Roth IRA: contributions are not federally tax deductible, but earnings and withdrawals are tax-exempt if used for qualified expenses. At the state level, net returns vary because of differences in tax treatment of contributions and withdrawals and differences in state marginal tax rates. Assuming a constant interest rate across states and a state income tax deduction upon contribution, a 10,000 investment, at a 5% state tax rate would equate to a $10,526 investment with tax-free growth.

Thus, it is reasonable to assume that funds in states that provide deductions or credits for contributions and exempt qualified distributions will have more investors, than those state plans with less favorable tax rules, all else equal. However, we found the opposite. The sign for our tax variable is negative and statistically significant. This result indicates that the higher the tax deduction permitted for residents that participate in resident plans, the fewer the number of accounts opened. This is a surprising result, because a tax deduction for contributions has an unambiguous positive effect on the ending amount available for education. Despite an unlimited

1 Sirri, Erik R. and Peter Tufano. 1998. "Costly search and mutual fund flows." *Journal of Finance* 53: 1589-1622. Ippolito, R. 1992. "Consumer reaction to measure of poor quality: Evidence from the mutual fund industry." *Journal of Law and Economics* 35: 45-70.

2 Several states have more than one plan.

3 Turgesen, Anne. 2004. "The 529 ate my tax break." *BusinessWeek*. August 16.

deduction for contributions to an in-state §529 plan, investors are choosing other plans, given all other factors are constants.

Fees/Marketing Efforts

To make purchase decisions, investors face a "costly search" process in which information is gathered about tax benefits, fees, plan features, and the fund family. Investors frequently use rating services (i.e., Morningstar) and financial literature to assist in the decision-making process. Consumer research would define the §529 plan investment decision as difficult.[4] Specifically, there are many alternatives (77 plans) and plan attributes (over 20 per plan). Further, some plan attributes are difficult to process (i.e., fee structure) or to assign a value (i.e., portability of benefits). Therefore, it is not surprising that a survey of households saving for college reports that 68% of §529 consumers relied upon advisor provided information.[5]

There is reason to believe that rational consumers seeking to maximize expected returns would choose low fee funds. Our results, instead, support the notion that investors are relying upon advisors' recommendations to reduce their search costs. The "fees" variable is positive and statistically significant, indicating that §529 plans with *high* fees have a greater number of accounts.

Other Results

The next table presents summary statistics by account quintile. On average, the funds with the most accounts have higher fees, have been in existence longer and are part of the largest fund families. Conversely, the funds with the fewest accounts have the lower fees, shorter tenure, and smaller fund families.

Means for Select Variables by Account Quintile

Quintile	Plan Accounts Mean	Plan Assets Mean	Fees Mean	Plan Length (quarters) Mean	Distributor Assets under Management Mean
1	1,577	8,453,448	0.510	1.548	15,810,000,000
2	6,904	32,238,068	0.873	3.500	101,700,000,000
3	17,380	94,492,135	1.427	5.946	223,500,000,000
4	40,376	245,800,000	2.179	8.880	321,400,000,000
5	170,931	1,205,000,000	2.711	14.404	828,600,000,000
Average	47,434	317,400,000	1.570	7.434	312,900,000,000

4 Bettman, James R., Eric Johnson, and John W. Payne. Consumer decision making. In Handbook of Consumer Behavior eds. Thomas S. Robertson and Harold H. Kassarjian, pg 50-84.

5 Investment Company Institute. 2003. "Profile of households saving for college." Investment Company Institute Research Series.

Selected statistics by quarter are presented in the table below. The number of accounts and plan assets have increased during this short time frame. Also of note is that the percentage of funds that can only be purchased through a broker nearly doubled from 17% to 32 %.

Descriptive Statistics by Quarter

Variable		4Q01 (n=40)	1Q02 (n=46)	2Q02 (n=50)	3Q02 (n=55)	4Q02 (n=60)	1Q03 (n=64)	2Q03 (n=65)	3Q03 (n=60)
Plan Accounts	Mean	32,499	38,025	42,635	44,723	46,803	50,138	53,979	61,744
	min	48	149	187	240	800	56	317	443
	max	217,000	287,000	326,000	352,000	399,652	424,450	452,465	478,079
Plan Assets	Mean	204,000,000	248,000,000	275,000,000	263,000,000	304,000,000	320,000,000	385,000,000	468,000,000
	min	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	2,000,000
	max	1,530,000,000	2,070,000,000	2,250,000,000	2,240,000,000	2,660,000,000	2,790,000,000	3,360,000,000	4,000,000,000
Broker Required? 1=yes, 0= no	Mean	0.175	0.239	0.240	0.309	0.300	0.313	0.308	0.317

Our Conclusions/Recommendations

During this start-up phase with limited investment choices and few plan administrators, §529 markets may be inefficient. §529 plan investors appear to be choosing high fee/broker sold funds rather then the lower fee, direct investment options. The federal and state tax governments are providing subsidies in the form of tax-exemption of earnings and withdrawals and state income tax deductions. However, the benefits of these subsidies are accruing to the mutual fund distributors, rather than to the plan owners. We support efforts to require uniform fee and performance disclosures. As investors become more able to make meaningful comparisons between funds, market forces will reduce the fees that brokers can extract from investors.

Our results also demonstrate that investors appear to be ignoring state tax benefits. However, data limitations preclude us from determining why this may be the case. We can not assess whether brokers are concealing state tax benefits or whether investors knowingly forgo these state tax deductions when selecting an out-of-state §529 plan. We support efforts to require disclosure of state-tax benefits.

