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Page 1 of 124

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - 2004 - 09
Amendment No.

Proposed Rule Change by Municipal Securities Rulemaking Board

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial	Amendment	Withdrawal	Section 19(b)(2)	Section 19(b)(3)(A)	Section 19(b)(3)(B)
☑	☐	☐	☑	☐	☐

Pilot ☐

Extension of Time Period for Commission Action ☐

Date Expires

Rule

☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☐ 19b-4(f)(6)

Exhibit 2 Sent As Paper Document ☐

Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the proposed rule change (limit 250 characters).

Proposed rule change to amend Rule G-21, on advertising, to establish specific requirements with respect to municipal fund securities.

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name: Ernesto Last Name: Lanza
Title: Senior Associate General Counsel
E-mail: elanza@msrb.org
Telephone: (703) 797-6600 Fax: (703) 797-6700

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

the Municipal Securities Rulemaking Board

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date 12/16/2004

By Ronald W. Smith
(Name)

Corporate Secretary
(Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Ronald W. Smith, rsmith@msrb.org

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information

Add Remove View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

Add Remove View

Exhibit Sent As Paper Document ☐

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

Add Remove View

Exhibit Sent As Paper Document ☐

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

Add Remove View

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

Add Remove View

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) The Municipal Securities Rulemaking Board (the "MSRB" or "Board") is hereby filing with the Securities and Exchange Commission (the "SEC" or "Commission") a proposed rule change amending Rule G-21, on advertising, to establish specific requirements with respect to advertisements by brokers, dealers and municipal securities dealers ("dealers") relating to municipal fund securities (the "proposed rule change"). The MSRB proposes an effective date for the proposed rule change of the first calendar day of the month beginning 90 or more calendar days after SEC approval. The text of the proposed rule change is set forth below:[1]

Rule G-21. Advertising.

(a)-(c) No change.

(d) *New Issue Advertisements.* In addition to the requirements of section (c), all advertisements for new issue municipal securities **(other than municipal fund securities)** shall **[also]** be subject to the following requirements:

(i)-(ii) No change.

(e) ***Municipal Fund Security Advertisements.*** **In addition to the requirements of section (c), all advertisements for municipal fund securities shall be subject to the following requirements:**

(i) *Required disclosures*. Each advertisement for municipal fund securities:

(A) must include a statement that:

(1) advises an investor to consider the investment objectives, risks, and charges and expenses associated with municipal fund securities before investing;

(2) explains that more information about municipal fund securities is available in the issuer's official statement;

(3) if the advertisement identifies a source from which an investor may obtain an official statement and the broker, dealer or municipal securities

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[1] Underlining indicates new language; brackets denote deletions.

dealer that publishes the advertisement is the underwriter for one or more of the issues of municipal fund securities for which any such official statement may be supplied, states that such broker, dealer or municipal securities dealer is the underwriter for one or more issues (as appropriate) of such municipal fund securities; and

(4) states that the official statement should be read carefully before investing.

(B) that refers by name (including marketing name) to any municipal fund security, issuer of municipal fund securities, state or other governmental entity that sponsors the issuance of municipal fund securities, or to any securities held as assets of municipal fund securities or to any issuer thereof, must include the following disclosures, as applicable:

(1) unless the offer of such municipal fund securities is exempt from Exchange Act Rule 15c2-12 and the issuer thereof has not produced an official statement, a source from which an investor may obtain an official statement;

(2) if the advertisement relates to municipal fund securities issued by a qualified tuition program under Internal Revenue Code Section 529, a statement that advises an investor to consider, before investing, whether the investor's or designated beneficiary's home state offers any state tax or other benefits that are only available for investments in such state's qualified tuition program; and

(3) if the advertisement is for a municipal fund security that the issuer holds out as having the characteristics of a money market fund, statements to the effect that an investment in the security is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency (unless such guarantee is provided by or on behalf of such issuer) and, if the security is held out as maintaining a stable net asset value, that although the issuer seeks to preserve the value of the investment at $1.00 per share or such other applicable fixed share price, it is possible to lose money by investing in the security.

(C) that includes performance data must include:

(1) a legend disclosing that the performance data included in the advertisement represents past performance; that past performance does not

guarantee future results; that the investment return and the value of the investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost (provided that the disclosure with respect to investment value fluctuation is not required for municipal fund securities that the issuer holds out as having the characteristics of a money market fund and as maintaining a stable net asset value); and that current performance may be lower or higher than the performance data included in the advertisement; and

(2) if a sales load or any other nonrecurring fee is charged, the maximum amount of the load or fee and, if the sales load or fee is not reflected in the performance data included in the advertisement, a statement that the performance data does not reflect the deduction of the sales load or fee and that the performance data would be lower if such load or fee were included.

(D) must present the statements required by clauses (A), (B) and (C) of this paragraph, when in a print advertisement, in a type size at least as large as and of a style different from, but at least as prominent as, that used in the major portion of the advertisement, provided that when performance data is presented in a type size smaller than that of the major portion of the advertisement, the statements required by clause (C) of this paragraph may appear in a type size no smaller than that of the performance data. If an advertisement is delivered through an electronic medium, the legibility requirements for the statements required by clauses (A), (B) and (C) of this paragraph relating to type size and style may be satisfied by presenting the statements in any manner reasonably calculated to draw investor attention to them. In a radio or television advertisement, the statements required by clauses (A), (B) and (C) of this paragraph must be given emphasis equal to that used in the major portion of the advertisement. The statements required by clause (C) of this paragraph must be presented in close proximity to the performance data and, in a print advertisement, must be presented in the body of the advertisement and not in a footnote unless the performance data appears only in such footnote.

(ii) ***Performance data.*** **Each advertisement that includes performance data relating to municipal fund securities must present performance data in the format, and calculated pursuant to the methods, prescribed in paragraph (d) of Securities Act Rule 482 (or, in the case of a municipal fund security that the issuer holds out as having the characteristics of a money market fund, paragraph (e) of Securities Act Rule 482), provided that:**

(A) to the extent that information necessary to calculate performance data is not available from an applicable balance sheet included in a registration statement, or

from a prospectus, the broker, dealer or municipal securities dealer shall use information derived from the issuer's official statement, otherwise made available by the issuer or its agents, or (when unavailable from the official statement, the issuer or the issuer's agents) derived from such other sources which the broker, dealer or municipal securities dealer reasonably believes are reliable;

(B) if the issuer first began issuing the municipal fund securities fewer than one, five, or ten years prior to the date of the submission of the advertisement for publication, such shorter period shall be substituted for any otherwise prescribed longer period in connection with the calculation of average annual total return or any similar returns;

(C) performance data shall be calculated as of the most recent calendar quarter ended prior to the submission of the advertisement for publication for which such performance data, or all information required for the calculation of such performance data, is available to the broker, dealer or municipal securities dealer as described in clause (A) of this paragraph;

(D) where such calculation is required to include expenses accrued under a plan adopted under Investment Company Act Rule 12b-1, the broker, dealer or municipal securities dealer shall include all such expenses as well as any expenses having the same characteristics as expenses under such a plan where such a plan is not required to be adopted under said Rule 12b-1 as a result of Section 2(b) of the Investment Company Act of 1940;

(E) in calculating tax-equivalent yields or after-tax returns, the broker, dealer or municipal securities dealer shall assume that any unreinvested distributions are used in the manner intended with respect to such municipal fund securities in order to qualify for any federal tax-exemption or other federally tax-advantaged treatment with respect to such distributions, provided that:

(1) the advertisement must also provide a general description of how federal law intends that such distributions be used and disclose that such yield or return would be lower if distributions are not used in this manner; and

(2) if the then-effective federal income tax treatment upon which such yield or return was based is subject to lapse or other adverse change without extension or change of federal law, the advertisement must disclose this fact and that such yield or return would be lower if the then-effective federal income tax treatment is not extended or otherwise changed.

