

## COMMENT LETTER

September 24, 2012

# ICI Comment Letter on MSRB Concept Proposal on Electronic Brokerage Disclosures

September 21, 2012 Ronald W. Smith, Corporate Secretary Municipal Securities Rulemaking Board 1900 Duke Street, Suite 600 Alexandria, VA 22314 Re: MSRB Notice 2012-41 Relating to Electronic Brokerages Dear Mr. Smith: The Investment Company Institute<sup>1</sup> is writing in response to the request of the Municipal Securities Rulemaking Board (MSRB) for comments on a concept proposal that would subject municipal securities dealers that offer and sell municipal securities through electronic brokerage platforms to additional account opening and supervision requirements.<sup>2</sup> These additional account opening procedures would include providing educational materials to new investors within ten days of opening an account. For the reasons discussed below, the Institute opposes the MSRB imposing such requirements in connection with the offer and sale of municipal fund securities, such as 529 college savings plans. As a preliminary matter, we are uncertain as to whether the MSRB intended for the concept proposal to apply to 529 plan transactions. The Notice does not discuss specifically whether the proposal would apply to 529 plans, but certain aspects of the Notice suggest that it might. For example, among the sixteen topics the proposed educational materials would be required to cover is “[m]unicipal fund securities, such as interests in 529 college savings plans.”<sup>3</sup> In addition, the Notice requests comment on whether “electronic brokerages that only effect transactions in municipal fund securities” should be “treated differently from or the same as electronic brokerages that effect transactions in

1 The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$13.3 trillion and serve over 90 million shareholders. 2 See Request for Comment on Concept Proposal to Strengthen Account Opening and Supervisory Practices of Dealers Effecting Online Municipal Securities Transactions with Individual Investors, MSRB Notice 2012-41 (Aug. 9, 2012) (the “Notice”). 3 Notice at p. 8. Ronald W. Smith, Corporate Secretary September 21, 2012 Page 2 municipal bonds and notes.”<sup>4</sup> Given these references to municipal fund securities, and because the MSRB’s staff has expressed interest in our views concerning application of the proposal to 529 plans, we are providing comments on the concept proposal. We strongly recommend that the MSRB expressly exclude municipal fund securities from any rulemaking envisioned by the Notice. The Notice provides no policy rationale for including them; it does not establish that 529 plan transactions raise the concerns the concept proposal seeks to address. In addition, as discussed below, it would

not be appropriate to apply the proposed requirements to 529 plan transactions. The Notice indicates that the concept proposal is intended to “improve the likelihood that individual investors who trade online would understand the features and risks of municipal securities and purchase securities that are appropriate based on their financial condition and risk tolerance.”<sup>5</sup> According to the Notice, the MSRB’s specific concerns include the following: (1) electronic brokerages often make a variety of complex municipal securities available for purchase without differentiating among potential purchasers as to their financial circumstances, investment objectives, or experience with municipal securities investments;<sup>6</sup> (2) individual investors who purchase municipal securities online may not be receiving all material information about the transactions known by the electronic brokerage or reasonably accessible to the market, as required by Rule G-17; (3) electronic brokerages may not be fulfilling their fair pricing obligations to individual investors; and (4) electronic brokerages that offer investors a limited universe of municipal securities may not be adhering to the suitability requirements in Rule G-19. To address these concerns, the proposal would require a new account review by a municipal securities principal prior to executing municipal securities transactions, delivery of an educational document, collection of information regarding the customer’s investment profile, and enhanced written supervisory procedures. The Notice does not indicate whether the concerns it identifies arise with respect to 529 plan investments or whether the proposed requirements are necessary or appropriate in that context. Notwithstanding the discrete references to municipal fund securities noted above, we do not believe the MSRB drafted the concept proposal with 529 plans in mind. Rather, the Notice seems to be aimed at 4 Id. at p. 10. 5 Id. at p. 1. 6 In this regard, the Notice poses the example of “an elderly investor on a fixed income with no experience with municipal securities investment” who “can, in many cases, open an electronic brokerage account and purchase the most complex and risky municipal securities without a meaningful analysis of the suitability of the transaction by a municipal securities representative.” Ronald W. Smith, Corporate Secretary September 21, 2012 Page 3 potential areas of concern in the municipal securities market more generally.<sup>7</sup> Along the same lines, most of the proposed contents of the new educational document that the concept proposal contemplates would be completely irrelevant to a person purchasing a 529 plan. For example, the materials would have to include information about the following topics: various other types of municipal securities besides municipal fund securities; primary market versus secondary market purchases of municipal securities; retail order periods; and principal versus agency transactions. As a result, in the case of 529 plans the materials would not enhance investor protection. Instead, they likely would cause confusion or be ignored. Moreover, 529 plans purchased online do not raise the same concerns as other types of municipal securities might with regard to the availability of material information. Websites that permit an investor to purchase 529 plan securities typically have abundant information regarding 529 plans and their features including, among other things, how the plans operate, their risks, investment options, tax advantages, and other educational information. Indeed, industry practice is to provide online, in marketing materials and in other venues, important information about these plans, which investors can access prior to purchase. This information generally includes disclosures relating to suitability and risk factors associated with the plan, as well as references to the plan’s official statement where more complete information is available. In addition to the information available on the website where the account is opened, there is also a great deal of information readily available to investors through public sources as well as a variety of tools to assist them in selecting a 529 plan that meets their needs and investment objectives.<sup>8</sup> Given this wealth of information specific to 529 plans, it is unnecessary to provide the type of more generic, less tailored, materials described in the Notice to those individuals opening a 529 plan account. The Notice mentions other online trading concerns