As noted above, our study did not include return variables because this information was not generally available during this time period. Some return information is now available through commercial services such as Morningstar and savingforcollege.com and in plan documents. However, comparisons of returns are still impossible. Some plans report returns for underlying funds without disclosing the percentages invested in each fund. Others report returns for each static or age-adjusted portfolio offered without presenting results for each underlying fund. Each return disclosure should include the following: historic returns for each static or age-based portfolio, historic returns for the underlying funds in each portfolio, and the percentage that each underlying fund comprises each portfolio for each period presented.

Thank you for allowing us to provide these comments. If you have any questions, please feel free to contact Raquel Alexander at 910-962-4259 or LeAnn Luna at 910-962-7632.

Sincerely,

Raquel Alexander, PhD
Assistant Professor

LeAnn Luna, PhD
Assistant Professor

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July 29, 2005

VIA FACSIMILE (703) 797-6700

Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, Virginia 22314

Re: MSRB Notice 2005-28 Regarding Draft Interpretation of Customer Protection Obligations Relating to College Savings Plans (529 Plans) Marketing

Dear Mr. Lanza:

USAA Investment Management Company (IMCO) appreciates the opportunity to comment on the Municipal Securities Rulemaking Board's (MSRB) draft interpretive guidance (Draft Guidance) regarding point of sale (POS) disclosure, suitability and other customer protection obligations of brokers, dealers and municipal security dealers (collectively, dealers) in connection with the sale of 529 college savings plans (Plans). IMCO supports the MSRB's Draft Guidance regarding the consideration of known information about a Plan beneficiary, such as the beneficiary's age and number of years until the funds will be needed, in determining whether an investment in a Plan is suitable. However, IMCO has significant concerns regarding other aspects of the Draft Guidance, most notably the required inquiries of the importance of state tax benefits and the requirement of a comparative analysis when Plans are offered to out-of-state investors, particularly when the dealer does not make any recommendation with respect to an investment in a Plan. Our main concerns are summarized below and explained in greater detail:

- The MSRB's proposed interpretation of Rule G-17 to impose a new inquiry duty and expanded disclosure obligation on dealers selling out-of-state Plans, including dealers who do not recommend such securities, would result in greatly increased costs and potential liability to dealers which would result in increased costs to investors or a reduction in the number of dealers selling Plan interests. This increase in cost is particularly troublesome to dealers not receiving commissions on the sale of Plan interests.
- The MSRB's proposed interpretation of Rule G-19 would dramatically expand a dealer's traditional responsibility to require dealers recommending out-of-state Plan interests to engage in a comparative analysis between the recommended Plan and all other Plans, even those not sold by the dealer. This proposed interpretation would effectively require dealers to render tax and other advice typically beyond their area of expertise. This comparative study requirement also raises practical problems with respect to determining an investor's home state and maintaining and updating sources of information of each State's Plans.
- We do not believe that the costs of educating investors about potential state tax benefits of existing Plans should be shifted to dealers, particularly if the dealer does not make a recommendation to invest in a Plan.

- The MSRB should wait until the Securities and Exchange Commission (SEC) finalizes its rules on point of sale and confirmation disclosure before imposing additional and possibly inconsistent requirements in the sale of Plans.

IMCO believes that POS disclosure for Plans should be focused on illuminating the distribution-related costs and resulting conflicts of interest associated with Plan investments, and that the program disclosure document, *e.g.*, the Plan Description, should remain the primary integrated document that provides investors with all material information about the Plan, including its ongoing fees and expenses. IMCO believes that the current interpretation of the Rules and disclosure obligations are satisfactory to identify to clients the possibility of additional Plans, with possible state tax law benefits, without requiring each firm to become an expert on securities and Plans that it does not sell or even recommend.

I. Background

IMCO is an indirect, wholly-owned subsidiary of United Services Automobile Association (USAA), a member-owned association. USAA seeks to facilitate the financial security of its members and their families by providing a full range of highly competitive financial products and services, including insurance, banking and investment products. USAA members are the American military community, and include present and former commissioned and noncommissioned officers, enlisted personnel, and their families. Although many of USAA's products and services, including the USAA College Savings Plan (the USAA CSP), may be purchased by non-members, USAA does not actively market beyond its eligible member base.

USAA CSP interests which are sponsored by the State of Nevada and purchased exclusively through IMCO in its capacity as a broker-dealer. Upromise Investments, Inc. is the Program Manager of the Plan. The USAA CSP includes certain of the USAA funds in the USAA family of funds (which are no-load, no 12b-1 retail funds) as underlying funds for the investment portfolios in the Plan. The USAA CSP does not charge any distribution fees or sales-based charges although it does include certain account fees. Interests in the USAA CSP are sold directly to customers through IMCO. IMCO member service representatives (MSRs) do not make any recommendation to a client whether to invest in the USAA CSP or to utilize another savings vehicle, such as a Coverdell or other account. If a client chooses to invest in the USAA CSP, IMCO MSRs, however, will assist the client in choosing the investment portfolio (age-based or investment style) that best suits the customer's investment objectives and risk tolerance. IMCO MSRs are salaried employees and do not earn any sales-based commissions or fees.

II. Primary Concerns with Draft Guidance

A. Proposed Interpretation of Rule G-17

The MSRB's Draft Guidance would require firms to seek information from each client purchasing a Plan interest, including the client's home state. If through the proposed inquiry, the dealer determines that the client is not a resident of the state of the Plan being offered, the dealer would be required to determine whether state-tax benefits were important to the client, and if so, to disclose publicly available information from industry sources about state law benefits offered by the home state plan to the customer or designated beneficiary. These requirements would be imposed on all dealers, including those like IMCO, who do not *recommend* an investment in a plan.

