

MEMO# 20264

August 10, 2006

MSRB Reminds Dealers That the MSRB's Interpretive Guidance Relating to the Sale of 529 Plans was Effective August 7th

©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. [20264] August 10, 2006 TO: 529 PLAN ADVISORY COMMITTEE No. 14-06 529 PLAN MEMBERS No. 14-06 RE: MSRB REMINDS DEALERS THAT THE MSRB'S INTERPRETIVE GUIDANCE RELATING TO THE SALE OF 529 PLANS WAS EFFECTIVE AUGUST 7TH The Municipal Securities Rulemaking Board (MSRB) has issued a notice reminding municipal securities dealers that the MSRB's interpretive guidance relating to customer protection obligations in connection with the marketing 529 college savings plans was effective August 7, 2006.¹ The Notice sets forth the contents of the interpretive guidance, which has not changed since its approval by the SEC in June 2006 and which is summarized below.² REQUIRED DISCLOSURES FOR SALES OF OUT-OF-STATE 529 PLANS According to the Notice, MSRB Rule G-17 requires dealers selling out-of-state 529 college savings plans 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; and □ The customer may wish to consult his or her home state or any other 529 college savings plan to learn more about their features. 1 See Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans Becomes Effective, MSRB Notice 2006-23 (August 7, 2006) (the "Notice"). A copy of the Notice is available on the MSRB's website at: <http://www.msrb.org/msrb1/whatsnew/2006-23.asp>. 2 See Institute Memorandum to 529 Plan Advisory Committee No. 11-06 and to 529 Plan Members No. 10-06 [No. 20125] dated June 21, 2006, which summarizes the MSRB's interpretative guidance as approved by the SEC. 2 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. The disclosure would be reasonably likely to be noted by an investor if it 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 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 is obligated to disclose such information separately to the customer no later than the time of the trade. If the dealer provides information to an out-of-state customer about the state tax or other benefits available through the customer's home state, Rule G-17 requires the dealer to ensure that the information is not false or misleading. Dealers should make sure that any information they provide to customers, whether pursuant to an affirmative disclosure obligation or in response to questions from the customer, is correct and not misleading. The disclosure a dealer is required to provide in connection with the sale of an out-of-state plan is in addition to any obligation the dealer has under Rule G-17 to disclose to its customers, at or prior to the time of trade, all material facts known by dealers about the 529 college savings plan interests it is selling to its customer. This disclosure is also in addition to the dealer's duty to disclose all material facts about the 529 college savings plan that are reasonably accessible to the market. SUITABILITY The Notice 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 Notice emphasizes that any dealer recommending a transaction must actively analyze information about the customer and the security and must consider 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. In connection with the dealer's suitability requirements, the MSRB believes that it is crucial for dealers to remain cognizant of the fact that 529 college savings plans are designed for a particular purpose and the purpose generally should match the customer's investment objective. Also, because an investor generally is required to designate a specific beneficiary for the plan, the MSRB believes that information about that designed beneficiary generally would be relevant in weighing the investment objectives of the customer as part of a suitability analysis. 3 OTHER SALES PRACTICE PRINCIPLES Based upon the particular facts and circumstances, the following may violate Rule G-17's requirement that dealers deal fairly with all persons and not engage in any dishonest or unfair practice: □ Engaging in transactions primarily designed to increase commission revenues in a manner that is unfair to customers; □ Recommending an unsuitable share class; □ Engaging in churning or recommending rollovers year after year; □ Consistently recommending that, of the various 529 plans offered by the dealer, customers invest in the one that offers the dealer the highest compensation; □ Recommending transactions in amounts designed to avoid commission discounts; □ Engaging in marketing activities that result in a customer being treated unfairly; and □ Acting in a manner that is reasonably likely to induce another dealer or its associated persons to violate Rule G-17 or other MSRB customer protection rules. Tamara K. Salmon Senior Associate Counsel