



January 10, 2003

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

Re: Draft Interpretive Notice on 529 Plan
Employee Payroll Deduction Programs

Dear Mr. Lanza:

The Investment Company Institute¹ appreciates the opportunity to comment on the *Draft Interpretive Notice on Marketing of 529 College Savings Plan Employee Payroll Deduction Programs* (the "draft Notice") recently published by the Municipal Securities Rulemaking Board (MSRB).² The Institute commends the MSRB and its staff for continuing to address issues arising in connection with the offer and sale of 529 plan securities to ensure that investors are provided all necessary information and dealt with fairly. In view of the fact that 529 plan securities offered through employers may be gaining in popularity, it seems appropriate for the MSRB to provide guidance to securities professionals regarding their obligations when utilizing this distribution channel. Overall, the Institute supports the views expressed in the MSRB's draft Notice. We recommend, however, various revisions to the draft Notice to provide greater clarification and flexibility regarding its provisions. Our recommendations are discussed in more detail below.

I. SCOPE OF THE DRAFT NOTICE

As currently proposed, the draft Notice is directed towards those programs offered to an employee through a "payroll deduction program." It is our understanding, however, that because implementing a payroll deduction plan for 529 plan securities involves operational

¹ The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,955 open-end investment companies ("mutual funds"), 533 closed-end investment companies and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about \$6.216 trillion, accounting for approximately 95% of total industry assets, and 90.2 million individual shareholders.

² See *Draft Interpretive Notice on Marketing of 529 College Savings Plan Employee Payroll Deduction Programs*, MSRB (November 18, 2002).

complexities and considerable expense, many employers instead may permit employees to utilize alternative funding methods, such as the use of an Automated Clearing House (ACH) debit system. Under these alternative funding methods, an employee may direct payments to the primary distributor of the program (or to the plan's transfer agent), rather than having such funds deducted from his or her paycheck by the employer and forwarded to the distributor. The Institute recommends that the MSRB clarify that the positions set forth in the draft Notice would be applicable to all programs involving payroll deductions, regardless of how the payments are transmitted to the primary distributor.

II. "INTRODUCING BROKER"

The draft Notice uses the term "introducing broker" to refer to the dealer that has signed a selling agreement to offer 529 plan securities. The Institute recommends that, in lieu of the term "introducing broker," the draft Notice use the term "selling dealer." This revision would better identify the role of the broker or dealer that interacts with the employees and that may have customer protection obligations under the MSRB's rules. Additionally, it will avoid the confusion that may result from the fact that the term "introducing broker" is used in other contexts under other federal securities laws to refer to entities that are different from those referred to in the MSRB's draft Notice.³

III. DISTRIBUTION ARRANGEMENTS

The draft Notice describes one type of program through which 529 plan securities are sold to employees.⁴ As with arrangements for the distribution of mutual fund securities, however, there are a variety of arrangements that may be used to distribute 529 plan securities to employees. In some instances, the primary distributor may enlist a selling dealer to provide marketing materials (*e.g.*, brochures) to employers regarding a particular plan, but limit the dealer from having any further involvement with the employer or its employees regarding such plan. Instead, an employee receiving the brochure who would like additional information about the plan or who wants to purchase 529 plan securities would contact the primary distributor or the plan's transfer agent directly. In other instances, the primary distributor may utilize various affiliated or unaffiliated dealers to sell its plans. Under this type of arrangement, the primary distributor may enter into contractual agreements with the selling dealers or the plan's transfer agent that address which entity will have responsibility for opening new accounts, processing transactions and distributions, maintaining account records and documentation, distributing the official statement, mailing confirmations and account statements, responding to customer inquiries, etc.⁵

³ See, *e.g.*, Rule 15c3-3 under the Securities Exchange Act of 1934.

⁴ The "payroll deduction program" described in the draft Notice involves a dealer signing a selling agreement with the primary distributor to make available to an employer the opportunity to initiate a payroll deduction plan for employees. As described in the draft Notice, employees would establish accounts with the primary distributor by completing an online account application and participation agreement that are submitted directly to the primary distributor.

