MSRB

Municipal Securities
Rulemaking Board

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April 14, 2004

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: Proposed Rule Regarding Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds (File No. S7-06-04)

Dear Mr. Katz:

The Municipal Securities Rulemaking Board ("MSRB") appreciates the opportunity to provide comments to the Securities and Exchange Commission ("Commission") on its proposal to adopt two new rules to enhance the information broker, dealers and municipal securities dealers ("broker-dealers") provide to their customers in connection with transactions in mutual fund shares, unit investment trust interests, and municipal fund securities used for education savings ("college savings plan interests"). The MSRB supports the adoption of proposed Rules 15c2-2 and 15c2-3 as they relate to transactions in college savings plan interests, subject to certain suggestions and comments described below. The MSRB shares the Commission's goal of ensuring that customers have access to vital information relevant to their securities transactions and believes that these disclosure requirements, if adopted, would serve as a significant supplement to the existing disclosure obligations under MSRB rules.

Since the MSRB's rulemaking authority under Section 15B of the Securities Exchange Act of 1934 (the "Exchange Act") is limited to broker-dealer transactions in municipal securities, we have restricted our review of the Commission's proposal to issues relating to college savings plan interests. In addition, although the MSRB agrees that the proposed rules would provide substantial benefits for investors, it has not undertaken an analysis as to whether the Commission's estimates of the substantial costs entailed in implementing the proposals are accurate or whether such costs would create burdens on the promotion of efficiency, competition and capital formation in the marketplace. The MSRB believes that such analysis is best conducted by those who would be directly affected by the proposal. Finally, the MSRB urges the Commission to consider the proposed rules' effects on the college savings plan market in conjunction with the work of the Chairman's Task Force on College Savings Plans. As we have previously informed staff of the Commission, the MSRB stands ready to assist the Task Force.

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Background on the MSRB and the College Savings Plan Market

College Savings Plans Under the Federal Securities Laws. College savings plans are established by states under Section 529(b)(1)(A)(ii) of the Internal Revenue Code as "qualified tuition programs" through which individuals make investments to accumulate savings for qualifying higher education costs of beneficiaries. In the typical model, individuals purchase interests in a trust established by the state or its instrumentality and trust assets are invested according to stated investment objectives. Issuers typically engage investment management firms to manage the investment of trust assets. In addition, most states engage broker-dealers to serve as primary distributors for the units or shares in their college savings plans.

In 1999, Commission staff advised the MSRB that at least some college savings plan interests, as well as interests in local government investment pools ("LGIPs"), are municipal securities.[1] The governmental nature of the issuer of college savings plan interests and the status of such interests as municipal securities result in broad exemptions for college savings plans under the Investment Company Act of 1940 (the "Investment Company Act"), the Securities Act of 1933 (the "Securities Act") and the Exchange Act, other than the anti-fraud provisions thereunder and broker-dealer regulation by the MSRB and the Commission.[2]

Issuers of interests in college savings plans, as largely unregulated entities, may act in their best judgment in widely divergent manners unconstrained by the requirements of the Investment Company Act, the Securities Act and the Exchange Act, although they remain subject to the anti-fraud provisions of the Securities Act and the Exchange Act. In structuring a college savings plan, an issuer is not required to meet the basic requirements set forth in the Investment Company Act that apply to mutual funds. The requirements from which college savings plans are exempted relate to such matters as registration with the Commission, preparation of a prospectus and statement of additional information ("SAI"), daily calculation of net asset value, end of day

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1 *See* Letter dated February 26, 1999 from Catherine McGuire, Chief Counsel, Division of Market Regulation, to Diane G. Klinke, MSRB General Counsel (the "1999 Commission Letter"). LGIPs are established by state or local governments as trusts that serve as vehicles for the pooled investment of public moneys of participating governmental entities. Participants purchase interests in the trust and trust assets are invested according to stated investment objectives.

2 Interests in college savings plans generally are considered exempted securities under Section 3(a)(2) of the Securities Act and municipal securities under Section 3(a)(29) of the Exchange Act. Section 2(b) of the Investment Company Act provides that the act does not apply to, among others, a state or any political subdivision of a state, or any agency, authority, or instrumentality of a state.

pricing of fund shares, limitations on "12b-1 plans" and "fund of funds" structures, changes in investment policy, transactions with affiliates and establishment of a board of directors that includes independent directors. However, states that wish to maintain favorable federal tax treatment for their college savings plans must comply with Section 529 of the Internal Revenue Code. In addition, each college savings plan is subject to the requirements of its state's authorizing legislation and other provisions of applicable state law.

Regulation of Broker-Dealer Transactions in Municipal Securities. The MSRB was created by Congress in 1975 under Section 15B of the Exchange Act with a mandate to adopt rules relating to transactions effected by broker-dealers in municipal securities. Among other purposes, the MSRB's rules are designed to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating, transactions in municipal securities; to remove impediments to and perfect the mechanism of a free and open market in municipal securities; and, in general, to protect investors and the public interest. The MSRB has adopted a comprehensive regulatory regime covering broker-dealer activities in connection with municipal securities.

The MSRB is not authorized to adopt rules applicable to issuers or any other party in connection with municipal securities, other than broker-dealers. In particular, Section 15B(d) of the Exchange Act expressly provides that neither the Commission nor the MSRB is authorized to require any issuer of municipal securities, directly or indirectly through a purchaser or prospective purchaser of securities from the issuer, to file with the Commission or the MSRB prior to the sale of such securities by the issuer any application, report or document in connection with the issuance, sale or distribution of such securities. Further, the MSRB is not authorized to require any issuer of municipal securities, directly or indirectly through a broker-dealer or otherwise, to furnish to the MSRB or to a purchaser or prospective purchaser of such securities any application, report, document or information with respect to such issuer (although once any such application, report, document or information becomes publicly available, the MSRB may require that broker-dealers furnish it to the MSRB or to purchasers of municipal securities).