The MSRB's Draft Guidance would effectively require each dealer to know the laws of each State, possible state law benefits, and the nuances of each Plan offered by each State, and then to discuss any possible state law benefit with an investor. This proposed interpretation would require firms, even those that do not recommend Plan securities, to engage in a comparative analysis to render tax and other advice to investors who make their own investment decisions. This would result in a problematic increase in potential liability for firms that sell Plans regardless of whether they recommend an investment in a Plan. We believe that this proposed interpretation would effectively require firms to educate investors in areas in which they are not qualified to discuss and evaluate. This is particularly troublesome given, as the MSRB acknowledge in the Draft Guidance, there currently is no centralized website which contains summary information about each Plan that would enable firms to perform this new duty. It would be fundamentally impractical to mandate that dealers learn about all features of all states' Plans, particularly those dealers like IMCO, that do not make any recommendation with respect to investing in a Plan and receive no separate commissions for sales of Plan interests. We are not aware of any other investment product that imposes a similar burden on a firm, and we do not believe that any basis has been established or articulated demonstrating the need to establish these novel duties.

Moreover, it would be administratively burdensome and impractical for each dealer to obtain, continually update, and have its representatives learn the features and nuances of every existing Plan. Instead, if the MSRB created and maintained a centralized website or other reliable source of summary information, IMCO believes requiring disclosure regarding the existence of such website or information to all prospective Plan investors would be more consistent with current interpretations of disclosure duties regarding the sale of other investment products.[1] This

[1] If the MSRB decides this route is preferable, we believe that this duty should apply only to those dealers who recommend investments in a Plan.

alternative would allow prospective Plan investors the opportunity to obtain uniform and reliable information regarding any and all Plans of interest to the investor.[2]

If the MSRB and SEC are concerned that investors are uninformed about potential state tax benefits, another way to address this issue would be for the two regulatory agencies to advocate for the standardization of state tax treatment of investments in, and distributions from, 529 Plans. If the state tax law benefits were standardized for all Plans, investors would have greater choice among Plans, and in choosing a Plan could concentrate on other features, including fees and underlying Plan performance. We believe that greater standardization could enhance price and performance competition among Plans to the ultimate benefit of American investors.

In essence, the Draft Guidance would unreasonably force dealers to provide free education to investors with increased potential liability. We believe that this would result in greatly increased fees to sell such Plans, which would likely be passed on to investors, or a reduction in the number of dealers that will sell any Plan interests to the ultimate detriment of investors. Instead, IMCO believes the POS disclosure requirement should be based on the need for the dealer to highlight any potential conflict of interest it faces in selling a particular Plan. If a dealer does not solicit or recommend a Plan to the customer, the comparative analysis would merely delay a customer's order and would increase the costs of operations of the dealer.

B. Proposed Interpretation of Rule G-19

Rule G-19 requires a dealer making a recommendation to a client to ensure that the particular security recommended to the client is suitable without regard to other securities that are available to customer. The MSRB's Draft Guidance would reinterpret this rule to require dealers making a recommendation in an out-of-state Plan to conduct a comparative analysis about other state plans that the dealer does not sell. The dealer could only then sell a less suitable out-of-state plan based on the investor's direction, provided that the dealer complies with certain recordkeeping, principal review, and an annual confirmation requirement.

Although IMCO does not currently make recommendations to clients about investing in Plans, we note that these proposed requirements would be unique and differ substantially from the suitability requirements imposed on dealers in recommending other securities. We are unaware of any other law or regulation that requires a firm to conduct a comparative analysis of securities that it does not sell or offer to sell. We do not believe that the MSRB has identified or

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[2] We also note that the Draft Guidance does not define an investor's home state, which would not be easy to determine for investors who have multiple residences or have significant contacts with different States, such as military members and their dependents. Given we serve the U.S. military community, this is of particular concern to us. IMCO believes that a dealer who recommends an investment in a Plan should highlight the possibility that the client's home state Plan could offer additional benefits, and then the client could best determine which other State Plans he or she should review.

articulated a specific need that would justify its proposed radical expansion of a dealer's duties with respect to suitability of investments in Plans.

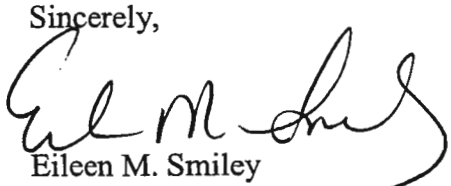
The incremental cost associated in meeting this unprecedented standard would cause firms to reevaluate whether offering Plans continues to make sense. For those who choose to continue offering Plans, they will need to determine how to recover the dramatic costs of meeting these proposed requirements. This will almost certainly result in at least some portion of these costs being passed on to investors. We encourage the MSRB to assess seriously and thoroughly whether the isolated concerns raised to date merit the dramatic expansion of a dealer's traditional duties and resulting cost increases that will result from implementing the requirements.

In conclusion, we believe that the Draft Guidance should be substantially revised or abandoned. We believe that if the MSRB chooses to dramatically expand a dealer's traditional duties with respect to the sale of Plan interests, it should justify the need for this reinterpretation. The Draft Guidance does not identify specific problems or abuses that prompted this proposed reinterpretation of existing MSRB rules. We note that identification of the problems or needs underlying this Draft Guidance also would give the industry an effective opportunity to comment on the need, and the opportunity to offer other reasonable alternatives. In our view, the MSRB has not articulated a specific need or abuse associated with Plan interests that would justify the dramatic increase in a firm's duties, and potential liabilities and costs, particularly those firms that do not recommend Plan investments.

