

April 2, 2012

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

Re: Notice 2012-10, Request for Comment on a Concept Proposal for Electronic  
Dissemination of 529 College Savings Plan Disclosure Documents

Dear Mr. Smith:

Sutherland represents a number of broker-dealers engaged in the distribution and sale of 529 college savings plans (“**529 Plans**”). We submit this comment letter in light of our representation of these broker-dealers in response to MSRB Notice 2012-10, *Request for Comment on a Concept Proposal for Electronic Dissemination of 529 College Savings Plan Disclosure Documents* (the “**Notice**”). We appreciate the Municipal Securities Rulemaking Board’s (the “**MSRB**”) continuing efforts to improve the regulatory scheme governing brokers, dealers, and municipal securities dealers (collectively “**dealers**”) who effect transactions in 529 Plans, including “advisor-sold” 529 college savings plans (“**Advisor Plans**”).<sup>1</sup>

As discussed in more detail below, our clients are very supportive of a change to MSRB Rule G-32 that would permit dealers to satisfy their delivery obligations under this rule by notifying customers how they may access Advisor Plan official statements electronically. However, a summary disclosure document would not be practical or helpful to customers given the structure of 529 Plans and the individualized nature of the information that would need to be disclosed. Finally, we are also concerned about some of the statements in the Notice concerning the role that a dealer may play with respect to a direct-sold 529 Plan. We believe it is essential for the MSRB to clarify these statements in a future regulatory notice.

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<sup>1</sup> Since the MSRB’s jurisdiction is limited to dealers and does not extend to issuers of 529 plans, interests in 529 plans that are sold without reliance on dealers are not subject to the MSRB’s rules. Accordingly, all references in this letter to “customers,” refer solely to customers of dealers who effect transactions in and/or sell interests in 529 plans.

## **I. Disseminating Plan Disclosure Documents Electronically**

As noted above, our clients are very supportive of a MSRB rule change that would permit dealers to satisfy their delivery obligations under Rule G-32 pursuant to an access equals delivery model for Advisor Plan disclosure documents by advising their customers that an Advisor Plan's official statement (the "*Official Statement*") is available for free electronically at certain web sites and that a printed copy can be provided upon request. Importantly, a customer would always have the option to request a printed copy (free of charge) from his/her dealer. This option would provide important customer protection for those customers that wish to continue receiving their Official Statement disclosure in hard copy.

The time to implement an access equals delivery disclosure model for the Advisor Plan marketplace is long overdue. Official Statement delivery obligations for all municipal securities, including 529 Plans, should be able to be satisfied via postings on EMMA or other approved/official web sites (such as the CSPN web site in the case of 529 Plans). Offering materials for many securities, including municipal securities, are already provided in accordance with such a disclosure regime. Electronic access to Official Statements in electronic form can benefit customers in several important ways. For instance, electronic versions of documents are searchable, available 24/7 from any place in the world, portable, downloadable, current and printable on a when-needed basis. We discern no legitimate reason to maintain the exception in Rule G-32(a)(ii)(A) for 529 plans, which prohibits the use of an access equals delivery disclosure regime for these securities.

### **A. The Current System is Outdated**

The current default of delivering paper materials, often through the United States postal system, dates back to the initial passage of the federal securities laws during the Great Depression — nearly 80 years ago. This paper default made sense at the time since the mail system was the dominant and timely mechanism used to deliver information about securities. Today, however, financial information delivered through the postal system can be outdated by the time it reaches its recipient, particularly in fast moving and volatile markets. Contrast this to the immediate access investors have to current information through the Internet. In addition, we note that the MSRB already permits dealers to satisfy delivery obligations under Rule G-32 with respect to other types of municipal securities by notifying their customers of how to obtain the official statement from EMMA. We believe the MSRB's reasons for treating traditional municipal securities and 529 Plans differently is without merit. The same regulatory scheme should apply to all municipal securities.