Consistent with the constraints placed on the Commission by Section 15B(d) of the Exchange Act, the Commission has adopted Exchange Act Rule 15c2-12, pursuant to which the underwriter for most primary offerings of municipal securities is obligated to obtain and review the issuer's near-final official statement before purchasing or offering the securities, to contract with the issuer to receive copies of the final official statement within specified timeframes after final agreement to purchase or offer the securities, and to distribute copies of the final official statement to potential customers upon request. Under Rule 15c2-12(f)(3), a final official statement must set forth information concerning the terms of the issue; information, including financial or operating data, concerning the issuer and other entities, enterprises, funds, accounts and other persons material to an evaluation of the offering; and a description of undertakings

regarding the provision of secondary market information, as well as disclosure of any failures to provide such information during the past five years.[3] In the college savings plan market, the official statement often is referred to as the "program disclosure document." The limited official statement content requirements under Rule 15c2-12 stand in contrast to the detailed prospectus and SAI content requirements set forth in Form N-1A for mutual fund offerings.

Regulation of Broker-Dealer Transactions in College Savings Plan Interests. Under MSRB rules, a "municipal fund security" is defined as a municipal security issued by an issuer that, but for the application of Section 2(b) of the Investment Company Act, would constitute an investment company within the meaning of Section 3 of the Investment Company Act.[4] The MSRB adopted this definition after being advised by Commission staff in the 1999 Commission Letter that at least some college savings plan interests and LGIP interests are municipal securities. Consistent with the Congressional purpose to provide for a regulatory structure for the municipal securities activities of broker-dealers while maintaining the exemption from direct regulation of issuers, the MSRB's rules are designed to recognize that issuers, as largely unregulated entities, may act in their best judgment in widely divergent manners. The lack of issuer regulation is often a significant factor in determining the appropriate regulatory approach with respect to broker-dealer activities, particularly in connection with broker-dealer disclosure obligations. It can be significantly more difficult, and in some cases nearly impossible, for a broker-dealer to disclose to a customer information about, or controlled by, the issuer where the issuer has no legal obligation to make such information available, as compared to a market such as the regulated mutual fund market where the information broker-dealers are required to disclose to customers generally is also required to be provided by issuers under the Investment Company Act and the Securities Act. Thus, although the college savings plan market bears considerable similarities to the mutual fund market, the differences in the fundamental legal obligations of issuers in the two markets can have a significant impact on the ability to impose

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3 Rule 15c2-12 also mandates secondary market disclosure undertakings, which entail the issuer agreeing to provide annual financial/operating information of the type included in the official statement and notice of certain material events relating to the offering to nationally recognized municipal securities information repositories, state information depositories and/or the MSRB.

4 The MSRB recognized when it adopted this definition that it was not strictly limited to interests in college savings plans and LGIPs but would apply as well to any other municipal security issued under a program that would, but for the identity of the issuer as a state or local governmental entity, constitute an investment company under the Investment Company Act. However, the MSRB was not aware – and continues to be unaware – of any other municipal fund securities that are marketed by broker-dealers.

broker-dealer disclosure requirements having the identical substance, method and timing requirements for the two markets.

In most states, broker-dealers are engaged to serve as primary distributors for the state's college savings plans. In many cases, primary distributors enter into selling arrangements with other broker-dealers to serve as selling broker-dealers to provide further distribution channels to customers. A number of unique marketing programs have developed in connection with college savings plans, including workplace marketing programs and affinity rebate programs that fund college savings plan accounts. The marketing of college savings plans by broker-dealers is not subject to the Investment Company Act but is regulated by MSRB rules and certain rules of the Commission, including but not limited to Exchange Act Rules 10b-5 and 15c2-12.

In all transactions with customers, broker-dealers must provide certain basic disclosures. The MSRB has interpreted its Rule G-17 to require a broker-dealer to disclose to its customer at or prior to the time of trade all material facts about the transaction known by the dealer, as well as material facts about the college savings plan interest that are reasonably accessible to the market.[5] Rule G-17 also obligates a broker-dealer that sells to a customer an out-of-state college savings plan interest to disclose at the time of trade that, depending upon the laws of the customer's home state, favorable state tax treatment for investing in a college savings plan may be limited to investments made in a college savings plan offered by the customer's home state.[6] These disclosures, required in all transactions regardless of whether the broker-dealer has made a recommendation to the customer, are referred to as the "MSRB point-of-sale disclosures." If the Commission adopts its proposed Rule 15c2-3, the disclosures provided for under that rule would serve as a significant supplement to the existing MSRB point-of-sale disclosures.

Further, in all transactions with customers, the broker-dealer is obligated under MSRB Rule G-32 to deliver to the customer by settlement of its transaction a copy of the issuer's program disclosure document. In the case of certain classes of repeat purchasers who have already received the program disclosure document, the broker-dealer generally is permitted to promptly send any amendments or supplements to the program disclosure document as they become available for purposes of subsequent investments in the college savings plan.

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5 *See* MSRB Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts, March 20, 2002.

6 *See* MSRB Interpretive Notice – Application of Fair Practice and Advertising Rules to Municipal Fund Securities, May 14, 2002 (the "MSRB Fair Practice Notice").