Finally, we note that the SEC has not yet finalized its proposed rulemaking regarding point of sale and confirmation disclosure requirements for transactions in Plans, mutual funds, and variable insurance products. We believe the MSRB should not issue interpretive guidance imposing additional POS requirements regarding the Plans until the SEC adopts final rulemaking in this area. Otherwise, dealers may be subject to conflicting regulatory mandates and standards which would create additional problems and confusion regarding the sale of Plans.

We appreciate the opportunity to provide comments on this Draft Guidance. If you have any questions regarding our comments, or would like additional information, please contact the undersigned at (210) 498-4103, or Mark Howard at (210) 498-8696.

Sincerely,



Eileen M. Smiley
Vice President & Assistant Secretary
USAA Investment Management Company

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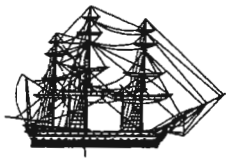

Vanguard®

July 28, 2005

Via Federal Express

Ernesto A. Lanza, Esq.
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

RE: MSRB Notice 2005-28: Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans

Dear Mr. Lanza:

Vanguard[1] appreciates the opportunity to comment on the Municipal Securities Rulemaking Board's proposal[2] relating to disclosure, suitability and other customer protection obligations of dealers in connection with marketing 529 college savings plans established under Section 529 of the Internal Revenue Code ("529 plans").[3] We fully support the MSRB's goals of providing 529 plan investors with the appropriate information with which to review and understand the myriad of 529 college plans available, and to make an informed investment decision. We also support the MSRB's attempt to ensure that dealers fulfill their duty to deal fairly with customers in the 529

[1] The Vanguard Group, Inc. ("Vanguard"), headquartered in Malvern, Pennsylvania, is the nation's second largest mutual fund firm. Vanguard serves 18 million shareholder accounts, and manages approximately $850 billion in U.S. mutual fund assets. Fourteen states have selected Vanguard mutual funds as investment options for their 529 college savings plan assets. Through these relationships, Vanguard manages approximately $9 billion in assets, representing approximately 15% of all 529 college savings plan assets (excluding prepaid tuition plan assets). *Source: The Vanguard Group, Inc. and 529 Plan Program Statistics, March 2005, Investment Company Institute.*

[2] *Request for Comments on Draft Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans,* MSRB Notice 2005-28 (May 19, 2005) (the "Proposal").

[3] Section 529 of the Internal Revenue Code permits states, state agencies and certain other groups to establish tax-advantaged college savings programs designed to help families save for the costs of higher education. As of March 2005, 49 states and the District of Columbia sponsored one or more 529 college savings plans with 5.6 million accounts totaling over $55 billion in assets (figures exclude prepaid tuition plans). The average 529 plan account size was about $9,900 in March 2005. *Source: 529 Plan Program Statistics, March 2005, Investment Company Institute.*

plan market. However, we have serious concerns regarding the practical application of many of the new obligations contained within the Proposal.[4]

Requiring dealers to inform investors about the specifics of tax law in their home state is, simply put, a bad idea for the following reasons:

- Since an investor could reside or pay income taxes in any jurisdiction, the requirement obligates dealers to become experts on the tax laws of the 50 states. This is not only a significant burden, but goes well beyond any reasonable understanding of a dealer's fair dealing obligations. The requirement is particularly troublesome in the context of dealers who do not make recommendations, and therefore have no suitability obligations.
- By singling out state tax treatment as the primary topic for additional required disclosures, the MSRB is, albeit unintentionally, encouraging dealers and investors to give disproportionate weight to one factor versus other, potentially more important, factors that affect the choice of a 529 plan.
- The costs associated with implementation of the Proposal are substantial and will increase costs to all 529 investors, while the benefits are limited.

We strongly encourage the MSRB to reconsider its Proposal and work with the industry to ensure that dealers provide investors with the appropriate degree of detail and relevant information about 529 plans. Dealers take seriously their obligation to communicate with their clients in a manner that is fair and not misleading. Working together with 529 issuers, dealers have worked diligently over the past several years – *e.g.*, developing, through the College Savings Plan Network, best practice disclosure guidelines – to improve the quality of disclosure provided to 529 investors.

The Proposal's required disclosure represents an unprecedented use of rulemaking authority and would inappropriately expand traditional dealer responsibilities by requiring disclosure about competing 529 plan securities.

Dealers clearly have an obligation to their clients to disclose detailed information about the 529 plan securities they sell. The problem with the Proposal is that it extends that obligation to 529 plan securities *not* sold by the dealer. In our view, this is an unprecedented expansion of regulatory authority and is contrary to the MSRB's own prior interpretations. In 2002, the MSRB stated that "the affirmative obligation arising under Rule G-17 to disclose material information regarding a particular transaction to a customer relates to material information about the securities that are the subject of the transaction rather than alternatives available in the market to such investment."[5] We

[4] This comment letter deals solely with the interpretation of MSRB Rule G-17 relating to a municipal dealer's duty of fair dealing. Vanguard does not make recommendations about particular 529 plans and therefore expresses no views on the interpretation of MSRB Rule G-19 relating to the suitability obligations of dealers who make recommendations.

[5] *Application of Fair Practice and Advertising Rules to Municipal Fund Securities*, MSRB Interpretive Notice (May 14, 2002) (section captioned "Disclosure Issues – Tax Treatment").

agree with this statement and do not believe that the proposed expansion of dealer disclosure obligations would further the MSRB's goals of ensuring fair dealing by brokers.