(F) notwithstanding any of the foregoing, this paragraph shall apply solely to the calculation of performance relating to municipal fund securities and does not apply to, or limit the applicability of any rule of the Commission, NASD or any other regulatory body relating to, the calculation of performance for any security held as an underlying asset of the municipal fund securities.

(iii) ***Nature of issuer and security.*** **An advertisement for a specific municipal fund security must provide sufficient information to identify such specific security in a manner that is not false or misleading. An advertisement that identifies a specific municipal fund security must include the name of the issuer (or the issuer's marketing name for its issuance of municipal fund securities, together with the state of the issuer), presented in a manner no less prominent than any other entity identified in the advertisement, and must not imply that a different entity is the issuer of the municipal fund security. An advertisement must not raise an inference that, because municipal fund securities are issued under a government-sponsored plan, investors are guaranteed against investment losses if no such guarantee exists. If an advertisement concerns a specific class or category of an issuer's municipal fund securities (*e.g.*, A shares versus B shares; direct sale shares versus advisor shares; in-state shares versus national shares; etc.), this must clearly be disclosed in a manner no less prominent than the information provided with respect to such class or category.**

(iv) ***Capacity of dealer and other parties*****. An advertisement that relates to or describes services provided with respect to municipal fund securities must clearly indicate the entity providing those services. If any person or entity other than the broker, dealer or municipal securities dealer is named in the advertisement, the advertisement must reflect any relationship between the broker, dealer or municipal securities dealer and such other person or entity. An advertisement soliciting purchases of municipal fund securities that would be effected by a broker, dealer or municipal securities dealer or any other entity other than the broker, dealer or municipal securities dealer that publishes the advertisement must identify which entity would effect the transaction, provided that the advertisement may identify one or more such entities in general descriptive terms but must specifically name any such other entity if it is the issuer, an affiliate of the issuer, or an affiliate of the broker, dealer or municipal securities dealer that publishes the advertisement.**

(v) ***Tax consequences and other features*****. Any discussion of tax implications or other benefits or features of investments in municipal fund securities included in an advertisement must not be false or misleading. In the case of an advertisement that includes statements regarding tax or other benefits offered in connection with such municipal fund securities or otherwise offered under state or federal law, the advertisement also must state that the availability of such tax or other benefits may be conditioned on meeting certain requirements.**

If the advertisement describes the nature of specific benefits, such advertisement must also briefly name the factors that may materially limit the availability of such benefits (such as residency, purpose for or timing of distributions, or other factors, as applicable). Such statements of conditions or limitations must be presented in close proximity to, and in a manner no less prominent than, the description of such benefits.

(vi) ***Underlying registered securities*****. If an advertisement for a municipal fund security provides specific details of a security held as an underlying asset of the municipal fund security, the details included in the advertisement relating to such underlying security must be presented in a manner that would be in compliance with any Commission or NASD advertising rules that would be applicable if the advertisement related solely to such underlying security; provided that details of the underlying security must be accompanied by any further statements relating to such details as are necessary to ensure that the inclusion of such details does not cause the advertisement to be false or misleading with respect to the municipal fund securities advertised. This paragraph does not limit the applicability of any rule of the Commission, NASD or any other regulatory body relating to advertisements of securities other than municipal fund securities, including advertisements that contain information about such other securities together with information about municipal securities.**

(f) [(e)] No change.

* * * * * * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was adopted by the MSRB at its November 10-11, 2004 meeting. Questions concerning this filing may be directed to Ernesto A. Lanza, Senior Associate General Counsel, at (703) 797-6600.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Rule G-21, on advertising, establishes standards for dealer advertisements relating to municipal securities. The MSRB has previously provided interpretive guidance to dealers regarding the

application of these standards to advertisements of municipal fund securities.[2] The proposed rule change amends Rule G-21 to establish specific standards applicable solely to dealer advertisements of municipal fund securities. In particular, the proposed rule change incorporates the advertising standards enunciated in the 2002 Notice into Rule G-21, with certain modifications. In addition, the proposed rule change includes specific requirements regarding the calculation and display of performance data for municipal fund securities in a manner consistent with Rule 482 adopted by the SEC under the Securities Act of 1933, as amended (the "Securities Act"), in connection with the advertisement of mutual fund performance. The proposed rule change also includes general disclosure requirements regarding municipal fund securities that are similar in most respects to generalized disclosures currently required for mutual fund advertisements under SEC rules.

General Disclosures

The proposed rule change includes in clauses (A) and (B) of Rule G-21(e)(i) disclosure provisions modeled after SEC general disclosure requirements for mutual fund advertisements, with certain modifications. The modifications recognize the difference between the prospectus required for mutual funds and the official statement indirectly required for municipal fund securities under Rule 15c2-12 adopted by the SEC under the Securities Exchange Act of 1934, as amended (the "Exchange Act"),[3] as well as other differences in characteristics between municipal fund securities and mutual funds.

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2 *See* Rule G-21 Interpretation – Application of Fair Practice and Advertising Rules to Municipal Fund Securities, May 14, 2002, *reprinted in* MSRB Rule Book (the "2002 Notice"). The 2002 MSRB Notice also confirmed previous guidance on advertisements of municipal fund securities published in 2001. *See* Rule G-30 Interpretation – Interpretive Notice on Commissions and Other Charges, Advertisements and Official Statements Relating to Municipal Fund Securities, December 19, 2001, *reprinted in* MSRB Rule Book. Municipal fund securities are municipal securities issued by an issuer that, but for the application of Section 2(b) of the Investment Company Act of 1940, as amended (the "Investment Company Act"), would constitute an investment company within the meaning of the Investment Company Act. The most common forms of municipal fund securities sold by dealers consist of interests in trusts established by states as qualified tuition programs under Section 529 of the Internal Revenue Code of 1986, as amended ("529 college savings plans"), and interests in local government investment pools ("LGIPs").

3 SEC Rule 15c2-12 provides, among other things, that the underwriter for most primary offerings of municipal securities must obtain and review the issuer's near-final official statement before purchasing or offering the securities, contract with the issuer to receive copies of the final official statement within specified timeframes after the final agreement to purchase or offer the securities, and distribute copies of the official statement to potential customers upon request.

(continued . . .)

New section (e)(i)(A) of Rule G-21 requires that all dealer advertisements relating to municipal fund securities include generalized disclosure that: (1) advises investors to consider the investment objectives, risks, and charges and expenses associated with municipal fund securities before investing; (2) explains that more information about municipal fund securities is available in the issuer's official statement; (3) if the advertisement identifies a source from which an investor may obtain an official statement and the dealer that publishes the advertisement is the underwriter for the municipal fund securities for which such official statement may be supplied, states that such dealer is the underwriter for such municipal fund securities; and (4) states that the official statement should be read carefully before investing. The disclosures required in clauses (1), (2) and (4) of Rule G-21(e)(i)(A) are substantially similar to the analogous disclosures required under section (b)(1)(i) of SEC Rule 482 in connection with a mutual fund advertisement that would be considered a prospectus under the Securities Act. The disclosure required in clause (3) of Rule G-21(e)(i)(A) is substantially similar to the analogous disclosure required under section (b) of Rule 135a adopted by the SEC under the Securities Act in connection with generic mutual fund advertisements.