Finally, in all transactions with customers, the broker-dealer is obligated under MSRB Rule G-15 to send a transaction confirmation to the customer at or before the completion of the transaction. The items required to be disclosed in the confirmation consist of the types of information generally required under Exchange Act Rule 10b-10 in connection with mutual fund transactions, supplemented by certain additional items specifically relating to college savings plans. In the case of certain classes of repeat purchasers, the broker-dealer can send a periodic statement that includes information regarding all transactions occurring in the preceding month or calendar quarter (depending upon the type of repeat customer) in lieu of individual transaction confirmations. If the Commission adopts its proposed Rule 15c2-2, the MSRB anticipates that it would amend MSRB Rule G-15 to require that broker-dealers effecting transactions in college savings plan interests comply with Exchange Act Rule 15c2-2 rather than MSRB Rule G-15.

In addition to these disclosure-related rules, the MSRB has rules governing such matters as the suitability of recommended transactions, fair pricing of transactions, gifts and other conflicts of interest (including its rule on political contributions) and advertising. The MSRB has provided interpretive guidance in all of these areas in the context of college savings plans. MSRB rules and interpretations relating to broker-dealer activities in the college savings plan market are available at www.msrb.org/msrb1/mfs.

Comments on the Proposing Release – General

Marketing Practices in Connection with College Savings Plans. In the proposing release, the Commission observed:

> In some cases, a broker, dealer or municipal securities dealer chooses to distribute only the municipal fund securities issued by a particular state, and does not provide its customers with the opportunity to invest in 529 plans issued by other states, even though those other plans may have lower loads or lower expense ratios, or may provide state income tax benefits that are absent from the plans being offered.

The MSRB believes that the practice of broker-dealers offering college savings plan interests of only one or a limited number of states mirrors the practice of offering mutual funds of only one or a limited number of fund families. It is unclear to the MSRB whether the Commission is suggesting that broker-dealers that market college savings plan interests are subject to a different legal standard from broker-dealers that market mutual funds with regard to which investment vehicles they offer. The MSRB is not aware of any requirements relating to the breadth of investment options offered by broker-dealers in the mutual fund market.

To the extent that the cited language is intended to express the Commission's concern about inducements for marketing one investment in preference over other investments that are offered by a broker-dealer (*i.e.*, B shares over A shares, or proprietary funds over non-proprietary

funds), the MSRB supports the Commission's proposal to require disclosure of differential compensation.[7] With regard to potential state tax benefits, the MSRB point-of-sale disclosure requirements obligate a broker-dealer that sells to a customer an out-of-state college savings plan interest to disclose at or before the time of trade that, depending upon the laws of the customer's home state, favorable state tax treatment for investing in a college savings plan may be limited to investments made in a college savings plan offered by the customer's home state.[8]

Finally, the Commission observes in the proposing release that current MSRB rules differ from those of NASD with respect sales incentives, including non-cash compensation. This area is currently under review by the MSRB.

1979 ICI No-Action Letter. The Commission notes that it intends to withdraw the no-action letter that the Division of Market Regulation granted to the Investment Company Institute in 1979 (the "ICI No-Action Letter") allowing mutual fund sales loads and related fees to be omitted from confirmations if they are included in the prospectus. The MSRB supports the withdrawal of the ICI No-Action Letter. The letter did not apply to transactions in municipal fund securities and the MSRB has not opted to extend the relief it provided to these transactions. The MSRB has always required broker-dealers to include disclosure of sales loads and related transaction-based charges on confirmations for municipal fund securities, regardless of whether such information was included in the program disclosure document. The MSRB believes that confirmation disclosure of sales loads and other transaction-related charges is vital to ensuring that customers understand the costs of their investments.

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7 The MSRB has previously stated that recommending a share class to a customer that is not suitable for that customer may, in addition to violating the MSRB's suitability rule, Rule G-19, constitute a violation of the MSRB's basic fair practice rule if the recommendation was made for the purpose of generating higher commission revenues. Further, the MSRB has noted that, if a broker-dealer engages in any marketing activities that result in a customer being treated unfairly, or if the broker-dealer engages in any deceptive, dishonest or unfair practice in connection with such marketing activities, the MSRB's fair practice rule could be violated. *See* MSRB Fair Practice Notice.

8 *See* MSRB Fair Practice Notice. The MSRB also has stated that broker-dealers may not mislead customers regarding the availability of state tax benefits, such as by informing a customer that investment in the college savings plan of the customer's own state did not provide the customer with any state tax benefit when the dealer knows or has reason to know that a state tax benefit likely would be available, or by informing a customer that investment in the college savings plan of another state would provide the customer with the same tax benefits as would be available if the customer were to invest in his or her own state's plan, if the dealer knows or has reason to know that this is not the case.

Anti-Fraud Provisions Continue to Apply. The proposed rules would include a preliminary note to the effect that the disclosure requirements under the rules are not determinative of, and do not exhaust, a broker-dealer's disclosure obligations under the antifraud provisions of the federal securities laws or under any other legal requirements. The MSRB agrees. In addition to the broker-dealer's confirmation and point-of-sale obligations under the proposed rules, a broker-dealer that effects a transaction in a college savings plan interest would continue to be obligated to provide customers with the MSRB point-of-sale disclosures under MSRB Rule G-17 and the program disclosure document under MSRB Rule G-32.