### **B. The Internet is Widely Accepted by Investors**

The Internet has grown to become a primary mechanism by which investors access information. Investors have embraced its "24/7" availability. Given that the MSRB has seemingly equated the sophistication level of 529 Plan Investors with mutual fund investors,<sup>2</sup>

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<sup>2</sup> In referencing the adoption of electronic delivery for other types of municipal securities, the Notice states that at "the time of the adoption of this public dissemination paradigm, the MSRB specifically excluded 529 Plans due to concerns that an electronic dissemination paradigm for 529 Plans might be inconsistent with the obligation of

references to Internet usage by mutual fund investors may be instructive. The Investment Company Institute found that nearly 90% of U.S. households owning mutual funds had Internet access, and of this group, 91% used the Internet to obtain access to e-mail and 82% used the Internet for financial purposes.<sup>3</sup> Overall, 80% of mutual fund owning households with Internet access used the Internet daily.<sup>4</sup> Importantly, under the proposal discussed in the Notice, a dealer's customer who did not want to access the Official Statement on the Internet would have the ability to ask for a paper copy, thus ensuring that this type of customer would not be disadvantaged by an access equals delivery regime.

### C. An Access Equals Delivery Regime is Consistent with Executive Mandates

Adoption of an access equals delivery disclosure regime for 529 Plans under which dealers notify customers how to electronically obtain Official Statements would be consistent with the requirements of Executive Order 13563 ("**Order**") which, while not applicable to the MSRB, should guide its regulatory practices, just as it does federal agencies.<sup>5</sup> The Order mandates in pertinent part that federal agencies:

- "identify and use the best, most innovative, and least burdensome tools for achieving regulatory ends. [Our regulatory system] must take into account benefits and costs...It must ensure that regulations are accessible..."
- "tailor its regulations to impose the least burden on society..."
- "select in choosing among alternative regulatory approaches, those approaches that maximize net benefits (including potential economic, environmental [benefits]..."<sup>6</sup>

An access equals delivery disclosure regime for all municipal securities, including 529 Plans, meets each of these requirements—it is innovative, less burdensome, cost effective, easily accessible and does not negatively harm the environment in the way that paper delivery of

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mutual fund companies to continue to deliver hard copies of mutual fund prospectuses under the rules of the Securities and Exchange Commission . . . ." We assume, by this statement, that the MSRB was merely equating the sophistication level of 529 Plan investors with mutual fund investors and was not implying that there is a mutual fund prospectus delivery obligation in connection with the sale of 529 Plans. The fact that most 529 Plans are two-tiered investment structures in which an investor has an ownership interest only in the 529 Plan trust issuing the security and is not a beneficial owner of any of the mutual funds underlying the 529 Plan is well settled. The 529 plan trusts are the beneficial owners of the underlying mutual fund shares. In a March 12, 2004 letter to Chairman Oxley of the House Committee on Financial Services, SEC Chairman William Donaldson attached a memorandum ("**SEC Memorandum**") from the SEC Staff which noted that "[i]nvestors in 529 tuition savings plans, however, hold interests in a municipal issuer—the state trust fund—that is exempt from the bulk of the federal securities laws. . . . Because 529 plan investors are not considered to be beneficial owners of the investment companies that serve as the underlying investments in their 529 plan accounts, the federal securities laws do not require delivery of disclosure documents such as annual reports, semi-annual reports, and proxy statements."

<sup>3</sup> See INVESTMENT COMPANY INSTITUTE 2011 INVESTMENT COMPANY FACT BOOK: A REVIEW OF TRENDS AND ACTIVITY IN THE INVESTMENT COMPANY INDUSTRY, 92-93 (51st ed. 2011) ("ICI Fact Book"), available at [http://www.ici.org/pdf/2011\\_factbook.pdf](http://www.ici.org/pdf/2011_factbook.pdf).

<sup>4</sup> *Id.*

<sup>5</sup> Executive Order 13563, Improving Regulation and Regulatory Review, 76 Fed. Reg. 3821 (Jan. 21, 2011).

<sup>6</sup> Order, 76 Fed. Reg. at 3821.

documents does.<sup>7</sup> The Order itself highlights the ubiquity of the Internet, specifically referencing the Internet as a powerful medium for federal agencies to use when discussing proposed regulations with the public. We believe the Order's acceptance of the Internet as a mainstream communication tool provides a solid rationale and basis for permitting dealers to direct their customers to the Internet to access Official Statements (regardless of the nature of the municipal security).

