



Securities Industry Association

120 Broadway, New York, NY 10271-0080, (212) 608-1500, Fax (212) 608-1604
1401 Eye Street, NW, Washington, DC 20005-2225, (202) 296-9410, Fax (202) 296-9775
info@sia.com, <http://www.sia.com>

January 10, 2003

Ernesto A. Lanza, Esq.
Senior Associate General Counsel
Municipal Securities Rulemaking Board
Suite 600
1900 Duke Street
Alexandria, Virginia 22314

Re: Municipal Securities Rulemaking Board ("MSRB")
Draft Interpretive Notice on Marketing of 529 College Savings Plan
Employees Payroll Deduction Programs

Dear Mr. Lanza:

The Securities Industry Association ("SIA")^{*} is taking this opportunity to comment on the above referenced draft interpretive notice ("Notice") concerning the application of various MSRB rules in the context of 529 college savings plans effectuated through employee payroll deduction programs. At the outset we would like to express our appreciation of MSRB's recognition that with regard to 529 Plan employee payroll deduction programs an "introducing" broker, rarely, if ever, provides specific investment advice with respect to a transaction, and thus would have no suitability obligation under MSRB Rule G-19. Additionally, we note that we generally concur with the MSRB's views regarding broker-dealer disclosure obligations under MSRB Rules G-17 and G-32, provided the MSRB clarifies that the various parties involved in making the 529 Plan available to the employee may reasonably rely upon arrangements between them

^{*} The Securities Industry Association brings together the shared interests of more than 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of nearly 93 million investors directly and indirectly through corporate, thrift, and pension plans. In the year 2001, the industry generated \$198 billion in U.S. revenue and \$358 billion in global revenues. Securities firms employ approximately 750,000 individuals in the United States. (More information about SIA is available on its home page: <http://www.sia.com> .)

regarding delivery to the employee of the official statement and any other required disclosure information.

We do believe however, that there are a number of matters in the Notice which require clarification, as well as issues that have not been addressed, and that the failure to address them will lead to uncertainty and potential unintended consequences. Therefore, as set forth below, we are proposing that the Notice include certain definitional refinements, and also that its scope be expanded to include alternative structures through which 529 Plan investments are offered to employees, on either a payroll deduction or other basis.

Definitional Items

As a threshold matter, the use of the phrase “introducing broker” is confusing because it is a term suggesting the existence of a clearing relationship between two firms. Clearly, the Notice did not intend to create such an implication, and we would suggest that instead the term “selling broker” be used to delineate the party who actually establishes a relationship with the employer to make available the opportunity for their employees to enroll in a 529 Plan and/or presents information about the 529 Plan to employees. We also recommend that the Notice articulate that the term “selling broker” encompasses not only a third-party broker that has signed a selling agreement with the primary distributor, but also the primary distributor itself, in those circumstances where the primary distributor directly establishes the relationship with the employer rather than through a third-party broker. In addition to recognizing that a selling broker rarely, if ever, has a suitability obligation in the context of a payroll deduction program, the Notice should clarify that a primary distributor who makes 529 Plan investments available through a third-party broker would not have a suitability obligation under Rule G-19, as it too makes no recommendation to an employee.

Alternative Models

The Notice presupposes a single model of how 529 Plan business is conducted both in the employer market, and as a general matter, and assumes that an “account” is established on the books and records of the “primary distributor.” The reality is that a variety of models have developed with respect to the operation and distribution of 529 Plans. These models, which are substantially similar to models that have developed over the years with respect to the operation and distribution of mutual funds, include:

- (a) ***Direct Model with Distributor.*** In this model, the issuer enters into a distribution agreement with a primary distributor, authorizing the primary distributor to engage in promotional efforts on the Plan’s behalf. However, its activities are limited to managing the overall marketing of the program and the production of marketing and promotional materials. The primary distributor does not handle any applications or orders and requests submitted by investors. Investors submit applications and orders

directly to the plan's transfer agent. A transfer agent hired by or on behalf of a 529 Plan typically performs most or all of the following services:

- process new account applications
- establish and maintain participant accounts
- process contributions and apply towards purchase of units in selected investment option
- process distribution requests
- tax reporting with respect to distributions
- issuance of confirmations and periodic statements to participants
- mailings to participants (e.g. update of offering document)
- tax compliance (i.e. monitoring of contribution limits)
- maintain designated beneficiary information
- process changes in investment options to extent permitted by tax law
- process rollovers and transfers into and out of plan
- maintain records relating to all of the foregoing

Accordingly, only the transfer agent maintains any investor records and these records are the plan's investor records. Thus, in this model, the primary distributor's regulatory responsibilities are limited primarily to compliance with applicable rules governing marketing materials but not those rules mandating customer account related procedures.