Scope of Persons Covered by Proposed Rules. The Commission invited comment about whether persons other than broker-dealers (including banks) also should be required to deliver confirmations and point of sale disclosures under the proposed rules. As the Commission knows, a bank that does not act as a dealer in municipal securities may engage in agency transactions involving college savings plans and other municipal fund securities without registering with the Commission as a municipal securities broker and without complying with MSRB rules.[9] The MSRB understands that all college savings plans are marketed on an agency basis. The MSRB believes that the marketing of college savings plans by banks nonetheless is subject to the same concerns raised in connection with broker-dealer marketing activities. The MSRB would be interested in exploring with the Commission and the federal banking regulators the appropriateness of such banking regulators adopting rules under their regulatory regimes with respect to agency transactions by banks that are not municipal securities dealers that would parallel, or seek to achieve many of the same objectives as, the rules of the MSRB and the Commission applicable to broker-dealers in municipal fund securities when undertaken on an agency basis.

Further, in some cases, college savings plan interests are marketed directly by issuers, which are not subject to the broker-dealer requirements of the Commission and the MSRB. The MSRB would be interested in exploring with the Commission and the issuer community the appropriateness of issuers that market their own plans voluntarily conforming their confirmation and disclosure practices to those which broker-dealers are required by law to undertake.

Transition Period. The Commission sought comment on whether a transitional period is needed to make adjustments necessary to comply with the proposed rules. Should the Commission adopt Rule 15c2-2, the MSRB would expect to undertake rulemaking in connection with its confirmation rule to avoid duplicative and potentially conflicting or inconsistent requirements on these transactions. Any MSRB action on Rule G-15 will necessarily be

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[9] *See* Staff Compliance Guide to Banks on Dealer Statutory Exceptions and Rules, Division of Market Regulation, Securities and Exchange Commission, Question #16.

dependent upon the nature of the Rule 15c2-2 requirements that the Commission ultimately adopts in connection with college savings plan interests. Depending upon, among other factors, the specific provisions of the final version of Rule 15c2-2 and the process of Commission approval of any MSRB rulemaking proposal, the MSRB anticipates that implementation of any MSRB rule amendments would require a period of approximately three to six months.

Comments on the Proposing Release – Confirmation Disclosure

Definition of Municipal Fund Security. "Municipal fund security" is defined in proposed Rule 15c2-2(f)(12) as:

> any municipal security that is issued pursuant to a qualified State tuition program as defined by section 529 of the Internal Revenue Code (26 U.S.C. 529), and that is issued by an issuer that, but for the application of section 2(b) of the Investment Company Act (15 U.S.C. 80a-2(b)), would constitute an investment company within the meaning of section 3 of the Investment Company Act (15 U.S.C. 80a-3).

This definition is modeled after the definition of "municipal fund security" in MSRB Rule D-12, which covers not only securities issued by a governmental issuer in connection with a qualified tuition program under Section 529 of the Internal Revenue Code but also any other securities issued by a governmental issuer that, but for the exception under the Investment Company Act for governmental issuers, would be considered an investment company. Interests in LGIPs are the primary examples of such other securities.

The MSRB agrees that the proposed rules should not be made applicable to sales of LGIP interests since this market is extremely specialized, consists of institutional customers and does not involve the same types of marketing practices seen in the mutual fund or college savings plan market. Broker-dealer transactions in LGIP interests would continue to be subject to the MSRB's confirmation, point-of-sale disclosure and other applicable MSRB requirements.

The MSRB suggests certain changes to the definition used by the Commission with respect to college savings plan interests. First, the MSRB believes that using the term "municipal fund security" in the proposed rules with a different meaning from the way such term has already come to be used under MSRB rules may cause confusion. To avoid potential confusion, the MSRB suggests that the term be change to "college savings plan interest."

Second, the MSRB suggests that the language used to limit the applicability of the proposed rules to college savings plan interests not be dependent upon the status of the plan as a qualified tuition program under Section 529 of the Internal Revenue Code. The status of a college savings plan interest as a municipal security and a municipal fund security is not dependent upon such tax status, and the MSRB does not believe that a state's failure to maintain

or seek qualification as a qualified tuition program should affect whether a customer receives a confirmation under proposed Rule 15c2-2.

Finally, if the Commission continues to define college savings plan interests in terms of Section 529, the MSRB notes that the language of that section of the Internal Revenue Code has been amended to delete the word "state" from the term "qualified tuition program" and therefore the word "State" should be deleted from the definition of "municipal fund security" in the proposed rule.

General Confirmation Disclosure Requirements. The MSRB agrees that the general confirmation disclosure requirements set forth in proposed Rule 15c2-2(b) are appropriate and should be included in confirmations of transactions in college savings plan interests. The MSRB provides the following suggestions with respect to certain elements under section (b):

- ***Issuer and class of covered security (section (b)(2))***. MSRB Rule G-15 requires the confirmation for municipal fund security transactions to show the name used by the issuer to identify the securities and, to the extent necessary to differentiate the securities from the issuer's other securities, any separate program series, portfolio or fund designation. This more explicit requirement helps to uniquely identify the specific investment within sometimes quite complex mixes of investment options offered by a particular college savings plan. The MSRB recommends that the Commission incorporate this requirement for college savings plan confirmations. In addition, the MSRB recommends that broker-dealers be required to disclose the state of the college savings plan if it is not otherwise included in the name of the securities since this information may be important for tax or other benefits provided in certain states.

