

**MEMO# 19995**

May 2, 2006

## **SEC Publishes for Comment MSRB's Proposed Interpretation of Customer Protection Obligations Relating to 529 Plan Sales**

©2006 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19995] May 2, 2006 TO: 529 PLAN ADVISORY COMMITTEE No. 8-06 529 PLAN MEMBERS No. 6-06 RE: SEC PUBLISHES FOR COMMENT MSRB'S PROPOSED INTERPRETATION OF CUSTOMER PROTECTION OBLIGATIONS RELATING TO 529 PLAN SALES We are pleased to report that, as a result of the concerns expressed by the Institute and others, the Municipal Securities Rulemaking Board has significantly revised draft interpretive guidance that it published in May 2005 relating to point-of-sale and disclosure obligations in the 529 plan market.<sup>1</sup> The revised version of the guidance, which has been published by the SEC for comment, is briefly summarized below. This guidance would be effective 60 days after the SEC's approval of it. Comments on the guidance are due to the SEC within 21 days of it being published in the Federal Register, which is expected in the near future. Please provide any comments you have on the proposed guidance to the undersigned no later than Friday, May 12th. Comments may be provided by phone (202-326-5825), fax (202-326-5839), or email (tamara@ici.org). Background As you may recall, in May 2005, the MSRB proposed for comment draft interpretative guidance regarding the point-of-sale inquiry and disclosure obligations of brokers, dealers, and municipal securities dealers (collectively "dealers") under MSRB Rules G-17 and G-19 in connection with the marketing of 529 plan securities.<sup>2</sup> The Institute filed a comment letter strongly opposing the proposed interpretation because, among other reasons, it would have imposed a series of unique, unprecedented, and unreasonable obligations on dealers and would have required dealers to be familiar 1 See SEC Release No. 34-53715 (Apr. 25, 2006), which is available at: <http://www.sec.gov/rules/sro/msrb/2006/34-53715.pdf>. 2 See Institute Memorandum to 529 Plan Advisory Committee No. 17-05 [No. 18876] and to 529 Plan Members No. 7-05 [No. 18877], dated May 20, 2005 (the "May 2005 Notice"). 2 with securities they did not offer for sale.<sup>3</sup> As a result, the Institute's letter expressed concern that, if adopted, the proposed interpretation would result in either dealers ceasing sales of out-of-state 529 plans or increasing investors' costs associated with such plans. The draft guidance has been significantly revised by the MSRB. The contents of the current version of the guidance, which has been filed with the SEC for approval, are summarized below.

**Required Disclosures for Sales of Out-of-State Plans** As proposed in the guidance, dealers selling out-of-state 529 college savings plans would be required to disclose to the customer, at or prior to the time of the trade, that: □ 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 plan; □ State-based benefits should be one of many appropriately weighted factors to be considered in making an investment decision; □ 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; □ The customer may wish to consult his or her home state or any other 529 college savings plan to learn more about their features. These disclosure obligations may be met through the issuer's program disclosure document provided that the customer receives the disclosure timely and it appears in the document in a manner that is reasonably likely to be noted by an investor. According to the guidance, this later requirement should be satisfied if the required disclosure is in close proximity to and presented with equal prominence to (1) the principal presentation of substantive information on other federal or state tax- related matters, and (2) each other presentation of information on state tax-related matters. If the issuer's disclosure document does not satisfy this standard, the guidance would provide that the disclosure obligation may be fulfilled by including the disclosure in the document in another manner so long as such disclosure is reasonably likely to be noted by an investor. Otherwise, the dealer would be obligated to disclose such information separately to the customer no later than the time of the trade.

**Suitability** The guidance reminds dealers that providing the required disclosures in connection with the sale of out-of-state plans does not relieve them from their suitability duties. These duties include the dealer's obligation to consider the customer's financial status, tax status, and investment objectives in connection with recommended transactions. The guidance emphasizes that any dealer recommending a transaction must actively analyze information about the customer and the security and must consider 3 See Institute Memorandum to 529 Plan Advisory Committee No. 22-05 and 529 Plan Members No. 12-05 [No. 19063], dated Aug. 3, 2005. 3 appropriately weighted factors that are relevant to the customer's particular situation. It also reminds dealers of their obligation to have and enforce written supervisory procedures that are reasonably designed to ensure compliance with their suitability obligations in connection with each recommended transaction.

**529 Plan Disclosure Dissemination System** The MSRB's May 2005 Notice reminded dealers of their obligation under MSRB Rule G-17 to disclose to the customer, prior to 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. This duty applies without regard to whether the transaction has been recommended by the dealer. To assist dealers in fulfilling their obligations under Rule G-17, the MSRB's May 2005 Notice sought comment on the feasibility of creating one or more centralized websites, or expanding existing web- based resources, to provide on-site summary information to dealers regarding the material features of the states' various 529 plans. The MSRB is not currently pursuing creation of a centralized information utility for the 529 plan market. The guidance notes, however, that 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 previously stated investor protection concerns. The MSRB's determination not to pursue a centralized data source is, in part, based on the fact that the College Savings Plan Network (CSPN) has undertaken to upgrade its existing website to provide a comprehensive centralized web-based utility for the 529 plan market. This utility is expected to provide a combination of on-site hyperlinked resources, including summary information formatted to allow meaningful comparisons of many of the material features of different 529 plans, together with direct links to such plans and to other sources that provide tools for investors to analyze potential 529 plan investments. In addition, CSPN has recently published its Disclosure Principals Statement

No. 2, which is designed to assist states in improving the quality and comparability of their 529 plan disclosure in the program disclosure documents. Also, NASD plans to introduce on its website in the near future an improved expense analyzer for the 529 plan market. Based upon these initiatives, the MSRB is not currently pursuing creation of a centralized information resource. Effective Date As noted above, the MSRB has proposed to delay effectiveness of the guidance until the 60th calendar day after the SEC approves it. This delay is to provide dealers with sufficient time to establish appropriate compliance procedures. Dealers are, however, urged to comply with the guidance as soon as practicable after SEC approval. Tamara K. Salmon Senior Associate Counsel

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