

COMMENT LETTER

September 10, 2004

ICI Comments on MSRB Advertising, 529 Plan Disclosure Proposals (pdf)

September 10, 2004 Ernesto A. Lanza, Esquire Senior Associate General Counsel Municipal Securities Rulemaking Board 1900 Duke Street, Suite 600 Alexandria, Virginia 22314 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 Institute¹ 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"). Ernesto A. Lanza, Esquire September 10, 2004 Page 2 of 6 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.

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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 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. Ernesto A. Lanza, Esquire September 10, 2004 Page 4 of 6 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 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. Ernesto A. Lanza, Esquire September 10, 2004 Page 5 of 6 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-21¹⁴ will be comparable to that experienced by mutual funds.

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. Ernesto A. Lanza, Esquire September 10, 2004 Page 6 of 6 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. * * * * 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.

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