- ***Net asset value and public offering price (section (b)(3))***. The MSRB agrees that confirmations should include both net asset value and public offering price, if different. However, the MSRB notes that calculating these figures may be difficult in the case of some college savings plan interests without the cooperation of issuers or its agents. Because of the exemption from the Investment Company Act, issuers of college savings plan interests are not required to calculate net asset value on a daily basis, to price their shares based on the end-of-day net asset value, or to calculate net asset value in the same way mutual funds do. Thus, if an issuer of college savings plan interests does not make such calculation, it would be incumbent on others to calculate the net asset value of shares based on information available to them. This information may not be readily available or, if available, may not be available within the same timeframe and with the same level of precision as would otherwise be available in connection with a registered mutual fund. Broker-dealers, issuers and other industry participants will need to work toward making net asset values, or the information necessary to calculate net asset value, available on a daily basis for all college savings plans that are marketed by broker-dealers in order to ensure that broker-dealers are not placed in the situation of not being able to comply with this proposed requirement.

- ***Commission and other compensation (section (b)(5))***. The MSRB believes that this information in connection with customer purchases should appear in section B of Schedule 15C, together with the other information regarding amounts paid by the customer to make an investment. This placement would make the presentation of information on the confirmation clearer to customers.

Additional Disclosure Requirements for Purchases. The MSRB agrees that the additional confirmation disclosure requirements for purchases set forth in proposed Rule 15c2-2(c) are appropriate and should be included in confirmations of transactions in college savings plan interests. However, as noted in the MSRB's comments to section (b)(3) of the proposed rule, since it is not clear that all college savings plans will always have a net asset value figure calculated in the same manner and at the same time as required under the Investment Company Act available to broker-dealers that market such plans, it is possible that some broker-dealers will face compliance difficulties with respect to those aspects of Rule 15c2-2 that require disclosures based on net asset value. In addition, the MSRB observes that the Commission is proposing certain amendments to Form N-1A with respect to issuer disclosure of front-end sales loads and back-end sales loads. These amendments are being made in part to make issuer disclosures in the mutual fund prospectus consistent with the types of disclosures that broker-dealers will be required to make under Rule 15c2-2(c). Since issuers of college savings plan interests are not required to use Form N-1A, no such required consistency will exist in the college savings plan market. The Form N-1A amendments also highlight the fact that, although much of the information that broker-dealers would be required to disclose on a mutual fund confirmation could be gleaned from the prospectus or SAI, there is no certainty that the same would be the case for broker-dealers confirming a college savings plan transaction.

The MSRB provides the following additional suggestions with respect to certain elements under section (c):

- ***Front-end sales load (section (c)(1))***. The MSRB supports the disclosure of front-end sales loads in both dollar and percentage terms, including the disclosure of information that would help to ensure that all applicable breakpoint discounts are honored. However, the MSRB believes that disclosing the approximate value of the holdings on which the breakpoint calculation was based would be significantly more useful to customers than a citation to the level of sales load to which such customer is entitled, particularly since this same information will already be provided in connection with the disclosure of the front-end sales load. By providing the approximate value of the holding on which the breakpoint calculation was made, the customer would be better able to determine whether the broker-dealer has appropriately calculated the breakpoint or has all the relevant information needed to calculate the breakpoint. Providing this information should not be a significant burden on broker-dealers since this information is necessary to calculate the appropriate front-end sales load.

The MSRB notes that proposed Rule 15c2-2(c)(1)(i) refers to the sales load set forth in the prospectus. As discussed above, the program disclosure document for college savings plans is not required to include sales load information.[10] Thus, in some cases, the program disclosure document may not include this information. The MSRB suggests that the Commission revise the language of section (c)(1)(i) to reflect that sales load disclosure is not required in the program disclosure document for college savings plans or, alternatively, consider providing further guidance under Rule 15c2-12(f)(3) as to what elements of information (including sales loads for municipal fund securities) must be included in an official statement for purposes of that rule.

In addition, in the rule language for section (c)(1), the term "time of purchase" is used in the lead-in paragraph but the term "time of sale" is used in subsections (i) and (ii). The MSRB believes that the usage in subsections (i) and (ii) should be changed to "time of purchase" to conform to the intent of section (c)(1) and to avoid potential confusion.

- ***Presentation of front-end sales load, back-end sales load, asset-based sales charges and service fees, and commission and other charges***. The Commission sought comment on alternative ways to show the required information on Schedule 15C. The Commission may wish to consider allowing or requiring that these payments be presented in a grid that would more clearly note for customers those payments being made on the day of investment, those that would be paid out over the upcoming year and those that would be payable upon a redemption.

Set forth below is an example of an alternative presentation of what the customer might pay for investing in a college savings plan. In establishing this grid, only the maximum back-end sales load is shown, with a description of the basis for its reduction over time and disclosure of when the back-end sales load becomes no longer applicable. The grid also shows commissions and other charges as a percent of the customer's investment, and the word "annual" is added to the description of the asset-based sales charges and sales fees to emphasize to customers that amounts in these regards will be payable in future years. The MSRB believes that providing

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[10] The MSRB has previously stated, however, its belief that a program disclosure document prepared by an issuer of municipal fund securities that is in compliance with Exchange Act Rules 10b-5 and 15c2-12 generally would provide disclosure of any fees or other charges imposed in connection with such securities that are material to investors. *See* Interpretive Notice on Commissions and Other Charges, Advertisements and Official Statements Relating to Municipal Fund Securities, December 19, 2001. However, even where the program disclosure document includes information about the cost of investing, there is no assurance that such information would be provided in a manner wholly consistent with the prospectus disclosure requirements for mutual funds.

these fees and expenses in this manner would allow customers to fully understand their current and future costs.