New section (e)(i)(B) of Rule G-21 requires that all dealer advertisements that refer by name (including marketing name) to any municipal fund security, issuer of municipal fund securities, governmental entity that sponsors the issuance of municipal fund securities, or to any securities held as assets of municipal fund securities or to any issuer of such securities held as assets, must include additional disclosure that: (1) identifies a source from which an investor may obtain an official statement; (2) if the advertisement relates to municipal fund securities issued through a 529 college savings plan, advises an investor to consider, before investing, whether the investor's or designated beneficiary's home state offers any state tax or other benefits that are only available for investments in such state's 529 college savings plan; and (3) if the advertisement is for a municipal fund security that the issuer holds out as having the characteristics of a money market fund, states that an investment in the security is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency (unless such guarantee is provided by or on behalf of such issuer) and that, if the security is held out as maintaining a stable net asset value, although the issuer seeks to preserve the value of the investment at a fixed share price, it is possible to lose money by investing in the security. The disclosure

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(. . . continued)

For purposes of the rule, 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. A final official statement need not contain each item of information required to be included in a prospectus under the Securities Act.

required in clause (1) of Rule G-21(e)(i)(B) is substantially similar to the analogous disclosure required under section (b)(1)(i) of SEC Rule 482. The disclosure required in clause (3) of Rule G-21(e)(i)(B) is substantially similar to the analogous disclosure required under section (b)(4) of SEC Rule 482. The disclosure required in clause (2) of Rule G-21(e)(i)(B) is not derived from SEC mutual fund advertising rules but is analogous to the point-of-sale disclosure obligation under Rule G-17 described in the 2002 Notice.[4]

New section (e)(i)(D) of Rule G-21 requires that these general disclosures be presented in the same format required under SEC Rule 482.

Historical Performance Data

The proposed rule change establishes in new section (e)(ii) of Rule G-21 specific requirements with respect to the inclusion of performance data in municipal fund security advertisements.

Calculation and Display of Performance Data. Under the proposed rule change, such advertisements must comply with the method of computing and displaying performance data for mutual funds as prescribed in section (d) or (e) of SEC Rule 482, with certain modifications described below. In effect, for municipal fund securities other than those that are held out by the issuer as having the characteristics of a money market fund, quotations of performance in an advertisement are limited to the average annual total return, current yield (but only if accompanied by average annual total return), tax-equivalent yield (but only if accompanied by average annual total return and current yield), after-tax return (but only if accompanied by average annual total return), or other non-prescribed performance measures (but only if accompanied by average annual total return and, if adjusted to reflect the effects of taxes, after-tax return), as provided in SEC Rule 482(d). In the case of municipal fund securities that are held out by the issuer as having the characteristics of a money market fund, quotations of performance in an advertisement are limited to the current yield, effective yield (but only if accompanied by current yield), tax-equivalent yield or tax-equivalent effective yield (but only if accompanied by current yield), or total return (but only if accompanied by current yield), as provided in SEC Rule 482(e).[5]

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[4] The specific disclosure required in the proposed rule change is somewhat broader than that currently required under the point-of-sale disclosure obligation described in the 2002 Notice. The MSRB expects to file with the SEC in the near future a proposed rule change that expands this point-of-sale disclosure requirement under Rule G-17 to also reference the possible existence of other non-tax state benefits. *See* MSRB Notice 2004-16 (June 10, 2004).

[5] SEC Rule 482 incorporates the calculation methods set forth in Forms N-1, N-3 and N-4 for purposes of calculating the various types of quotations described in the rule. These methods are

(continued . . .)

Clauses (A) through (E) of Rule G-21(e)(ii) modify the basic performance data calculation methods established for mutual funds to reflect the fact that certain items of information that exist in the mutual fund industry – such as the registration statement and the specific items of information required to be disclosed in the prospectus and statement of additional information – do not exist for municipal fund securities, as well as to reflect other differences in characteristics between municipal fund securities and mutual funds. Thus, Rule G-21(e)(ii) provides that: (A) a dealer can use information provided in the issuer's official statement, otherwise made available by the issuer, or otherwise obtained from other reliable sources to calculate performance to the extent such information is not available from a balance sheet in a registration statement or from a prospectus; (B) the life of a municipal fund securities issue should be measured from when the issuer first issues the securities; (C) performance data in advertisements must be calculated as of the most recent calendar quarter ended prior to the submission of the advertisement for publication for which such performance data, or all information required for the calculation of such performance data, is available to the dealer;[6] (D) expenses having the same characteristics as those permitted to be paid under Rule 12b-1 adopted by the SEC under the Investment Company Act but not technically accrued under a 12b-1 plan must be treated as 12b-1 expenses for purposes of calculating performance;[7] and (E) in calculating tax-equivalent yields or after-tax returns, the dealer shall assume that any unreinvested distributions are used in a manner that qualifies for any federal tax-exemption or other federally tax-advantaged treatment with respect to such distributions, provided that: (1) the advertisement also provides a general description of how federal law intends such distributions be used and discloses that such yield or return would be lower if distributions are not used in this manner; and (2) if the federal income tax treatment upon which such yield or return is based is subject to lapse or other adverse change without extension or change of federal law, the advertisement must disclose this fact and that such yield or return would be lower if the federal income tax treatment is not extended or otherwise change.

(. . . continued)

also incorporated into Rule G-21(e)(ii).

6 As noted in footnote 13 and accompanying text, *infra*, the MSRB is publishing for comment concurrent with this filing a draft amendment that would modify this clause (C).

7 Thus, asset-based charges paid to the program manager or investment advisor, to the issuer or its agents, or to any other party generally are to be treated as 12b-1 expenses for purposes of calculating performance even if any such charges may not technically be paid under a formal 12b-1 plan. In addition, any 12b-1 expenses incurred in connection with underlying assets of the municipal fund securities also must be treated as 12b-1 expenses of the municipal fund securities to the extent that such expenses are not waived or not included within the asset-based charges described in the preceding sentence.

Performance data included in municipal fund security advertisements are required to be displayed in the manner provided in section (d) or (e) of SEC Rule 482, as appropriate, with respect to prominence and positioning of information.

Disclosures Accompanying Performance Data. New Section (e)(i)(C) of Rule G-21 requires that advertisements that include performance data for municipal fund securities also include certain related legends and disclosures modeled after those required under SEC Rule 482 for mutual funds advertisements that display performance information. These disclosures emphasize that the performance data is historical and does not guarantee future results, that the value of holdings is subject to fluctuation (except where the municipal fund security is held out as having the characteristics of a money market fund and as maintaining a stable net asset value), and that current performance may be different from the performance data included in the advertisement.[8] Advertisements containing performance data also are required to include the maximum amount of any sales load or other nonrecurring fee and, if such load or fee is not reflected in the performance data, to disclose that the load or fee is not so reflected and that performance would be lower if it had been reflected. These nonrecurring fees that are subject to disclosure include such fees imposed not only by the dealer but also by the issuer or any other party to the issuance of the municipal fund securities or the maintenance of investments therein.

New Section (e)(i)(D) requires that these legends and disclosures be presented in the same format required under SEC Rule 482.

Additional Requirements

The proposed rule change includes in new paragraphs (iii) through (vi) of Rule G-21(e) additional requirements with respect to municipal fund security advertisements, based largely on interpretive guidance provided in the 2002 Notice.

Nature of Issuer and Security. New paragraph (iii) requires that an advertisement: (1) for a specific municipal fund security provide sufficient information to identify the security in a manner that is not false or misleading; (2) that identifies a specific municipal fund security include the name of the issuer (or its marketing name, including state), presented in a manner no less prominent than any other entity identified in the advertisement, and not imply that a different entity is the issuer; (3) not raise an inference that, because municipal fund securities are issued under a government-sponsored plan, investors are

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[8] As noted in footnote 13 and accompanying text, *infra*, the MSRB is publishing for comment concurrent with this filing a draft amendment that would modify this provision.

guaranteed against investment losses if no such guarantee exists; and (4) that concerns a specific class or category municipal fund securities (*e.g.*, A shares versus B shares; direct sale shares versus advisor shares; in-state shares versus national shares; etc.) clearly disclose this fact in a manner no less prominent than the information provided with respect to such class or category.

Capacity of Dealer and Other Parties. New paragraph (iv) requires an advertisement about services provided with respect to municipal fund securities to clearly indicate the entity providing such services. If any person or entity other than the dealer is named in the advertisement, it must reflect any relationship between the dealer and such other person or entity. An advertisement soliciting purchases that would be effected by any party other than the dealer that publishes the advertisement (*i.e.*, the issuer or another dealer) must identify which entity would effect the transaction, provided that it may identify one or more such entities in general descriptive terms but must specifically name any such other entity if it is the issuer, an affiliate of the issuer, or an affiliate of the dealer that publishes the advertisement.