Currently, the MSRB requires 529 plan dealers to inform investors that their home state's 529 plan may offer state tax and other benefits not otherwise available through out-of-state plans.[6] MSRB seeks to expand this requirement by requiring dealers to disclose "material information from established industry sources" about benefits offered by the investor's home state's plan -- even if the dealer does not sell 529 plan securities offered by the home state.[7] The MSRB release acknowledges that the proposed expansion involves providing prospective investors with information about *other* municipal securities: "Dealers are reminded that this specific disclosure obligation with respect to sales of out-of-state 529 plan interests – which involves providing information to the customer about *an investment option other than the 529 plan interests being offered by such dealers* – is in addition to their existing general obligation under Rule G-17 to disclose to their customers at the point-of-sale all material facts" (emphasis added). We are not aware of any other situation in which a broker-dealer is required to discuss with customers competing products that it does not even offer.[8]

The MSRB is attempting to impose this new disclosure obligation through an interpretation of its fair dealing rule, Rule G-17. *See also* NASD Interpretive Material 2310-2. Although the MSRB, NASD and courts of law have cited fair dealing rules to articulate statements of general principle regarding a broker-dealer's duties to its customers, "[t]hese statements of general principle have not . . . led to the development in the case law of an expansive view of brokers' duties."[9] Now, however, the MSRB is trying to do just that – use Rule G-17 to develop an expansive view of a municipal

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[6] *See id.*

[7] Specifically, the Proposal would require a dealer to disclose, among other items, (1) material information available from established industry sources about state-based benefits offered by the home state of the customer or designated beneficiary *for investing in its 529 plan*, and (2) suggest the customer contact his or her home state or any other 529 plan to learn more about state-based benefits that might be available in conjunction with an investment *in that state's 529 plan*.

[8] Commenters strongly criticized the Securities and Exchange Commission about ten years ago when it proposed a similar requirement in connection with the adoption of a rule permitting mutual funds to issue multiple share classes, and the SEC ultimately withdrew that aspect of the rule before adopting it. *See Adoption of Rule 18f-3 under the Investment Company Act of 1940 and Related Disclosure Requirements*, Investment Company Act Release No. 20915 (Feb. 23, 1995). Specifically, commenters criticized the proposed rule for requiring an issuer to provide in the prospectus for one share class disclosure about other share classes not offered through that prospectus. One commenter remarked that "[s]uch a requirement of disclosure about products offered by competitors and the assumption of liability for such disclosures would be entirely unprecedented in the securities industry." *See id.* at fn 75 (citing letter from Kirkpatrick & Lockhart on behalf of Signature Financial Group).

[9] Barbara Black, *Economic Suicide: The Collision of Ethics and Risk in Securities Law,* 64 U. Pitt. L. Rev. 483, 489-90 (Spring 2003).

dealer's duties. In essence, the MSRB is attempting to import a duty to inquire about a customer's tax status into Rule G-17. But it is well established that such a duty arises only when a dealer is making a recommendation. *See* MSRB Rule G-19; NASD Rule 2310. The MSRB's proposed expansion of a broker-dealer's obligations under its duty of fair dealing represents a radical break from decades of broker-dealer regulation – and one that the MSRB has wholly failed to justify.

In short, we do not believe that a dealer selling a particular municipal security should be required to disclose information about *other* municipal securities.

The Proposal promotes excessive attention to potential state tax benefits to the inappropriate exclusion of other, equally important factors.

The Proposal would require dealers to discuss any home state tax and other benefits available to a customer who is investing in an out-of-state 529 plan. This required conversation involves nine items of information, or queries,[10] all primarily aimed at the issue of state tax benefits. Singling out tax for discussion with prospective investors is inconsistent with the MSRB's position that state-based benefits are "but one of many appropriately weighted factors" when choosing a 529 plan. We believe this mandated emphasis on state tax treatment, to the exclusion of any other factor, does customers a disservice and could ultimately mislead investors. Moreover, since a dealer is not required to make any inquiries of customers who are purchasing plans offered by their home state, the natural conclusion to be reached is that a home state 529 plan is automatically more suitable than any other 529 plan.[11] However, it may not be in an investor's best interest to purchase his or her home state 529 plan, particularly if the home state offers minimal or no state tax benefits, but, for example, instead has high fees or consistently poor performance.

Requiring dealers to discuss home state tax treatment is particularly inappropriate in cases where a customer's home state offers no state tax benefits at all. Twenty-five states – including three of the four and nine of the fifteen most populous states – currently do not offer any state tax benefits for contributions to 529 plans. For residents of these states, the issue of home state tax benefits is irrelevant. For these investors in particular, state tax benefits are clearly outweighed by other important factors, including, among others, program management, fees, costs, investment options, performance, and investment minimums.

We believe that singling out the issue of state tax benefits is potentially misleading and is not in the best interests of 529 plan investors. Rather, current requirements that every 529 advertisement and every dealer effecting a sale of 529

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[10] *See infra* note 12.

[11] The MSRB notes that there should be no "presumption that investment in the home state 529 plan is necessarily superior" but the Proposal's requirement that dealers hold lengthy discussion with prospects about tax matters undoubtedly will lead some of those prospects to reach a different conclusion.

securities state that investors should consider whether their or their beneficiary's home state offers a 529 plan that has additional state tax benefits provides the appropriate level of disclosure and emphasis. We recommend the MSRB maintain this current level of disclosure in this area.

The Proposal's required state tax treatment disclosures will increase costs to 529 investors without commensurate benefits and result in tax disclosure by those who lack expertise.