## II. Summary Disclosure Document

The Notice, while acknowledging that the MSRB does not have the authority to require the preparation of a summary disclosure document for 529 Plans, asks whether 529 Plans would benefit from an approach similar to the summary prospectus permitted by the Securities and Exchange Commission ("**SEC**") for mutual funds, "given the fact that most 529 plans consist primarily of underlying mutual fund options." A 529 Plan does not "consist" primarily of underlying mutual funds. Rather, a 529 Plan typically has a two-tier investment structure. Specifically, the 529 Plan, not the 529 Plan account owner, invests in and owns the underlying mutual fund shares, while a 529 Plan account owner invests in the 529 Plan options. Even if the MSRB did have such authority, a 529 Plan Official Statement simply does not lend itself to a summary format in the same way that a mutual fund does. Thus, utilization of a summary document is not practical and would not be useful to customers.

A mutual fund, which is registered with the SEC as an investment company, is heavily regulated by the Investment Company Act of 1940, as amended ("**Company Act**"). Form N-1A is the registration form required by the SEC to be utilized by all mutual funds. This is in contrast to a 529 Plan, which is established pursuant to section 529 of the Internal Revenue Code, as amended, and the individual laws of the state issuing the plan. There is no required format for the Official Statement of a 529 Plan (and since 529 Plans are exempt from registration under the Company Act, there is no regulatory agency with authority to require any such format).

A mutual fund prospectus contains details of the investment characteristics of the fund, including the investment objective, strategies, risks, fees and how one can purchase and redeem shares. This type of disclosure easily lends itself to a summary format and comprises the bulk of the information contained in a summary prospectus. Form N-1A requires each summary prospectus to present the same type of information in the same order. Thus, a summary prospectus for a mutual fund can be a helpful tool to an investor who is trying to compare one mutual fund to another. Furthermore, it is important to note that, even in a mutual fund trust

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<sup>7</sup> Although it is difficult to estimate how many pages are printed each year in order to print Advisor Plan Official Statements that are delivered by dealers to their customers, the estimates of the environmental impact of printing one billion pages are very telling. Eliminating the equivalent of one billion printed pages preserves nearly 65,000 trees, saves 84 million British Thermal Units of energy (equivalent to the annual use of 927 homes (using an assumption of 2700 tons of uncoated copy paper containing 10% recycled content)), prevents the production of 71,000 pounds of sulfur dioxide (equivalent to the collective annual emissions of almost 13,000 18-wheelers), prevents the production of 15.5 million pounds of greenhouse gases, including carbon dioxide (equivalent to the annual emissions of 1400 cars), prevents the production of nearly 16,000 pounds of particulates, or small particles that can present health risks when inhaled, (equivalent to the emissions of 1400 buses annually), and prevents the production of almost 57 million gallons of wastewater (equivalent to filling 86 Olympic swimming pools). See Conservatree, *Trees into Paper*, available at <http://conservatree.org/learn/EnviroIssues/TreeStats.shtml>; The Environmental Paper Network's Paper Calculator, available at <http://calculator.environmentalpaper.org/baseline>.

comprised of multiple series, each summary prospectus describes only one of the series, which prevents the document from getting too lengthy.

It is unclear what a summary document for a 529 Plan would look like. A 529 Plan is first and foremost a tax-advantaged vehicle permitted by federal statute and created by each state. An investor needs to understand how a 529 Plan works from both a federal and a state tax perspective, and what federal and state tax benefits might be available to an investor, as well as the tax consequences of certain transactions such as withdrawals or changing the beneficiary of an account. This type of information can be complicated and does not lend itself to being provided in a summary format.

In this respect, each 529 Plan typically makes available many different investment options, each of which needs to be described in the Official Statement. This is because account owners invest in the plan and determine how their contributions are to be allocated among the various plan investment options. Combining all of this information would produce a “summary” document that would be lengthy and thus unhelpful to investors. Unfortunately, one cannot simply produce a summary document for a 529 Plan that describes a single investment option of a 529 Plan in the way one can produce a summary prospectus that describes a single fund or series of a mutual fund. A potential investor of a 529 Plan must understand much more than just the details about the various investment options and this additional information typically varies from state to state.

In short, mutual fund investors invest in individual series of a trust and not the trust itself, whereas 529 Plan investors purchase interests in the trust and determine how their contributions are allocated among the various investment options offered. This critical structural difference between mutual funds and 529 Plans, along with the unique features and tax treatment of 529 Plans, illustrates why a summary disclosure document for 529 Plans will not work as well as the summary prospectus works for mutual funds.