What you pay for this transaction	You paid today	You will pay during the coming year from your invested moneys	You will pay if you sell your shares during the coming year
Front-end sales load (__% of your investment)			
Commission/other compensation (__% of your investment)			
Other charges (__% of your investment)			
Estimated first-year annual asset-based sales charge (__% of your investment)			
Estimated first-year asset-based sales fee (__% of your investment)			
Back-end sales load if shares sold in one year (__% of your investment, reduced by 1% each year until no sales load during ____ year)			maximum of $____
TOTAL	$____	$____	maximum of $____

- ***Revenue sharing and portfolio securities transactions (section (c)(5))***. The MSRB supports the principle of disclosing payments in respect of revenue sharing and portfolio securities transaction arrangements as these types of payments may be used in a manner that could influence a broker-dealer's recommendation of a particular transaction. However, the MSRB has certain concerns with the definition of "fund complex" and the types of revenue sharing payments subject to disclosure, as discussed below.

    - Definition of "fund complex" – For purposes of a college savings plan interest, the fund complex (as defined in proposed Rule 15c2-2(f)(1)) would include the issuer of the college savings plan interest (typically, a state board of trustees or state agency), any agent of the issuer, any investment adviser for the issuer, and any affiliated person of the issuer or investment adviser. The term "affiliated person" is used as defined in Section 2(a)(3) of the Investment Company Act.[11] The MSRB seeks guidance as to whether such definition should be interpreted by giving effect to, or by ignoring, Section 2(b) of the Investment Company Act.[12] If the term "affiliated person" is interpreted to apply to a state issuer for purposes of the proposed rules, the term "fund complex" would include the

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11 This term includes, among others, any person directly or indirectly controlling, controlled by, or under common control with, a person.

12 Section 2(b) provides that the Investment Company Act does not apply to any political subdivision of a state, or any of its agencies, authorities or instrumentalities.

state itself and any other governmental entity that is directly or indirectly controlling, controlled by or under common control with the issuer. The MSRB believes that such an interpretation would result in unintended consequences that would not further the purposes of proposed Rule 15c2-2 and therefore suggests that governmental affiliates of the issuer of college savings plans be exempted from the "fund complex" definition. The consequences of including such other state entities are discussed below.

- Revenue sharing payments – Proposed Rule 15c2-2(f)(16) defines revenue sharing as any arrangement in which a person within the fund complex, other than the issuer, makes payments to a broker-dealer or its associated persons, other than amounts otherwise required to be disclosed under the proposed rule. Under section (c)(5), the revenue sharing payments that are required to be disclosed are not limited only to payments for or in connection with the broker-dealer's transactions in the covered securities. In the context of college savings plans, this could mean that a payment made by another governmental entity within the state (for example, fees paid for banking services or an underwriter's discount granted to an underwriter of municipal bonds) to an affiliated entity of a selling broker-dealer of that state's college savings plan would be disclosable as a revenue sharing payment on the selling broker-dealer's confirmation to its customer. The MSRB seeks clarification as to whether these are the types of payments that the Commission seeks to have disclosed.

  Under section (c)(5)(ii) of the proposed rule, revenue sharing payments are to be shown as a percentage of the total cumulative net asset value of the securities issued by the fund complex that are sold by the broker-dealer over the four most recent calendar quarters. Particularly if unrelated payments such as those described in the preceding paragraph are included in this calculation, it is unclear whether the percentage derived from this calculation would be useful to customers and could in fact provide a misleading impression of the nature of the relationship between the payment and the transaction entered into with the broker-dealer. For example, if a broker-dealer or its affiliate earned a typical underwriting fee for an issue of a state's municipal bonds and the broker-dealer only sells a limited number of shares of the state's college savings plan, the revenue sharing percentage could very well exceed 100%. In fact, where the level of payments that are counted as revenue sharing payments is fixed or otherwise not proportional to the level of investments effected by the broker-dealer, the percentage calculation will tend to result in the highest percentages for the broker-dealers effecting the fewest transactions. A similarly anomalous effect would occur with respect to the dollar amount calculation pursuant to section (c)(5)(iii) of the proposed rule.

Comparison Ranges. The MSRB supports the Commission's goal of providing customers with a basis for comparing the cost of investing in a particular college savings plan as compared to other plans. The MSRB believes that implementation of confirmation-based comparison ranges will require extensive study and consultation with the investing public and industry participants to ensure that the comparison data is calculated and presented in a meaningful manner. Although the MSRB has not thoroughly reviewed the issues raised by the Commission's comparison range proposal, certain limited comments are provided below:

- ***Inclusion of costs of investing directly through states***. To provide customers with a fuller view of the costs of investing throughout the college savings plan market, comparison data for investments made directly through states without the services of a broker-dealer would need to be included. The Commission might face significant implementation difficulties since it would be unable to require issuers to provide the needed data under current law.

- ***"Load" vs. "no load" investments***. If "load" and "no load" investments are included within the same comparison range, an average sales load figure calculated from all investments in the category may constitute a mid-point figure that in fact is not common for that type of investment.[13] The MSRB is concerned that the median and 95th percentile range may not always work well, other than as an "over-under" dividing line, if the category to which it applies consists of data elements that congregate around two distinct poles. Thus, the Commission may wish to consider whether it would be appropriate to separate no load investments from those having a sales load.

- ***Technical corrections***. The reference in section (e)(1)(v) to paragraph (c)(5)(i) should be changed to paragraph (c)(5)(ii)(A) and the reference in section (e)(1)(vi) to paragraph (c)(5)(ii) should be changed to paragraph (c)(5)(ii)(B).

- ***Presentation of comparison ranges***. If the Commission ultimately approves the inclusion of comparison ranges, the MSRB believes that such ranges could be shown in a second grid substantially in the format of the grid shown above with respect to sales loads, asset-based charges and commissions.