The MSRB has proposed a series of disclosures regarding state-based benefits that must be made at or prior to the point-of-sale of 529 plan securities.[12] Vanguard strongly opposes these additional disclosures because we believe that it is wholly inappropriate to require dealers to be fully versed in the individual state tax treatment of every 529 plan in each of the 50 states. We believe the current requirement that dealers inform investors that their home state may offer tax and other benefits not available for investments in out-of-state 529 plans, and that investors should contact their personal tax advisor, is the correct approach and one that should be maintained. The current approach furthers the MSRB's goal of highlighting the issue of state tax benefits without imposing on 529 plan dealers the onerous burden of knowing the state tax benefits provided to in-state and out-of-state 529 investors in all 50 states. The MSRB developed the current approach after concluding that "dealers cannot reasonably be expected to become expert in state tax laws throughout the country."[13] The Proposal fails to articulate why this conclusion, reached only three years ago, is no longer valid.

To comply with the Proposal, dealers will have to acquire and maintain complete knowledge regarding 50 states' tax laws, and to train their sales personnel accordingly. In addition, the Proposal's requirement that dealers provide additional information about home state tax treatment to clients would involve either developing tailored materials or possibly mailing copies of another state's official statement.[14] All of these mandates will

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[12] The Proposal would require a dealer to: (1) disclose, at or prior to the time of trade, that, depending upon the laws of the home state of the customer or designated beneficiary, favorable state-based benefits offered by the state in connection with investing in 529 plans may be available only if the customer invests in a 529 plan offered by the home state of the customer or designated beneficiary; and (2) advise the customer that any state-based benefit offered with respect to a particular 529 plan should be considered as one of many appropriately weighted factors that should be considered. To satisfy the point of sale disclosure requirement, dealers must also (3) inquire whether the customer or designated beneficiary is a resident of the state of the 529 plan being marketed, (4) advise the customer of possible loss of state-based benefits, and (5) inquire whether realizing state-based benefits are important to the customer and (6), if yes, disclose material information available from established industry sources about state-based benefits offered by the home state of the customer or designated beneficiary for investing in its 529 plan, (7) disclose whether such benefits apply to investment in another state's plan, (8) suggest that the customer consult with his or her financial, tax or other adviser to learn more about such benefits, and (9) suggest the customer contact his or her home state or any other 529 plan to learn more about state-based benefits that might be available in conjunction with an investment in that state's 529 plan.

[13] MSRB Interpretive Notice, *supra* note 5.

[14] *See Proposal* at footnote 14 and accompanying text.

take significant time and resources and increase dealer costs. We are concerned that these increased costs could translate into higher fees for 529 investors. We question whether it is good policy to promulgate a standard that increases costs for all 529 investors when, as noted above, investors in 25 states will not benefit because their home states provide no tax advantages for investing in home-state 529 plans. We note that the alternative currently in place -- to tell investors that their home state may offer tax (and other) benefits not available through an out-of-state plan -- is virtually costless and achieves similar benefits in alerting investors to the importance of state tax benefits.

In the Proposal, the MSRB observes that information on state tax treatment is "extremely complex" and "difficult to fully summarize . . . without a significant risk that material facts may be omitted or may not be fully explained."[15] We agree. That is why we believe that investors would be better served by obtaining information about their home state's tax treatment of 529 plans from their home state, a dealer for their home state's tax plan, or a tax advisor – and not from a dealer relying on summaries in established industry sources. In this way, those who are most familiar with the state tax benefits would be the ones disclosing such information. Indeed, the MSRB has acknowledged this very point. The Proposal requires dealers to "suggest" that customers consult with a tax advisor and contact his or her home state to learn more about state-based benefits because those entities are "best positioned" to provide such information.[16]

State tax laws not only are complex, they also change over time. Accordingly, we are concerned that the proposed disclosure requirement will be extremely difficult to implement. At what point will dealers be deemed to have sufficient knowledge? Would dealers be required to check all appropriate industry sources for the 50 states on a daily basis to ensure that nothing has changed, or that no new interpretations have emerged? We do not believe that requiring dealers to expend the significant resources that would be needed to develop and maintain a current knowledge base of the 50 state's evolving tax laws and their individual 529 plan official statements is an appropriate use of dealer, or industry, resources.

If dealers are comfortable engaging in a discussion of another state's 529 plan state tax benefits, they are free to do so as a matter of individual service levels offered in a competitive marketplace. However, such a discussion should not be mandated. We believe the current requirement that dealers inform investors that their home state 529 plans may offer tax benefits not available to purchasers of out-of-state plans and direct investors to their own tax advisors is the correct approach. It strikes the appropriate balance by putting investors on notice to inquire further about their home state's

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[15] Notwithstanding the MSRB's stated position on the difficulties of providing summary information, the agency has proposed establishment of a centralized website intended to provide precisely such summary information. We are concerned that any reliance on a centralized website's summary information could, despite an intention to the contrary, cause dealers to incur significant risk.

[16] *See* Proposal at footnote 11 and accompanying text.

treatment of 529 plan investments without imposing on dealers a difficult and expensive disclosure obligation.

The Proposal should not apply to direct-sold 529 plans where dealers make no recommendations.

If despite the foregoing arguments the MSRB proceeds with this proposal, we strongly urge the MSRB to limit imposition of the expanded tax disclosure to transactions in which a dealer has made a recommendation to its customer. As discussed more fully above, there is no support for interpreting the duty of fair dealing to require a dealer to inquire about a customer's tax status or tax needs. Such an inquiry should arise only when the dealer has a suitability obligation triggered by the making of a recommendation. In the absence of a duty to inquire about tax issues, there can be no obligation to provide tax information tailored to the customer's particular circumstances.