- (b) ***Third Party Broker Sales with Distributor Model.*** In this model, the primary distributor enters into selling agreements with third party selling brokers who market the 529 Plan, and establish relationships with employers to gain access to the employer's employees. Employees might submit orders or applications to the third party selling brokers who, in turn submit orders and applications to the plan or its transfer agent on an "application way" basis or otherwise. Alternatively, employees in a payroll deduction program might submit initial applications directly to the plan or its transfer agent (e.g. via a website). In each case, orders are submitted to the 529 Plan's transfer agent – and not the primary distributor – and the transfer agent maintains investor records reflecting the

processing of those orders. In this model, the primary distributor maintains no customer account related procedures for investors; and, as noted below, it is unclear what, if any, customer account related records and procedures would need to be maintained by the selling broker. Whether a third party broker submits the initial order on an “application way” basis, or the employee submits an application directly to the plan or its transfer agent, subsequent transactions may be effected by the employee order being submitted directly to the transfer agent. In that case, the third party broker ordinarily would not maintain any records relating to subsequent transactions (other than those relating to commissions received on those transactions). In this respect, the third party broker essentially “hands off” the account to the transfer agent following submission of the application and carries out no customer-related account procedures with regard to the customer’s subsequent transactions.

It is possible that a single 529 Plan might follow a combination of the above models to reflect the multiple distribution channels in which the 529 Plan is sold.

Given the business dynamics of the 529 Plan market, any guidance issued by the MSRB should recognize and address alternative models including, but not limited to, the examples provided herein. These alternative models have characteristics that differ from the model presumed by the MSRB. These differences, including the roles played by the primary distributor and selling broker, support different conclusions regarding a distributor’s and selling broker’s obligations under the MSRB rules than the ones reached in the Notice. In particular, the Notice should clarify the responsibilities (in terms of recordkeeping and account/transaction approval), if any, of the selling broker with respect to accounts and transactions in the context of the models described above in which orders are submitted directly to the 529 Plan’s transfer agent and not to the primary distributor or selling broker. At a minimum, it should be clarified that transaction approval requirements do not apply to any subsequent transactions, whether such transactions are effected with the primary distributor or the transfer agent.

Additionally, the Notice should clarify whether its guidance applies only to true payroll deduction programs or also to non-payroll deduction models, such as ACH or lump sum check deposits, which have even less employer or selling broker involvement.

Applicability of Other MSRB Rules

We believe that in light of the various alternative models, and combinations thereof, described above, the MSRB should re-assess whether 529 Plan accounts, are actually “accounts” of either the selling broker or the primary distributor for purposes of the account/transaction approval requirements under Rule G-27 or the recordkeeping requirements under Rule G-8. With regard to payroll deduction contributions, it is not clear what customer protection or other regulatory objective is served by requiring a

selling broker to review customer accounts and transactions on an after the fact basis, days, weeks or months after a transaction is executed. We would respectfully suggest that the primary regulatory predicate for Rules G-8 and G-27 is to assure that all essential information has been obtained to evaluate the suitability of account transactions, and to create an audit trail to enable internal supervisory personnel and regulators to satisfy themselves that all suitability obligations have been met. Where no suitability obligation exists and there is no expectation that the investor will effectuate anything other than self-directed 529 Plan transactions, there seems to be no compelling reason to impose account recordkeeping requirements on a selling broker or primary distributor, where other arrangements have been made which will enable the investor to receive timely transactional and disclosure information.