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13 For example, if a category consisted of five investments with no load and five investments having a sales load of 4%, the median load would be 2% and the 95th percentile range would be 0% - 4%. If instead the category consisted of nine investments, nearly evenly split between no load investments and investments with a 4% sales load, the median would be 0% if five investments were no load and would be 4% if five investments had a load of 4%. However, the MSRB has not conducted a study to determine whether these types of results would occur using market-wide data.

Alternative Periodic Reporting. MSRB Rule G-15(a)(viii) allows for periodic reporting of transactions in certain periodic and non-periodic municipal fund security plans. The MSRB believes that most arrangements that currently qualify for treatment as periodic municipal fund security plans would also qualify as covered securities plans under proposed Rule 15c2-2 but that non-periodic municipal fund security programs generally would not qualify. In non-periodic municipal fund security programs, the investor may make investments in a specified municipal fund security in such amounts and at such times as the investor determines. The MSRB does not have any information as to the prevalence of use of periodic statements in lieu of transaction confirmations for non-periodic municipal fund security programs or the occurrence of problems in connection with such usage. The Commission may wish to seek input from broker-dealers who currently engage in this practice before adoption of this provision.

Proposed Rule 15c2-2(f)(5) provides that a covered securities plan, in addition to including transactions for a specific security at the applicable public offering price in specified amounts at specified time intervals, may also include transactions occurring at the time dividends or other distributions are paid by the issuer. The MSRB observes that these additional transactions covered within the scope of the definition may be sufficient to permit periodic reporting of purchases made with matching funds provided by some college savings plan issuers. However, some college savings plans permit payments earned as credits for consumer purchases made by customers through various affiliation programs to be automatically invested in the college savings plan account of such customer. In many respects, such arrangements are similar to dividend reinvestment programs. The Commission may wish to consider permitting such types of investments to be included within the definition of a covered securities plan.

Finally, the reference in section (d)(2) of proposed Rule 15c2-2 to paragraph (d)(1) should be changed to paragraph (d)(1)(i).

Disclosure About Transactions Effected by Multiple Firms. The proposing release provides guidance regarding the manner in which transactions that are effected by more than one broker-dealer should be confirmed to the customer. The Commission states that the sales fees, revenue sharing and portfolio brokerage commissions earned by each firm must be disclosed separately. The MSRB agrees with the need to show all payments made to each firm.

The Commission provides an example where a broker-dealer solicits customers at their workplace as part of an employer-sponsored marketing arrangement and observes that, although the broker-dealer that solicits transactions may be paid on a transaction basis, the customer account may be opened at a different broker-dealer. The MSRB understands that this scenario is becoming increasingly common in the college savings plan market. The Commission states that proposed Rule 15c2-2 would require disclosure of payments to the broker-dealer soliciting the transaction, even if it does not maintain the account. The MSRB agrees with this position. However, the Commission notes that, absent an agreement disclosed to the customer, it is unlikely that the selling broker-dealer would be able to send a single confirmation jointly with

another firm effecting the transaction.[14] The MSRB believes that, assuming appropriate arrangements have been made between the selling broker-dealer and the executing broker-dealer, a single confirmation sent by the executing broker-dealer should be permitted identifying the role of each broker-dealer and showing all required information separately for each of the two firms.[15]

Clarification of Terminology. The term "primary distributor" is used in the definition of "dealer concession" in proposed Rule 15c2-2(f)(8), whereas the term "principal underwriter" is used in the definition of "proprietary covered security" in proposed Rule 15c-2(f)(15). The MSRB seeks clarification as to whether the terms primary distributor and principal underwriter are intended to be used with different meanings.

Comments on the Proposing Release – Point of Sale Disclosure

The MSRB supports the Commission's proposal in Rule 15c2-3 to require point of sale disclosure of information relating to the cost of investing in college savings plan interests. This information should serve as a significant supplement to the existing MSRB point-of-sale disclosures and would greatly assist customers in making informed investment decisions. Although the information needed by a broker-dealer to comply with Rule 15c2-3 is less extensive than with respect to Rule 15c2-2, the limitations on the accessibility to such information in the college savings plan market described above might affect the ability of broker-dealers to fully comply with this point of sale disclosure obligation under certain circumstances.

The MSRB provides the following suggestions with respect to certain elements of this proposal:

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14 The proposing release cites to the Commission's Office of Compliance Inspections and Examinations, "Inspection Report on the Soft Dollar Practices of Broker-Dealers, Investment Advisers and Mutual Funds" (September 22, 1998) at n. 78, which cites Commission No-Action Letter, "Prime Broker Committee" (January 25, 1994). The MSRB notes that the scenario contemplated in this no-action letter involved the delivery of the confirmation to the customer by the non-executing broker-dealer, which received the confirmation from the executing broker-dealer as an intermediary for the customer.

15 In fact, the Commission's release acknowledges in footnote 138 that in some cases a selling broker-dealer may not be aware of a transaction until after the investment is made. It is unclear to the MSRB how such a selling broker-dealer would be able to comply with the confirmation requirement of proposed Rule 15c2-2 unless the broker-dealer that executed the transaction were permitted to send the confirmation on the selling broker-dealer's behalf.

Timing of Point of Sale. Proposed Rule 15c2-3 defines the point of sale differently depending upon the circumstances. In most cases, the point of sale is immediately prior to the time that the broker-dealer accepts an order from the customer. This timeframe coincides with the timing for required MSRB point-of-sale disclosures. However, the Commission considers the point of sale to be the time that the broker-dealer first communicates with the customer about the security (either specifically or in conjunction with other potential investments) in transactions (i) for customers who have not opened an account with the broker-dealer or (ii) in which the broker-dealer does not accept the order from the customer. The MSRB believes that the second timeframe within the definition of point of sale raises some concerns.