Unsolicited 529 transactions frequently occur online, with no contact between the investor and a dealer representative. We are concerned that as drafted the Proposal's required disclosures would make online account openings impractical. In our experience, online users research investments before making an investment decision, but then prefer a streamlined process. We are concerned that adding a significant number of additional steps to the online account opening process would cause some investors to abandon the process. And there is no doubt that additional steps would have to be added to the process. In the context of an online transaction, the MSRB's nine items of disclosure (see note 12) would likely require nine separate pop-up messages, as well as links to a home state's 529 plan tax discussion or alternate sources of information.

We think the current approach of informing investors to consider their home state tax (and other) benefits is the right one in all cases, but particularly those where the dealer has not solicited the transaction.

The MSRB should adopt a compliance period that accounts for the significant time it will take to implement any of the proposed requirements.

We encourage the MSRB to modify its current Proposal by removing the interpretation of Rule G-17 that would require dealers to disclose material information about state-based benefits offered by the home state of the customer or designated beneficiary for investing in its 529 plan. In the absence of such changes, we urge the MSRB to provide dealers with a reasonable time frame – nine months, at a minimum – in which to accomplish the significant changes recommended in the Proposal.

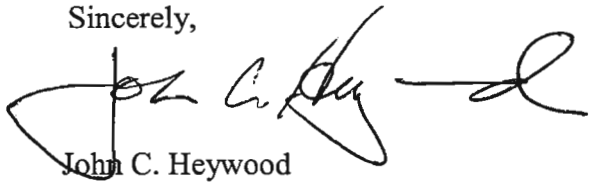
Finally, we note that the MSRB recently amended Rule G-21, significantly changing the disclosure obligations relating to 529 plan advertisements. In the case of the G-21 amendments, the MSRB's compliance date was a mere three months from the date of the published rule change. This is an extremely short time frame for an industry where marketing campaigns are developed over the course of months. Given the hardships created by amended Rule G-21's limited compliance period, we urge the

MSRB to adopt a compliance period for the Proposal that provides the industry with the time needed to make changes and adapt to any new requirements.

* * *

If you would like to discuss these comments further, or if you have any questions, please do not hesitate to contact me at 610-669-6741, or Barry A. Mendelson, Principal, in Vanguard's Legal Department, at 610-503-2398.

Sincerely,



John C. Heywood
Principal
Education Markets Group

cc: F. William McNabb, Managing Director
Barry A. Mendelson, Principal

COMMONWEALTH of VIRGINIA

VIRGINIA COLLEGE SAVINGS PLAN

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July 29, 2005

Ernesto A. Lanza, Esq.
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, Virginia 22314

RE: Comments Concerning MSRB Notice 2005-28
Draft Interpretation on Customer Protection Obligations Relating to the Marketing of Section 529 College Savings Plans

Dear Mr. Lanza:

The Virginia College Savings Plan, which represents over 1.1 million Section 529 accounts nationwide and over $12.7 billion in assets, strongly supports the College Savings Plans Network's comment letter dated July 29, 2005, related to the above-referenced MSRB Notice 2005-28. Should you have any questions or concerns related to the CSPN comment letter, please do not hesitate to contact me at (804) 786-0832.

I appreciate very much your participation in our recent national conference and enjoyed your remarks.

Sincerely,

Diana F. Cantor
Executive Director

Enclosure

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WACHOVIA SECURITIES

July 29, 2005

Ernesto A. Lanza, Senior Associate General Counsel
MSRB
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: MSRB's Request for Comments on Draft Interpretation on Customer Protection Obligations Relations to the Marketing of 529 College Savings Plans (MSRB Notice 2005-28) (hereinafter the "Draft Interpretation")

Dear Mr. Lanza:

Wachovia Securities, LLC ("Wachovia Securities") appreciates the opportunity to comment on the above-referenced Draft Interpretation concerning customer protection standards in the marketing of 529 college savings plans. Wachovia Securities is a significant provider of 529 plans for the many clients who are finding it a useful vehicle to save for education expenses. Given the import that saving for college education carries for most clients, Wachovia Securities is generally supportive of guidance that helps a dealer execute its obligation to deal fairly with customers under the MSRB rules. Wachovia Securities nonetheless hopes that commenting briefly on some aspects of the Draft Interpretation will aid the MSRB in constructing a final version that assists dealer convey clear and important information about 529 plans while balancing the need to avoid complicating the investment process and confusing investors.

I. Introduction and Overview

Wachovia Securities is a full service brokerage firm serving clients in 49 states. It offers its 5.7 million active retail accounts an array of financial services, including 529 plans. Wachovia Securities has worked diligently to embody both the letter and the spirit of MSRB rules as it meets clients' needs to include 529 savings plans in their overall financial portfolio.

The Guidance on Point-of-Sale Disclosures

Again,we applaud the MSRB in reminding of the dealer community of its suitability obligation and assisting it in its efforts to effectively market 529 plans to investors . In discussing the disclosure obligation, however, the Draft Interpretation would require that a dealer disclose "any material fact ... made publicly available." The Draft

Interpretation expresses the view that it is not enough that a dealer obtain sufficient information from a given source (such as the 529 plan's website) but the dealer must also assure himself that the source provides "sufficiently complete and timely information." On its face, this requirement imposes on the registered person an almost impossible task of canvassing all available information and assessing its materiality for each 529 plan that a full-service firm such as Wachovia Securities might offer, a costly and time-consuming endeavor. Assuming that a dealer could mount this hurdle, the dealer would then be expected to engage in a point-of-sale dialogue that communicates the all of the possible differences between an in-state plan and several potential out-of-state plans. Such a regime is ripe with the potential to paralyze investors with an overabundance of information. We believe that the MSRB might better serve the dealer community if its guidance provided fundamental standards or core information that a dealer would need to communicate to an investor. Such a required checklist could make the process of providing disclosures on a given plan and comparisons with other plans feasible and ultimately useful to the investor. As equally as significant, it will allow dealers the freedom to craft disclosures that best respond to its clients' needs and circumstances.