that regulators have expressed in the past, including the risks of online investors “overtrading” or failing to diversify their investments. In the case of 529 plans, there are strong incentives against overtrading. To maintain the tax advantages that are one of the main benefits of 529 plan accounts, the accountholder must not sell shares in one investment option offered by the plan in order to purchase shares in another option offered by the plan more than once each year.<sup>9</sup> Investments in 529 plan securities also should not raise concerns about a lack of diversification. Every 529 plan offers a variety of investment options specifically designed as savings.<sup>7</sup> See, e.g., Notice at p. 7 (“liquidity is dependent on dealers that buy and sell municipal securities out of inventory”; “written supervisory procedures [for electronic brokerages] should be designed ... to ensure... that the aggregate transaction price to customers in principal trades is fair and reasonable ....”).<sup>8</sup> Sources of public information include, among others, websites of the 529 plans themselves, the College Savings Plan Network (CSPN), and Savingforcollege.com. The Securities and Exchange Commission’s website also includes “An Introduction to 529 Plans.” See <http://www.sec.gov/investor/pubs/intro529.htm>.<sup>9</sup> See Section 529 of the Internal Revenue Code. Ronald W. Smith, Corporate Secretary September 21, 2012 Page 4 vehicles for educational expenses, and the accountholder can select among the available investment options based on his or her needs and investment objectives. Investment options typically consist of mutual funds, which by their nature provide diversification.<sup>10</sup> Accordingly, while the Institute appreciates the MSRB’s continuing interest in strengthening its rules as necessary to protect investors, we do not believe the MSRB has established that the measures outlined in the concept proposal are necessary or appropriate for 529 plan securities. As we have previously noted, 529 plan securities and the 529 plan market are significantly different from municipal securities and the market for such securities.<sup>11</sup> As the MSRB continues to pursue reforms applicable to municipal securities and municipal securities dealers, we urge it to give due consideration at the outset to whether such reforms should apply to municipal fund securities and, if so, to tailor any specific requirements as needed to be effective and workable in the 529 plan context. The Institute appreciates the opportunity to share its views with the MSRB on the Notice. If you have any questions regarding our comments, please do not hesitate to contact the undersigned at (202) 326-5825. Regards, /s/ Tamara K. Salmon Senior Associate Counsel<sup>10</sup> See, e.g., Subchapter M of the Internal Revenue Code and Section 5 of the Investment Company Act of 1940. <sup>11</sup> See, e.g., Letter from the undersigned to Ronald W. Smith, Corporate Secretary, MSRB, dated July 30, 2012 (discussing MSRB Notice 2012-28, relating to public disclosure of financial incentives paid by dealers).