### **III. Clarification of the Role Served by Dealers**

Certain statements in the Notice regarding the depiction and characterization of the services dealers perform in the context of a direct-sold plan appear to be inaccurate. For instance, the “Background” section of the Notice states that “[o]ften, dealers act as primary distributors of such plans.” Similarly, the “MSRB Fair Dealing and Disclosure Requirements” section states “[c]ertain dealers that participate in the sale of direct-sold plans, such as primary distributors of such plans . . . .” These two statements (together, the “*MSRB Statements*”) are confusing, inconsistent with previous regulatory characterization of the 529 Plan market, at odds with the plain meaning of the terms used and, to a large extent, contrary to industry practice.

To state that dealers play a role with respect to direct-sold plans is an oxymoron. If a plan is “direct-sold” then, by definition, it means no dealer plays a role with respect to selling interests/effecting transactions in the 529 Plan. Accordingly, to call a plan “direct-sold” and simultaneously assert that dealers are involved in the sale of such securities does not make sense and is confusing. The SEC recognized this by noting the following in the SEC Memorandum:

There are two categories of 529 tuition savings plans, distinguishable primarily by the methods through which they are sold. The first category is composed of 529 tuition savings plans in which investors acquire interests in the state trust directly from the state trust or a state agency on behalf of the trust, and do not involve a sales intermediary (“direct-sold 529 plans”). The second category is composed of 529 tuition savings plans in which the state trust interests are distributed through financial intermediaries, such as brokers, dealers, bank dealers and other banks (“broker-sold 529 plans”).

Thus, the SEC distinguished between 529 Plans by the methods through which they are sold and categorized direct-sold 529 Plans as “529 tuition savings plans in which investors acquire interests in the state trust directly from the state trust or a state agency on behalf of the trust, and do not involve a sales intermediary” (emphasis added). Prior to the SEC Memorandum, most industry participants had understood direct-sold plans in a manner consistent with the SEC’s description in the SEC Memorandum. Since then the SEC’s description has generally reflected the industry’s understanding. Thus, the MSRB Statements are inconsistent with the SEC’s description of direct-sold plans in the SEC Memorandum in 2004 and inconsistent with how the majority of industry participants have thought of such plans prior to and after the SEC Memorandum. Accordingly, the MSRB’s usage of the term “direct-sold” in the Notice is confounding, at odds with prior regulatory statements and inconsistent with how participants in the industry have generally described such plans for over a decade.

Finally, the MSRB’s usage of the term “direct-sold” is at odds with the plain meaning of the term “direct-sold” and how that term evolved under rule 3a4-1 under the Securities Exchange Act of 1934, as amended. How can a security be distributed “directly” and at the same time be sold by a dealer? Such a characterization describes something that is impossible. In fact, the MSRB defines a direct-sold plan in the Notice as one which is sold “directly through the state, either by state employees or their designees.” The MSRB Statements in the Notice are thus inconsistent with the MSRB’s own definition.

For all of the foregoing reasons, the MSRB should eliminate the regulatory confusion created by the MSRB Statements quoted above.<sup>8</sup>

A. Roles Played by a Dealer with Respect to a Direct-Sold Plan

As noted by the SEC, direct-sold 529 Plans do not involve a dealer selling interests in the plan to its customers. The interests in a direct-sold 529 Plan are sold directly by the state issuer to investors. Most state issuers of 529 Plans do, however, hire financial services firms (typically referred to as “*plan managers*”) to provide certain services to the plans on behalf of the issuer. It is true that certain state issuers have asked plan managers to assist the state issuer in general marketing of the 529 Plan or to staff a call center.<sup>9</sup> As discussed below, assisting in general

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<sup>8</sup> While certain dealers may hold themselves out as a primary distributor or principal underwriter of a direct-sold plan, in our experience such dealers are not functioning in the capacity of a primary distributor as such term is used by the MSRB. Dealers that refer to themselves as “primary distributors” or “principal underwriters” of a direct-sold plan are not, to our knowledge, in fact acting as underwriters within the meaning of rule 15c2-12(f)(8) under the Exchange Act.

<sup>9</sup> These activities typically are carried out by the plan manager or an affiliated dealer in cases where the plan manager is not itself registered as a dealer.

marketing efforts (e.g., overseeing a marketing campaign on television, radio and via print ads or through meetings with members of the general public interested in knowing more about the 529 Plan, engaging in general education and outreach, etc.) does not make a dealer a principal underwriter/primary distributor of the direct-sold 529 Plan.