Tax Consequences and Other Features. New paragraph (v) requires that any discussion of tax implications or other benefits or features of investments in municipal fund securities included in an advertisement not be false or misleading. If an advertisement includes statements regarding tax or other benefits offered in connection with such municipal fund securities or otherwise offered under state or federal law, it must also state that the availability of such tax or other benefits may be conditioned on meeting certain requirements. If the advertisement describes the nature of specific benefits, such advertisement must also briefly name the factors that may materially limit the availability of such benefits (such as residency, purpose for or timing of distributions, or other factors, as applicable).[9] Such statements of conditions or limitations must be presented in close proximity to, and in a manner no less prominent than, the description of such benefits.

Underlying Registered Securities. New paragraph (vi) requires that, if an advertisement for a municipal fund security provides specific details of a security held as an underlying asset of the municipal fund security, the details included in the advertisement relating to such underlying security be presented in a manner that would be in compliance with any SEC or NASD advertising rules that would be applicable if the advertisement related solely to such underlying security. Details of the underlying security included in the advertisement must be accompanied by any further statements necessary to ensure that the inclusion of such details does not cause the advertisement to be false or misleading with

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[9] For example, if an advertisement notes that investors in a particular 529 college savings plan may qualify for scholarships or matching grants, it may also need to state that such scholarships or matching grants are available only for attendance at in-state colleges or to in-state investors, if that is in fact the case.

respect to the municipal fund securities advertised. This provision does not limit the applicability of any rule of the SEC, NASD or any other regulatory body relating to advertisements of securities other than municipal fund securities, including advertisements that contain information about such other securities together with information about municipal fund securities.

Exemption from New Issue Price/Yield Requirement

The proposed rule change exempts municipal fund security advertisements from the provision of Rule G-21(d) relating to advertisements of initial reoffering prices or yields of new issue municipal securities. This provision is designed for advertisements by underwriting syndicates for municipal debt offerings and does not deal with matters relevant to municipal fund securities.

(b) The MSRB has adopted the proposed rule change pursuant to Section 15B(b)(2)(C) of the Exchange Act, which provides that MSRB's rules shall:

> be 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 believes that the proposed rule change is consistent with the Exchange Act because it will further investor protection by raising the standards for advertisements of municipal fund securities and by making information provided in such advertisements comparable for different municipal fund securities investments and between municipal fund securities and registered mutual funds.

4. Self-Regulatory Organization's Statement on Burden on Competition

The MSRB does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act since it would apply equally to all dealers.

5. Self-Regulatory Organization's Statement on Comments Received on the Proposed Rule Change by Members, Participants, or Others

On June 10, 2004, the MSRB published for comment draft rule changes to Rule G-21 with respect to advertisements of municipal fund securities.[10] The MSRB received eight comment letters.[11] After reviewing these comments, the MSRB approved the draft amendments, with certain modifications, for filing with the SEC. The comments and modifications to the draft amendments are discussed below.

General Disclosures

Summary of Draft Amendment. Draft Rule G-21(e)(i)(A) would require dealer advertisements of municipal fund securities to include generalized disclosure to the effect that investors should consider the securities' investment objectives, risks and charges before investing; that more information about the securities is available in the issuer's official statement; identifies where an official statement can be obtained; and states that the official statement should be read carefully before investing. Advertisements of 529 college savings plans also must advise investors to consider whether their home states offer state tax or other benefits only available for investments in the in-state plans.

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10 *See* MSRB Notice 2004-16 (June 10, 2004).

11 Letter from Kenneth B. Roberts, Hawkins Delafield & Wood LLP ("Hawkins"), to Ernesto A. Lanza, Senior Associate General Counsel, MSRB, dated August 20, 2004; letter from Mary L. Schapiro, Vice Chairman, NASD, and President, Regulatory Policy and Oversight, to Ernesto A. Lanza, dated September 9, 2004; letter from Tamara K. Salmon, Senior Associate Counsel, Investment Company Institute ("ICI"), to Ernesto A. Lanza, dated September 10, 2004; letter from David J. Pearlman, College Savings Foundation ("CSF"), to Ernesto A. Lanza, dated September 13, 2004; letter from Elizabeth L. Bordowitz, General Counsel, Finance Authority of Maine ("FAME"), to Ernesto A. Lanza, dated September 13, 2004; letter from Diana F. Cantor, Chair, College Savings Plan Network ("CSPN"), and Executive Director, Virginia College Savings Plan, to Ernesto A. Lanza, dated September 15, 2004; letter from Elizabeth Varley and Michael D. Udoff, Co-Staff Advisers, Securities Industry Association ("SIA") Ad Hoc 529 Plans Committee, to Ernesto A. Lanza, dated September 15, 2004; and letter from Raquel Alexander, PhD, Assistant Professor, and LeAnn Luna, PhD, Assistant Professor, University of North Carolina at Wilmington, to Ernesto A. Lanza, dated September 15, 2004. Most commentators also provided comments on the proposed modification to the MSRB's existing point-of-sale disclosure obligation relating to sales of out-of-state 529 college savings plans, as described in the June notice. The MSRB expects to file with the SEC in the near future a proposed rule change that expands this point-of-sale disclosure requirement under Rule G-17 to also reference the possible existence of other non-tax state benefits. The MSRB will address comments on this subject at that time.

Further, advertisements for municipal fund securities that are marketed as money market securities would be required to disclose that investments are not insured and, if marketed as maintaining a stable net asset value, it is still possible to lose money. These disclosures would be required to be given emphasis equal to that used in the major portion of the advertisement. In addition, the MSRB sought comment on whether the rule should require that dealers that advertise 529 college savings plans include in their generalized disclosure language the URL of an MSRB-maintained web site where investors can obtain general information about the 529 college savings plan market.

Discussion of Comments. Commentators generally supported the proposed general disclosures, with several providing suggested changes.

- ***State tax and other benefits –*** Three commentators representative of, or generally acting on behalf of, state issuers suggested modifications to the language relating to the potential benefits of investing in an in-state plan. CSPN and FAME stated that the proposed language should reflect that some benefits may be dependent on the designated beneficiary's home state (rather than or in addition to the home state of the investor). Hawkins suggested that if a state's 529 college savings plan is offered solely within that state and an advertisement of such plan is distributed solely within such state, the advertisement should be exempted from the proposed disclosure regarding potential benefits of investing in an in-state plan.

The MSRB agrees that the general disclosure language in Rule G-21(e)(i)(B)(2) should be modified to include reference to the designated beneficiary when discussing the benefits of in-state investments. However, the MSRB does not believe that the additional changes suggested by the commentators should be made. The MSRB believes that disclosure of potential in-state benefits should apply to all 529 college savings plan advertisements, even if the advertisement for a 529 college savings plan offered solely within a particular state is distributed solely within that state, as this would ensure uniform practices and avoid sometimes difficult factual determinations.

- ***Advertisements with limited information –*** Several commentators (CSF, CSPN, FAME and SIA) suggested that the proposed amendments permit an abbreviated form of the general disclosures for purposes of radio and television advertisements in view of the limited amount of time available in such advertisements to provide all required information. SIA argued that the requirement that equal prominence be given to the general disclosures would result in the advertisement's intended message being lost. CSF stated that the practical consequence of this requirement would quite possibly be that there would be no more radio or television advertisements of 529 college savings plans by dealers. CSF and SIA suggested that a broadcast advertisement that merely presents the dealer's name and address, the name of the 529 college savings plan and the name of the sponsoring state be permitted to substitute an abbreviated reference to the official statement for further information. SIA further suggested that such a broadcast advertisement urge the investor to read the official statement carefully before investing and state how an investor may obtain the official statement.

The MSRB notes that SEC Rule 135a effectively permits the use of certain types of mutual fund advertisements containing very limited information without including the disclosures required under SEC Rule 482. SEC Rule 135a covers advertisements that include no more than explanatory information relating to mutual funds generally and/or to specific categories of mutual funds, as well as an invitation to inquire for further information. Such advertisements must contain the name and address of the dealer sponsoring the advertisement and whether the dealer is the principal underwriter of any mutual fund with respect to which information will be sent to any investor who asks for more information. However, such advertisements must not specifically refer by name to any mutual fund or fund family.