For example, a selling broker-dealer may have an initial conversation with a customer during which the broker-dealer identifies a particular college savings plan as a potential investment for the customer but does not provide the Commission's required point of sale disclosure at that time (*e.g.*, a customer may have asked about the availability of a college savings plan in his or her home state, and the broker-dealer – although generally aware of the existence of such plan – may not have immediate access to specific information about that particular plan). However, in a follow-up conversation with the customer the selling broker-dealer may provide more detailed information about the investment, including the required point of sale disclosures. After this second conversation, the customer may place an order with the primary distributor. In this scenario, even though the disclosures are provided by the selling broker-dealer at a time that is earlier than when the primary distributor would be required to make such disclosure (*i.e.*, immediately prior to accepting the order), the selling broker-dealer nonetheless would be in violation of proposed Rule 15c2-3.[16] The MSRB does not believe a finding of a violation in these circumstances provides significant investor protection.

The MSRB suggests, in the alternative, that the point of sale be defined as prior to the time that an order placed by the customer is accepted by the broker-dealer, by another broker-dealer that executes the transaction, or by the issuer or its agent. Under this formulation, the onus would remain on the selling broker-dealer that does not itself execute the customer transaction to ensure that it provides the customer with the required disclosure before he or she has an opportunity to place the order, but leaves it to the broker-dealer's best judgment, based on the particular circumstances, as to the precise timing for providing such disclosure. This formulation also deletes the word "immediately" since the MSRB believes that such disclosure

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[16] Further, if the selling broker-dealer mentions a variety of investment options during the first communication with the customer, the selling broker-dealer would be obligated to provide the complete point of sale disclosure for each such investment during this initial conversation. This is true even if the broker-dealer recommends only one of these options once a more thorough review of the customer's investment objectives and the features of the various investment options is completed during the second conversation.

may be given at any time prior to the order being accepted, not just in the moments immediately preceding such acceptance. This timeframe would be consistent with the long-standing MSRB point-of-sale disclosure obligation in connection with material transaction information.

Information Requirements. The Commission may wish to consider whether any commission or other compensation the broker-dealer would receive in connection with the transaction from the customer (which would be disclosed in the transaction confirmation) also should be included in the point of sale disclosure. Omitting such amounts might result in confusion by customers who could perceive this non-disclosure at the point of sale as an attempt to pass on a hidden charge to the customer that only becomes disclosed after the transaction is completed.

Customer's Right to Terminate Orders Made Prior to Disclosure. Proposed Rule 15c2-3(b) provides that an order received by a broker-dealer prior to the point of sale disclosure required under the rule shall be treated as an indication of interest until after the information is disclosed to the customer and, following disclosure, the customer has had an opportunity to determine whether to place an order. The MSRB seeks clarification as to whether this provision would operate to provide customers with any right of rescission subsequent to the execution of a transaction if the required point of sale disclosure has not been provided.

Exceptions to Point of Sale Requirement. The MSRB is concerned about the exception provided under section (e)(2) of the proposed rule for clearing broker-dealers and primary distributors that do not communicate with a customer other than to accept the order and that reasonably believe that another broker-dealer has delivered the required point of sale information to the customer. It is unclear how the exception operates in this context. If the exception simply relieves such parties from the disclosure obligation, the clearing broker-dealer or primary distributor in this scenario would not be in a position to know whether the order it has received from a customer is in fact merely an indication of interest that is subject to being withdrawn because the introducing or selling broker-dealer has failed to provide the required disclosure. If, on the other hand, the exception eliminates the treatment of pre-disclosure orders as indications of interest in the context of these types of transactions, then this exception would be carving out a significant population of customers from an important element of the protections afforded by the proposed rule. Furthermore, the disclosure on Schedule 15D regarding this customer right could be misleading under these circumstances.

The MSRB believes that the Commission should consider whether the best interests of customers could be more reliably served in this context by having the point of sale disclosures delivered in a more centralized manner than envisioned by this exception. Thus, in the case of college savings plan interests, if the selling broker-dealer and the primary distributor conclude that the primary distributor is better positioned to provide the required point of sale disclosure to customers, those parties should be permitted to reach an agreement to have this function centralized at the primary distributor. This promotes making the point of sale disclosure in the

most effective manner while avoiding the uncertainties identified in the preceding paragraph. It also may allow for greater efficiency in generating point of sale disclosures, helping to reduce the costs to industry participants of complying with proposed Rule 15c2-3.

The MSRB supports the exception for transactions effected as part of a covered securities plan but believes that this exception could be broadened to include other types of repeat customers. No significant purpose is served by requiring that point of sale disclosures be repeatedly given to customers that make multiple separate investments in the same covered security that do not qualify for a covered securities plan, such as where an investor may from time to time invest varying sums in a previously opened college savings plan account under a non-periodic municipal fund security program. In such an instance, where the information that would be required to be delivered pursuant to the point of sale disclosure requirement would vary from transaction to transaction depending upon the size of each individual investment, the Commission could condition such exception upon the periodic delivery of the standardized information required in connection with the Commission's proposed exception for mail orders in section (e)(1) of the proposed rule.

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Again, we appreciate the opportunity to provide comments to the Commission on this important proposal. If you have any questions or if the MSRB may be of further assistance to the Commission, please do not hesitate to contact me or Ernesto A. Lanza at (703) 797-6600.

Sincerely,

Christopher A. Taylor
Executive Director