B. Definition of a Principal Underwriter/Primary Distributor

The term principal underwriter/primary distributor<sup>10</sup> has been carefully defined by the SEC. Rule 15c2-12(f)(8) under the Exchange Act defines an underwriter as follows:

The term *underwriter* means any person who has purchased from an issuer of municipal securities with a view to, or offers or sells for an issuer of municipal securities in connection with, the offering of any municipal security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; except, that such term shall not include a person whose interest is limited to a commission, concession, or allowance from an underwriter, broker, dealer, or municipal securities dealer not in excess of the usual and customary distributors' or sellers' commission, concession, or allowance.

Typically, a dealer has contractually agreed to serve as the principal underwriter and the issuer typically selects such an entity to serve in such a capacity.<sup>11</sup> The SEC has elaborated on the very important and specific roles that a principal underwriter plays. For instance, in proposing Rule 15c2-12, the SEC notes that

An underwriter, whether of municipal or other securities, occupies a vital position in an offering. The underwriter stands between the issuer and the public purchasers, assisting the issuer in pricing and, at times, in structuring the financing and preparing disclosure documents. Most importantly, its role is to place the offered securities with public investors. . . .<sup>12</sup>

The special role played by underwriters is underscored by the following statements from the same release:

The opportunity for the underwriters to require disclosure from the issuer, as well as the special selling pressures involved in the distribution of securities, generally have given rise to a heightened obligation on the part of underwriters . . .

There is no entity that serves such a role and functions in the capacities described above with respect to a direct-sold plan where interests are sold directly by the state. And, as discussed above, any dealer that simply engages in general marketing or staffs a call center for a direct-sold 529 Plan does not function as a principal underwriter and such limited activity should not give

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<sup>10</sup> This comment letter uses the terms “primary distributor” and “principal underwriter” interchangeably.

<sup>11</sup> See, e.g., SEC Release No. 34-33741, Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others, 59 Fed. Reg. 12748 (March 9, 1994); SEC Release No. 34-34961, Municipal Securities Disclosure, 59 Fed. Reg. 59590 (Nov. 10, 1994).

<sup>12</sup> SEC Release No. 34-2611, Municipal Securities Disclosure, 53 Fed. Reg. 37778 (Sept. 22, 1988).

rise to any of the obligations imposed on a dealer that actually underwrites securities and distributes them to the market. Finally, we note that the when a state does ask a plan manager to assist in general marketing activity, the manager (or affiliated dealer) does not even earn “a commission, concession, or allowance” let alone one that is “in excess of the usual and customary distributors’ or sellers’ commission, concession, or allowance.”

C. No Customer Relationship is Created in a Direct-Sold 529 Plan

Finally, we are concerned of the potential implications of the following statement in the Notice: “[c]ertain dealers that participate in the sale of direct-sold plans, such as primary distributors of such plans, elect to deliver the Plan Disclosure Document electronically, as part of an enrollment kit, upon account opening by the customer.” This statement seems to imply that the MSRB believes there is a customer relationship under the MSRB rules created with respect to a direct-sold 529 Plan. This is not, and cannot be, the case. Even with respect to a dealer that engages in general marketing activity on behalf of a state issuer, such a dealer does not effect transactions in direct plan securities and does not have a customer relationship with investors that decide to purchase interests in a direct-sold 529 Plan, even if the individual’s decision to purchase interests in such a plan is influenced by the general marketing activity engaged in on behalf of the state issuer by the plan manager (or affiliated dealer).<sup>13</sup> The plan manager (or affiliated dealer) has no relationship with investors that decide to purchase interests in a direct-sold plan from the state.<sup>14</sup>

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

Very truly yours,

Michael Koffler

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<sup>13</sup> Even the Notice seems to acknowledge this through the discussion that most direct-sold plan investors open 529 Plan accounts on their own through the Plan’s Internet Web site.

<sup>14</sup> Even in Advisor Plans, the primary distributor often is not the broker-dealer that sells the security to investors or delivers Plan Disclosure Documents to investors; these activities often are carried out by a so-called “Selling Firm” broker-dealer that has entered into a selling agreement with the primary distributor in order to obtain authority to sell the security. In such instances, only the Selling Firm has a customer relationship with the 529 Plan owner.