The suggestion of CSF and SIA would provide for including the name of the 529 college savings plan and its sponsoring state, unlike under SEC Rule 135a. However, their proposal would provide for retaining certain of the general disclosures of the proposal that are not otherwise required under SEC Rule 135a. The MSRB believes that the general disclosure provision should be modified to permit more abbreviated general disclosures, set forth in Rule G-21(e)(i)(A), where an advertisement does not refer by name (including marketing name) to any specific municipal fund security, issuer of municipal fund securities or state or other governmental entity that sponsors the issuance of municipal fund securities, or to any securities held as assets of municipal fund securities or to any issuer of such securities held as assets. Such disclosures would be limited to statements advising investors to consider the investment objectives, risks and charges of municipal fund securities before investing; that more information about municipal fund securities is available in the issuer's official statement; and that the official statement should be read carefully before investing. Because these disclosures would be considerably shorter than otherwise required, the MSRB does not believe that the equal prominence requirement for such statements should be changed. Further, the MSRB does not believe that dealers should be permitted to identify a specific product in advertisements where only these more abbreviated general disclosures are provided. Any advertisement that specifically identifies a product must also include the general disclosures set forth in Rule G-21(e)(i)(B), as applicable.

- ***Reference to MSRB web site*** – Most commentators stated that the MSRB should not require that 529 college savings plan advertisements include reference to an MSRB-maintained web site on 529 college savings plans, and no commentator supported such a requirement. The MSRB will take no further action with respect to such proposal at this time. However, the MSRB will continue to maintain and update its existing web pages, at http://www.msrb.org/msrb1/mfs, that provide generalized information about municipal fund securities.

- ***Applicability to LGIPs*** – Hawkins suggested that the general disclosure provisions be made inapplicable to advertisements of LGIPs, arguing that the required references to the official statement are inappropriate because official statements are not typically prepared for LGIPs. The MSRB understands that most LGIPs do in fact prepare official statements (often referred to as

information statements), and dealers marketing LGIPs generally are subject to SEC Rule 15c2-12. Therefore, the MSRB has not exempted dealer advertisements of LGIPs from the rule requirements.

Performance Data

Summary of Proposal. Draft Rule G-21(e)(ii) would require advertisements that include performance data to comply with the method of computing and displaying mutual fund performance data provided under SEC Rule 482, with certain modifications. Among other things, the draft amendment would require that performance data shown in an advertisement be calculated as of the most recent calendar quarter for which such data, or all information required to calculate such performance data, is reasonably available to the dealer. SEC Rule 482 requires that such data be shown in mutual fund advertisements as of the most recent calendar quarter but does not make the determination of which calendar quarter is the most recent dependent upon the availability of such data.

In addition, draft Rule G-21(e)(i) would require certain related disclosures for municipal fund securities advertisements that contain performance data. The disclosures emphasize that the performance information is historical and does not guarantee future results, the value of holdings is subject to fluctuation, and current performance may be lower or higher than the performance quoted. Advertisements containing performance data also would be required to include basic information about sales loads and other nonrecurring fees and note the impact of such loads or fees on performance as shown. The disclosures must be given emphasis equal to that of the performance data itself. These disclosures are required under SEC Rule 482 in mutual funds advertisements that display performance information.

Discussion of Comments. Commentators generally supported the proposed performance data calculation methods and related legends and disclosures, with several providing suggested changes.

- ***Most recent quarterly performance data –*** NASD stated that the difference in the language regarding the timing of quarterly data used in Rule G-21 as compared to the language used in SEC Rule 482 "appears to give dealers latitude" that "may undermine the ability of investors to compare different municipal fund securities programs, or even the same program offered by different dealers who impose varying end dates for their performance calculation. At a minimum, the disparity between the language in Rule 482 and the MSRB's proposal would create confusion for broker-dealers that must comply with both provisions."

The language used in the draft amendment was not designed to give dealers latitude in deciding which timeframes to include in advertisements, nor would it normally lead to a different result under the

draft rule as compared to SEC Rule 482.[12] Rather, the language reflects the MSRB's recognition that its rulemaking should not be used to indirectly regulate state issuers in structuring their programs and that a state's structure might result in making compliance with the specific language of Rule 482 impossible without forcing a change in the structure. However, to mitigate the possibility of unintended ambiguity and possible inconsistent application of the rule between different dealers, the MSRB has modified the language of Rule G-21(e)(ii)(C) to provide that calculations must be made as of the most recent quarter for which necessary information is available, rather than when such information is *reasonably* available. Dealers wishing to advertise performance would be tasked with taking all appropriate actions necessary to obtain information that is in fact available for purposes of such calculation.

- ***Most recent month-end performance data –*** ICI and NASD suggested that the MSRB add a requirement that dealers include in municipal fund security advertisements that contain performance data a phone number or web address where investors may obtain performance data current to the most recent month-end. They stated that this would make the MSRB's advertising rule consistent with the similar requirement established under SEC Rule 482. Rule 482 requires that mutual fund advertisements that show performance data also include a phone number or web site address at which performance data may be obtained that is current to the most recent month, available no later than seven business days after the end of the month. This requirement was not included in draft Rule G-21(e). Concurrent with the filing of this proposed rule change, the MSRB is publishing for industry comment a draft amendment to Rule G-21 that would require inclusion in dealer advertisements that contain performance data for municipal fund securities of a phone number or web address where investors may obtain performance data current to the most recent month-end.[13]

- ***Affect of federal tax treatment of 529 plans –*** The MSRB sought comment on whether the methods of calculating performance provided under SEC Rule 482, as modified by the draft amendments, were appropriate for municipal fund securities. ICI stated that "the proposed modifications satisfactorily address any disparities that should be taken into account in incorporating the provisions of Rule 482 into Rule G-21." CSPN and FAME strongly supported the effort to develop a uniform method of calculating performance. They suggested that the MSRB establish basic assumptions that 529 college savings plan distributions will be used in a manner that would preserve their tax-exempt nature (with a footnote to the effect that after-tax returns would differ if current law sunsets). In

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[12] The MSRB notes that SEC Rule 482(g) provides a basic timeliness standard based on the "most recent practicable date considering the type of investment company and the media through which data will be conveyed" that also could be viewed as giving some latitude in deciding which timeframes to include in advertisements.

[13] *See* MSRB Notice 2004-43 (December 16, 2004).

addition, they suggested that after-tax returns should not be required to be shown for 529 college savings plan advertisements since such investments are intended to be tax-exempt.

The MSRB does not believe that such assumptions about the tax-exempt nature of 529 college savings plan investments should apply for all purposes of calculating performance. Thus, the baseline total return calculation would continue to ignore all tax effects. However, in calculating tax-equivalent yields or after-tax returns, the MSRB believes it is appropriate to assume that unreinvested distributions are used for purposes that would maintain any intended federal tax benefit, as set forth in Rule G-21(e)(ii)(E). Such assumption would require that the advertisement include a general description of how federal law intends that such distributions be used to maintain the favorable tax treatment and a disclosure that the tax-equivalent yield or after-tax return would be lower if distributions are not used in such manner. In addition, if the favorable tax treatment is subject to lapse or other adverse change without extension or other change of law, the advertisement must disclose this fact and that such yield or return would be lower if the favorable tax treatment is not extended or otherwise changed.

Further, the MSRB does not believe that the provision requiring the inclusion of after tax-return should be eliminated. The only circumstance in which a dealer would be required to show after-tax return is if the advertisement also includes a performance measure that is adjusted to reflect the effect of taxes (*e.g.*, a tax equivalent return intended to show how the tax benefits of investing in 529 college savings plans compares to other fully taxable investments). Under this circumstance, it is appropriate that the advertisement also include performance that does not include such adjustment.