Other Clarifications

There are a number of statements contained in the Notice which we believe are either unclear as to their application, or may lead to unintended consequences. Among other things, the MSRB should clarify the meaning of the statement at the beginning of the last paragraph of the Notice that "Dealers should note that none of the foregoing obviates the need for primary distributors to fulfill all of their customer protection obligations under MSRB rules." Specifically, what rules would apply to the primary distributor? The MSRB should clarify that this statement assumes that the primary distributor is involved in the transaction and does not apply to models in which applications and orders are submitted directly to the 529 Plan's transfer agent rather than the primary distributor. Such an interpretation would be consistent with the subsequent sentence in the Notice which refers to subsequent transactions that are "effected directly between the employer and the primary distributor."

Clarification is also needed with respect to a number of points relating to the relationship with, and the role of, the employer in conjunction with 529 Plan employee payroll deduction plans. These points are enumerated below by the paragraph of the Notice in which they appear:

Third Paragraph-Information furnished to an employer regarding an employee's "enrollment" is generally limited to that which is necessary to implement the payroll deduction. Is the MSRB suggesting any additional information be provided, and if so, what and why? In our experience employers view their role as facilitating access to 529 Plan information provided by a primary distributor or selling broker, and as administering payroll deductions pursuant to employee instruction. Extensive employer involvement may result in ERISA implications, thereby creating a disincentive for employers to offer a 529 payroll deduction or similar program to employees.

Sixth Paragraph-Since the employer is not the client, why is the dealer obligated to comply with G-17 with respect to the employer? What is meant by the dealer being obligated "to disclose to the employer all material facts known by the dealer concerning the transactions it is attempting to induce"? We would assume that "material facts"

relates to the major characteristics of the 529 Plan described in the Official Statement, as well as the applicability of favorable state tax treatment, but would not encompass information relating to the employee effectuating the transaction. We would appreciate your confirming that our understanding is correct.

Eighth Paragraph-What is meant by “the introducing (“selling”) broker” also is required to record the name and principal business address of any employer participating in a payroll deduction program, together with the signature of the appropriate principal who undertook such review and approval”? It is unclear what would need to be reviewed, and why, and whose signature must be obtained?

Finally, we request clarification as to the rationale for certain statements in the last paragraph of the letter. In particular we do not understand why the receipt of compensation should in any way be determinative of whether an “introducing” broker has a recordkeeping requirement under rule G-8(a)(ii). We respectfully suggest that such requirement should only be applicable if the broker has a suitability obligation or otherwise is involved in the processing of the transactions. We also believe that the statement that a dealer may not rely on any actions of the issuer in fulfilling its obligation under MSRB rules certainly is in need of clarification. Does this mean that a dealer could not in good faith rely on an agreement with the issuer that the latter will provide program disclosure documents and updates thereof to an investor? If not, why not?

Summary and Conclusion

We very much appreciate the MSRB’s acknowledgment that a selling broker does not have a suitability obligation in the context of an employer’s payroll deduction plan (nor presumably with respect to non-payroll deduction models) where no recommendation is made in conjunction with the employee’s 529 Plan transaction. At the same time, we recognize that regardless of the existence of a suitability obligation, the MSRB rules with respect to the delivery of required disclosure documents and information to the employee continue to apply. However, we would ask that the MSRB clarify, that parties having obligations under such rules may satisfy such obligations through reasonable reliance on arrangements with others, including other dealers, employers and/or issuers.

Additionally, we have set forth a number of matters that require further clarification, including how the Notice in particular, and MSRB rules in general, will apply to 529 Plan employee payroll deduction models other than the one described in the Notice. In some instances we have made recommendations on how issues should be resolved, and on others we would be prepared to offer recommendations after further clarification is received. In any event, we are grateful for the ongoing opportunity we have had to share our views with MSRB staff as 529 Plans have evolved, and we would welcome the opportunity to further discuss our comments on the instant Notice with you. If you have any questions regarding the contents of this letter, or we can otherwise be of

Ernesto A. Lanza, Esq.

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assistance please do not hesitate to contact Michael Udoff of SIA staff at 212-618-0509 or mudoff@sia.com.

Very truly yours,

Stuart J. Kaswell
Senior Vice President
and General Counsel

cc: Jill Finder, Esq.