⁵ For example, the selling dealer may have exclusive responsibility for the account and all communications from the primary distributor would be provided to the dealer to forward to the investor. In other instances, the selling dealer may have primary responsibility for the account, but the primary distributor may provide certain limited information

The Institute recommends that the MSRB revise its draft Notice to reflect both the variety of payroll deduction arrangements in which an employer may participate and the fact that, as a result of this variety, the entity responsible for compliance with specific rules of the MSRB may vary. So, for example, the draft Notice should clarify that, depending upon the arrangements between a primary distributor and a selling dealer, the selling dealer may fulfill its supervisory obligation to review and approve customer accounts and transactions by having adequate policies and procedures in place to condition the offer or sale of 529 plan securities on the primary distributor (or other appropriate person) providing assurances to the selling dealer that such review and approval is occurring as required by Rule G-27.⁶ Revising the draft Notice in this manner would better ensure that members of the MSRB do not mistakenly interpret it as requiring that all 529 payroll deduction programs in which an employer participates be structured in the manner set forth in the draft Notice and would better clarify that responsibility for compliance with the MSRB's rules need not be identical to that set forth in the draft Notice. It would also further the MSRB's interest in protecting investors who pay for their plans through a payroll deduction program while, at the same time, providing sufficient flexibility to the industry to accommodate the various distribution arrangements in this market.

In addition, the Institute recommends that the draft Notice be revised to recognize that, notwithstanding any arrangements between the employer and the selling dealer, there may be other factors impacting the regulatory responsibilities relating to a transaction in 529 plan securities. Two such examples are when an employee elects to utilize its own broker-dealer to effect a transaction in 529 plan securities, notwithstanding any arrangements its employer has made with a selling dealer,⁷ and when, after the payroll deduction program is in place, the selling dealer is no longer authorized to distribute the issuer's securities.⁸ As currently drafted, in each of these situations, the draft Notice would seem to impose on the selling dealer participating in the program obligations that it may either be unable to fulfill or that are more appropriately the responsibility of another entity.⁹

directly to the investor (e.g., the annual Form 1099 for tax reporting purposes). In still other instances, both the selling dealer and the primary distributor or transfer agent may share responsibility for the account.

⁶ This revision would be consistent with the approach taken in the draft Notice regarding responsibility for the delivery of the issuer's official statement.

⁷ In such instance, an employee may receive a 529 plan brochure provided by its employer but choose to invest on the advice of and through its own broker-dealer, even though the employee will utilize a payroll deduction plan to pay for the program on an ongoing basis.

⁸ An example of this would be when an issuer of 529 plan securities terminates its relationship with the primary distributor (and consequently the selling dealers) and transfers these responsibilities to other entities. In such an instance, if the new primary distributor has no relationship with the selling dealer that originally opened the account, it is possible that the distributor may be reluctant to share ongoing account information with that dealer.

⁹ Along these same lines, the Institute notes that, according to the draft Notice, a selling dealer that enlists an employer to participate in a payroll deduction program must fulfill all of its responsibilities under the MSRB rules in connection with any transactions effected by an employee directly with the governmental issuer of the securities. The Institute recommends that the MSRB expressly clarify that the selling dealer's obligations under the MSRB's rules will vary depending upon the facts and circumstances surrounding the transaction. Indeed, the mere fact that an employee utilizes an employer's payroll deduction program to pay for 529 plan securities, in and of itself, should

IV. RECORDKEEPING REQUIREMENTS

The Institute recommends that the MSRB clarify a statement in the draft Notice concerning the recordkeeping obligations of a selling dealer under Rule G-8. In particular, according to the draft Notice, a selling dealer must "record the name and principal business address of any employer participating in a payroll deduction program." Rule G-8(a)(xi)(E), however, appears only to require a dealer to include in its required customer account information the name and address of a customer's employer, without regarding to whether such employer is "participating in a payroll deduction program."¹⁰ The Institute seeks confirmation that the above cited provision in the draft Notice refers only to a selling dealer's obligation to comply with Rule G-8(a)(xi)(E) and is not intended to impose any additional recordkeeping requirement.

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The Institute appreciates the opportunity to provide these comments in response to the MSRB's draft Notice. If you have any questions concerning these comments or would like additional information, please contact the undersigned by phone (202-326-5825) or e-mail (tamara@ici.org).

Sincerely,



Tamara K. Salmon
Senior Associate Counsel

cc: Jill C. Finder, Associate General Counsel

not impose upon the selling dealer the same panoply of responsibilities that may be imposed under the MSRB's rules on a selling dealer that is actively involved in the transaction.

¹⁰ Aside from this provision in Rule G-8, there does not appear to be any further recordkeeping requirement relating to a customer's employer or whether such employer participates in a payroll deduction program.