Additional Requirements

Draft Rule G-21 would incorporate, with certain modifications, several existing interpretive positions from the 2002 Notice. Commentators generally supported the incorporation of these positions into the rule, with several providing suggested changes.

- ***Nature of Issuer and Security*** – Draft Rule 21(e)(iii) would require, among other things, that an advertisement that identifies a specific municipal fund security include the name of the issuer presented in a manner no less prominent than any other entity identified in the advertisement.

CSF argued that, in some cases, providing the name of the legal issuer in connection with 529 college savings plan securities may not help consumers understand the nature of the issuer and may result in confusion since the legal issuer may be an obscure state trust. CSF suggested that it would be more helpful to identify the 529 college savings plan by marketing name, together with the name of the state that establishes and maintains the plan. CSF also suggested that dealers be permitted to include the marketing logo, rather than a logo of the legal issuer, in advertisements, which logo should appear at least as prominently as the dealer's logo. SIA stated that the requirement that the issuer's name be given equal prominence to that of the dealer is unnecessary and subject to second guessing. SIA argued

that the policy objective of the proposed rule, which is to prevent investor confusion as to who the issuer of the security is, is satisfied by the other requirements set forth in this section that the issuer be identified and that the advertisement not imply that another entity is the issuer of the security.

The MSRB believes that it is appropriate to permit dealers to use the marketing name and state of a 529 college savings plan in substitution for the legal name of the issuer. However, the MSRB does not agree that such issuer information should be permitted to be presented in a manner that is less prominent than any other entity identified in the advertisement. This provision would also permit the use of the 529 college savings plans logo, so long as such logo is presented in a manner no less prominent than any other entity's logo included in the advertisement.

- ***Capacity of Dealer and Other Parties –*** Draft Rule 21(e)(iv) would require an advertisement that relates to or describes services provided with respect to municipal fund securities to clearly indicate the entity providing such services. In addition, an advertisement soliciting purchases of municipal fund securities that would be effected by any party other than the dealer that publishes the advertisement (*i.e.*, the issuer or another dealer) must clearly state which entity would effect the transaction.

CSF and SIA argued that many 529 college savings plans are marketed through hundreds of dealers and it would be extremely difficult if not impossible for a primary distributor to list in its advertisement all such dealers. CSF suggested that only dealers that are affiliates of the dealer publishing the advertisement and, if applicable, the issuer itself be required to be identified by name in such advertisements. NASD stated that this provision resembles, but is not identical to, NASD Rule 2210(d)(2)(C), which generally requires that all sales material prominently disclose the name of the member and, if it includes other names, reflect which products or services are being offered by the member.

It was not the intent of the original proposal to require that a primary distributor list its many hundreds of selling dealers used in the 529 college savings plan's distribution channels. The MSRB has modified this provision so that the only parties effecting transactions in municipal fund securities that must be specifically named in an advertisement are the dealer publishing the advertisement, any other dealer affiliated with such dealer and the issuer, as applicable. In addition, the rule language has been revised to more closely track the NASD requirement that, if any parties other than the dealer is named in a municipal fund securities advertisement, the products or services offered by such parties in connection with such municipal fund securities must be stated.

- ***Tax Consequences and Other Features –*** Draft Rule 21(e)(v) would require, among other things, that an advertisement that includes statements regarding tax or other benefits offered under state or federal law must make clear the nature of such benefits and that the availability of such benefits may be materially limited based upon residency, purpose for or timing of share redemptions, or other

factors, as applicable. These limitations would be required to be described in the advertisement in close proximity to, and in a manner no less prominent than, the description of such benefits.

CSF argued that state tax treatment of 529 college savings plans is extremely complex and that not all variations in state treatment will be a benefit to in-state investors. It suggested that the reference in the rule language to "state tax or other benefits" should be changed to "different state tax or other consequences." CSF also expressed concern over the proposal's requirement that an advertisement that includes information about tax or other state benefits must "make clear the nature of such benefits." CSF stated:

> If all that would be required is a general statement that tax and other benefits may be available only through the home-state program, the guidance should so state…. If a laundry list of all potential aspects of differing treatment is required, we are concerned that such a list could not practically be updated to account for all new state laws, and that even if it could, space limitations would make it impractical or impossible to achieve compliance.

CSPN and Hawkins stated that only general statements of limitation are appropriate where an advertisement contains only general statements of benefits, so long as the investor is directed to the official statement for additional information. Hawkins suggested that the proposed rule language appears to require dealer advertisements that refer in any manner to tax or other benefits to include a detailed description of the nature of, and of limitations applicable to receipt of, such benefits. Hawkins argued that it may be impractical to include such a detailed description within most advertisements without resulting in potentially misleading or incomplete statements.

FAME suggested certain changes to terminology in this provision, stating that references to "shares" are not appropriate for many 529 college savings plans. In addition, CSPN and FAME stated that some state benefits may not be specifically provided for under state law but are created by state entities under general grants of authority.

The MSRB has modified the rule language to more narrowly focus the types of disclosures that would be required to be made in an advertisement that includes descriptions of tax or other beneficial features offered under state or federal law in connection with an investment in municipal fund securities. Thus, the modified language would make clear that general statements regarding the existence of beneficial features would not require an extensive listing of all such features but would require general disclosure that such features may be subject to limitations. However, as the information about tax matters becomes more detailed, the rule would require comparably detailed discussion of potential limitations. However, the reference to "benefits" has not been eliminated from the rule. The rule already addresses the broader concept of "tax implications" but is also specifically aimed at ensuring that the "hyping" of beneficial treatment is tempered by an equally prominent discussion of potential limitations.

Further, certain limited modifications have been made to the rule language to address the concerns regarding use of the term "shares" and reference to benefits provided under state law.

6. Extension of Time Period for Commission Action

The MSRB declines to consent to an extension of the time period specified in Section 19(b)(2) of the Exchange Act. The similarities and differences between the proposed rule change and these SEC rules are described in Items 3(a) and 5 above.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

The proposed rule change is based in part on SEC Rules 482 and 135a under the Securities Act.

9. Exhibits

1. Federal Register Notice.

2. MSRB Notice 2004-16 (June 10, 2004) and comment letters.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(RELEASE NO. 34- ; File No. SR-MSRB-2004-09)

SELF-REGULATORY ORGANIZATIONS

Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Advertisements of Municipal Fund Securities Under MSRB Rule G-21

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78s(b)(1) (the "Exchange Act"), notice is hereby given that on December 16, 2004, the Municipal Securities Rulemaking Board (the "MSRB") filed with the Securities and Exchange Commission (the "SEC") a proposed rule change (File No. SR-MSRB-2004-09) (the "proposed rule change") as described in Items, I, II, and III below, which Items have been prepared by the MSRB. The SEC is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

The MSRB has filed with the SEC a proposed rule change amending Rule G-21, on advertising, to establish specific requirements with respect to advertisements by brokers, dealers and municipal securities dealers ("dealers") relating to municipal fund securities. The MSRB proposes an effective date for the proposed rule change of the first calendar day of the month beginning 90 or more calendar days after SEC approval. Additions are italicized; deletions are bracketed. The proposed rule change is as follows:

Rule G-21. Advertising.

(a)-(c) No change.

(d) *New Issue Advertisements.* In addition to the requirements of section (c), all advertisements for new issue municipal securities *(other than municipal fund securities)* shall [also] be subject to the following requirements:

(i)-(ii) No change.

(e) *Municipal Fund Security Advertisements. In addition to the requirements of section (c), all advertisements for municipal fund securities shall be subject to the following requirements:*

(i) Required disclosures. Each advertisement for municipal fund securities:

(A) must include a statement that:

(1) advises an investor to consider the investment objectives, risks, and charges and expenses associated with municipal fund securities before investing;

(2) explains that more information about municipal fund securities is available in the issuer's official statement;

(3) if the advertisement identifies a source from which an investor may obtain an official statement and the broker, dealer or municipal securities dealer that publishes the advertisement is the underwriter for

one or more of the issues of municipal fund securities for which any such official statement may be supplied, states that such broker, dealer or municipal securities dealer is the underwriter for one or more issues (as appropriate) of such municipal fund securities; and

(4) states that the official statement should be read carefully before investing.