The Draft Interpretation also seems to suggest that dealers will have an obligation to become well-versed in the intricacies of a tremendous number of plans, all with varying characteristics. With that familiarity, the dealer is then expected to engage in a point-of-sale dialogue that communicates the various differences between an in-state plan and several out-of-state plans. Before enacting the Draft Interpretation in its current form, it will be important that MSRB conduct a thorough cost-benefit analysis of what could very well be an expensive and very difficult undertaking for dealers. While one could ordinarily state that a dealer must know what she is selling, it is a very different issue to require that dealer to have a thorough *comparative* analysis at hand for every product.

As it relates to point-of-sale disclosures for out-of-state plans, it appears that again MSRB might wish to rethink the Draft Interpretation. It proposes to require that dealers specifically state favorable state-based benefits might require that the investor purchase a 529 plan of his home state. The Draft Interpretation would also command that a dealer advise that the client consider the state based benefit as one of the factors the investor should consider. While such two-prong disclosure guidance could be cumbersome, if MSRB ended the Draft Interpretation there, dealers might be able to manage to assist investors. The Draft Interpretation, however, also requires that the dealer also engage in a "feelings" inquiry with investors as to whether they desire state-based benefits. We feel that such an analysiswill start the investment process down a slippery slope of painstakingly ranking the importance of the myriad of factors – investment advisors, annual fees and other costs, etc. – that go into any investment decision. Such a precise, step-by-step guidance may be unnecessary where, as MSRB makes abundantly clear, coupled with the two disclosures mentioned above, the overall suitability obligations of the dealer palace an investor in a position to have sufficient information to make her investment decision.

It is unclear, however, if the Draft Interpretation requires too much of a dealer in demanding that he do a "comparative analysis" of an out-of-state plan with the benefits of the home state plan. As the MSRB correctly points out, a customer's tax situation and other status may contain issues and factors beyond the expertise of a municipal securities dealer. Having the dealer do a comparative analysis of home state and out-of-state plans could tend to elevate that sole factor far above other considerations for both the investor and the intended beneficiary of the 529 plan.

We suggest that the Draft Interpretation focus on the concept of overall suitability of 529 plans and a general disclosure of key information concerning home state's benefits to provide an investor with a sound basis with which to take an informed investment decision. In light of proposals by the SEC concerning point-of-sale disclosures, it appears that the Draft Interpretation would better serve the investor by allowing the SEC proposals to drive the point-of-sale regimen for 529 plans. There is a real concern that to finalize the Draft Interpretation in its final form, MSRB will create a transactional logjam of disclosures that will cause many investors to simply seek other vehicles for financing education expenses. A single, consistent disclosure regime would serve both investors and registered representatives alike.

II. Conclusion

Wachovia Securities again supports MSRB's overall effort to ensure that dealers have sufficient guidance to assist them in the marketing of 529 plans. We ask that the MSRB considermodifying its Draft Interpretation so that an investor can purchase 529 plans in a less complex and burdensome fashion than what the Draft Interpretation presently suggests. We appreciate the opportunity to provide these comments and would be pleased to answer any questions as the MSRB finalizes this interpretation.

Very truly yours,

Ronald C. Long

Ronald C. Long
Senior Vice President
Regulatory Policy and Administration
Wachovia Securities, LLC

STATE OF WEST VIRGINIA

JOHN D. PERDUE
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West Virginia College Prepaid Tuition and Savings Program
1900 Kanawha Boulevard, East
Charleston, WV 25305-0860

July 29, 2005

Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Subject: Expression of support for comments from the College Savings Plans Network Concerning MSRB Notice 2005-28, Draft Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans

Dear Mr. Lanza:

The purpose of this communication is to express my complete support for the comments contained in the letter, dated July 29, 2005, submitted by Tim Berry, chairman of the College Savings Plans Network related to MSRB Notice 2005-28. I generally believe that current regulation is sufficient and fear that the addition of measures proposed in the notice will add greatly to the complexities and administrative costs of operating a 529 plan. These additional costs and complexities can only, in the end, hurt the ability of states to provide effective and efficient savings options to our citizens, and therefore, work against our goal of promoting adequate college savings.

Since 1997, with the passage of the West Virginia Prepaid Tuition Trust Act, it has been public policy in the State of West Virginia to promote families to adequately save for their children's higher education expenses. Since that time the state has appropriated well over $1.5 million

dollars to support the advertising and administration of our 529 state college savings program. Promoting college savings is very important here and we are very committed to it. We are also extremely pleased that so many thousands of our citizens have chosen to participate in our 529 program.

As a group the state college savings plans have greatly increased the awareness of college savings as a special segment of family financial planning needs, and they have provided attractive savings vehicles specifically designed to meet that need.

While we do offer our own West Virginia college savings plan, we recognize that there are many viable savings options in the marketplace. Our primary goal is to be successful in encouraging people to save for college.

Sincerely yours,

State Treasurer John D. Perdue
Chairman of the Board of Trustees of the West Virginia
College Prepaid Tuition and Savings Program