(B) that refers by name (including marketing name) to any municipal fund security, issuer of municipal fund securities, state or other governmental entity that sponsors the issuance of municipal fund securities, or to any securities held as assets of municipal fund securities or to any issuer thereof, must include the following disclosures, as applicable:

(1) unless the offer of such municipal fund securities is exempt from Exchange Act Rule 15c2-12 and the issuer thereof has not produced an official statement, a source from which an investor may obtain an official statement;

(2) if the advertisement relates to municipal fund securities issued by a qualified tuition program under Internal Revenue Code Section 529, a statement that advises an investor to consider, before investing, whether the investor's or designated beneficiary's home state offers any state tax

or other benefits that are only available for investments in such state's qualified tuition program; and

(3) if the advertisement is for a municipal fund security that the issuer holds out as having the characteristics of a money market fund, statements to the effect that an investment in the security is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency (unless such guarantee is provided by or on behalf of such issuer) and, if the security is held out as maintaining a stable net asset value, that although the issuer seeks to preserve the value of the investment at $1.00 per share or such other applicable fixed share price, it is possible to lose money by investing in the security.

(C) that includes performance data must include:

(1) a legend disclosing that the performance data included in the advertisement represents past performance; that past performance does not guarantee future results; that the investment return and the value of the investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost (provided that the disclosure with respect to investment value fluctuation is not required for municipal fund securities that the issuer holds out as having the characteristics of a money market fund and as maintaining a stable net

asset value); and that current performance may be lower or higher than the performance data included in the advertisement; and

(2) if a sales load or any other nonrecurring fee is charged, the maximum amount of the load or fee and, if the sales load or fee is not reflected in the performance data included in the advertisement, a statement that the performance data does not reflect the deduction of the sales load or fee and that the performance data would be lower if such load or fee were included.

(D) must present the statements required by clauses (A), (B) and (C) of this paragraph, when in a print advertisement, in a type size at least as large as and of a style different from, but at least as prominent as, that used in the major portion of the advertisement, provided that when performance data is presented in a type size smaller than that of the major portion of the advertisement, the statements required by clause (C) of this paragraph may appear in a type size no smaller than that of the performance data. If an advertisement is delivered through an electronic medium, the legibility requirements for the statements required by clauses (A), (B) and (C) of this paragraph relating to type size and style may be satisfied by presenting the statements in any manner reasonably calculated to draw investor attention to them. In a radio or television advertisement, the statements required by clauses (A), (B) and (C) of this paragraph must be given

emphasis equal to that used in the major portion of the advertisement. The statements required by clause (C) of this paragraph must be presented in close proximity to the performance data and, in a print advertisement, must be presented in the body of the advertisement and not in a footnote unless the performance data appears only in such footnote.

(ii) Performance data. Each advertisement that includes performance data relating to municipal fund securities must present performance data in the format, and calculated pursuant to the methods, prescribed in paragraph (d) of Securities Act Rule 482 (or, in the case of a municipal fund security that the issuer holds out as having the characteristics of a money market fund, paragraph (e) of Securities Act Rule 482), provided that:

(A) to the extent that information necessary to calculate performance data is not available from an applicable balance sheet included in a registration statement, or from a prospectus, the broker, dealer or municipal securities dealer shall use information derived from the issuer's official statement, otherwise made available by the issuer or its agents, or (when unavailable from the official statement, the issuer or the issuer's agents) derived from such other sources which the broker, dealer or municipal securities dealer reasonably believes are reliable;

(B) if the issuer first began issuing the municipal fund securities fewer than one, five, or ten years prior to the date of the submission of the advertisement for publication, such shorter period shall be substituted for any otherwise prescribed longer period in connection with the calculation of average annual total return or any similar returns;

(C) performance data shall be calculated as of the most recent calendar quarter ended prior to the submission of the advertisement for publication for which such performance data, or all information required for the calculation of such performance data, is available to the broker, dealer or municipal securities dealer as described in clause (A) of this paragraph;

(D) where such calculation is required to include expenses accrued under a plan adopted under Investment Company Act Rule 12b-1, the broker, dealer or municipal securities dealer shall include all such expenses as well as any expenses having the same characteristics as expenses under such a plan where such a plan is not required to be adopted under said Rule 12b-1 as a result of Section 2(b) of the Investment Company Act of 1940;

(E) in calculating tax-equivalent yields or after-tax returns, the broker, dealer or municipal securities dealer shall assume that any unreinvested distributions are used in the manner intended with respect to such municipal fund

securities in order to qualify for any federal tax-exemption or other federally tax-advantaged treatment with respect to such distributions, provided that:

(1) the advertisement must also provide a general description of how federal law intends that such distributions be used and disclose that such yield or return would be lower if distributions are not used in this manner; and

(2) if the then-effective federal income tax treatment upon which such yield or return was based is subject to lapse or other adverse change without extension or change of federal law, the advertisement must disclose this fact and that such yield or return would be lower if the then-effective federal income tax treatment is not extended or otherwise changed.

(F) notwithstanding any of the foregoing, this paragraph shall apply solely to the calculation of performance relating to municipal fund securities and does not apply to, or limit the applicability of any rule of the Commission, NASD or any other regulatory body relating to, the calculation of performance for any security held as an underlying asset of the municipal fund securities.

(iii) Nature of issuer and security. An advertisement for a specific municipal fund security must provide sufficient information to identify such specific security in a manner that is not false or misleading. An advertisement that identifies a specific municipal fund

security must include the name of the issuer (or the issuer's marketing name for its issuance of municipal fund securities, together with the state of the issuer), presented in a manner no less prominent than any other entity identified in the advertisement, and must not imply that a different entity is the issuer of the municipal fund security. An advertisement must not raise an inference that, because municipal fund securities are issued under a government-sponsored plan, investors are guaranteed against investment losses if no such guarantee exists. If an advertisement concerns a specific class or category of an issuer's municipal fund securities (e.g., A shares versus B shares; direct sale shares versus advisor shares; in-state shares versus national shares; etc.), this must clearly be disclosed in a manner no less prominent than the information provided with respect to such class or category.

(iv) Capacity of dealer and other parties. An advertisement that relates to or describes services provided with respect to municipal fund securities must clearly indicate the entity providing those services. If any person or entity other than the broker, dealer or municipal securities dealer is named in the advertisement, the advertisement must reflect any relationship between the broker, dealer or municipal securities dealer and such other person or entity. An advertisement soliciting purchases of municipal fund securities that would be effected by a broker, dealer or municipal securities dealer or any other entity other than the broker, dealer or municipal securities dealer that publishes the advertisement must identify which entity would effect the transaction, provided that the

advertisement may identify one or more such entities in general descriptive terms but must specifically name any such other entity if it is the issuer, an affiliate of the issuer, or an affiliate of the broker, dealer or municipal securities dealer that publishes the advertisement.

(v) Tax consequences and other features. Any discussion of tax implications or other benefits or features of investments in municipal fund securities included in an advertisement must not be false or misleading. In the case of an advertisement that includes statements regarding tax or other benefits offered in connection with such municipal fund securities or otherwise offered under state or federal law, the advertisement also must state that the availability of such tax or other benefits may be conditioned on meeting certain requirements. If the advertisement describes the nature of specific benefits, such advertisement must also briefly name the factors that may materially limit the availability of such benefits (such as residency, purpose for or timing of distributions, or other factors, as applicable). Such statements of conditions or limitations must be presented in close proximity to, and in a manner no less prominent than, the description of such benefits.

(vi) Underlying registered securities. If an advertisement for a municipal fund security provides specific details of a security held as an underlying asset of the municipal fund security, the details included in the advertisement relating to such underlying security must be presented in a manner that would be in compliance with any

Commission or NASD advertising rules that would be applicable if the advertisement related solely to such underlying security; provided that details of the underlying security must be accompanied by any further statements relating to such details as are necessary to ensure that the inclusion of such details does not cause the advertisement to be false or misleading with respect to the municipal fund securities advertised. This paragraph does not limit the applicability of any rule of the Commission, NASD or any other regulatory body relating to advertisements of securities other than municipal fund securities, including advertisements that contain information about such other securities together with information about municipal securities.

(f) [(e)] No change.

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the SEC, the MSRB included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The MSRB has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Rule G-21, on advertising, establishes standards for dealer advertisements relating to municipal securities. The MSRB has previously provided interpretive guidance to dealers

regarding the application of these standards to advertisements of municipal fund securities.[1] The proposed rule change amends Rule G-21 to establish specific standards applicable solely to dealer advertisements of municipal fund securities. In particular, the proposed rule change incorporates the advertising standards enunciated in the 2002 Notice into Rule G-21, with certain modifications. In addition, the proposed rule change includes specific requirements regarding the calculation and display of performance data for municipal fund securities in a manner consistent with Rule 482 adopted by the SEC under the Securities Act of 1933, as amended (the "Securities Act"), in connection with the advertisement of mutual fund performance. The proposed rule change also includes general disclosure requirements regarding municipal fund securities that are similar in most respects to generalized disclosures currently required for mutual fund advertisements under SEC rules.

General Disclosures

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1 *See* Rule G-21 Interpretation – Application of Fair Practice and Advertising Rules to Municipal Fund Securities, May 14, 2002, *reprinted in* MSRB Rule Book (the "2002 Notice"). The 2002 MSRB Notice also confirmed previous guidance on advertisements of municipal fund securities published in 2001. *See* Rule G-30 Interpretation – Interpretive Notice on Commissions and Other Charges, Advertisements and Official Statements Relating to Municipal Fund Securities, December 19, 2001, *reprinted in* MSRB Rule Book. Municipal fund securities are municipal securities issued by an issuer that, but for the application of Section 2(b) of the Investment Company Act of 1940, as amended (the "Investment Company Act"), would constitute an investment company within the meaning of the Investment Company Act. The most common forms of municipal fund securities sold by dealers consist of interests in trusts established by states as qualified tuition programs under Section 529 of the Internal Revenue Code of 1986, as amended ("529 college savings plans"), and interests in local government investment pools ("LGIPs").

The proposed rule change includes in clauses (A) and (B) of Rule G-21(e)(i) disclosure provisions modeled after SEC general disclosure requirements for mutual fund advertisements, with certain modifications. The modifications recognize the difference between the prospectus required for mutual funds and the official statement indirectly required for municipal fund securities under Rule 15c2-12 adopted by the SEC under the Securities Exchange Act of 1934, as amended (the "Exchange Act"),[2] as well as other differences in characteristics between municipal fund securities and mutual funds.

New section (e)(i)(A) of Rule G-21 requires that all dealer advertisements relating to municipal fund securities include generalized disclosure that: (1) advises investors to consider the investment objectives, risks, and charges and expenses associated with municipal fund securities before investing; (2) explains that more information about municipal fund securities is available in the issuer's official statement; (3) if the advertisement identifies a source from which an investor

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[2] SEC Rule 15c2-12 provides, among other things, that the underwriter for most primary offerings of municipal securities must obtain and review the issuer's near-final official statement before purchasing or offering the securities, contract with the issuer to receive copies of the final official statement within specified timeframes after the final agreement to purchase or offer the securities, and distribute copies of the official statement to potential customers upon request. For purposes of the rule, 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. A final official statement need not contain each item of information required to be included in a prospectus under the Securities Act.

may obtain an official statement and the dealer that publishes the advertisement is the underwriter for the municipal fund securities for which such official statement may be supplied, states that such dealer is the underwriter for such municipal fund securities; and (4) states that the official statement should be read carefully before investing. The disclosures required in clauses (1), (2) and (4) of Rule G-21(e)(i)(A) are substantially similar to the analogous disclosures required under section (b)(1)(i) of SEC Rule 482 in connection with a mutual fund advertisement that would be considered a prospectus under the Securities Act. The disclosure required in clause (3) of Rule G-21(e)(i)(A) is substantially similar to the analogous disclosure required under section (b) of Rule 135a adopted by the SEC under the Securities Act in connection with generic mutual fund advertisements.

New section (e)(i)(B) of Rule G-21 requires that all dealer advertisements that refer by name (including marketing name) to any municipal fund security, issuer of municipal fund securities, governmental entity that sponsors the issuance of municipal fund securities, or to any securities held as assets of municipal fund securities or to any issuer of such securities held as assets, must include additional disclosure that: (1) identifies a source from which an investor may obtain an official statement; (2) if the advertisement relates to municipal fund securities issued through a 529 college savings plan, advises an investor to consider, before investing, whether the investor's or designated beneficiary's home state offers any state tax or other benefits that are only available for investments in such state's 529 college savings plan; and (3) if the advertisement is for a municipal fund security that the issuer holds out as having the

characteristics of a money market fund, states that an investment in the security is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency (unless such guarantee is provided by or on behalf of such issuer) and that, if the security is held out as maintaining a stable net asset value, although the issuer seeks to preserve the value of the investment at a fixed share price, it is possible to lose money by investing in the security. The disclosure required in clause (1) of Rule G-21(e)(i)(B) is substantially similar to the analogous disclosure required under section (b)(1)(i) of SEC Rule 482. The disclosure required in clause (3) of Rule G-21(e)(i)(B) is substantially similar to the analogous disclosure required under section (b)(4) of SEC Rule 482. The disclosure required in clause (2) of Rule G-21(e)(i)(B) is not derived from SEC mutual fund advertising rules but is analogous to the point-of-sale disclosure obligation under Rule G-17 described in the 2002 Notice.[3]

New section (e)(i)(D) of Rule G-21 requires that these general disclosures be presented in the same format required under SEC Rule 482.

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[3] The specific disclosure required in the proposed rule change is somewhat broader than that currently required under the point-of-sale disclosure obligation described in the 2002 Notice. The MSRB expects to file with the SEC in the near future a proposed rule change that expands this point-of-sale disclosure requirement under Rule G-17 to also reference the possible existence of other non-tax state benefits. *See* MSRB Notice 2004-16 (June 10, 2004).

Historical Performance Data

The proposed rule change establishes in new section (e)(ii) of Rule G-21 specific requirements with respect to the inclusion of performance data in municipal fund security advertisements.

Calculation and Display of Performance Data. Under the proposed rule change, such advertisements must comply with the method of computing and displaying performance data for mutual funds as prescribed in section (d) or (e) of SEC Rule 482, with certain modifications described below. In effect, for municipal fund securities other than those that are held out by the issuer as having the characteristics of a money market fund, quotations of performance in an advertisement are limited to the average annual total return, current yield (but only if accompanied by average annual total return), tax-equivalent yield (but only if accompanied by average annual total return and current yield), after-tax return (but only if accompanied by average annual total return), or other non-prescribed performance measures (but only if accompanied by average annual total return and, if adjusted to reflect the effects of taxes, after-tax return), as provided in SEC Rule 482(d). In the case of municipal fund securities that are held out by the issuer as having the characteristics of a money market fund, quotations of performance in an advertisement are limited to the current yield, effective yield (but only if accompanied by current yield), tax-equivalent yield or tax-equivalent effective yield

(but only if accompanied by current yield), or total return (but only if accompanied by current yield), as provided in SEC Rule 482(e).[4]

Clauses (A) through (E) of Rule G-21(e)(ii) modify the basic performance data calculation methods established for mutual funds to reflect the fact that certain items of information that exist in the mutual fund industry – such as the registration statement and the specific items of information required to be disclosed in the prospectus and statement of additional information – do not exist for municipal fund securities, as well as to reflect other differences in characteristics between municipal fund securities and mutual funds. Thus, Rule G-21(e)(ii) provides that: (A) a dealer can use information provided in the issuer's official statement, otherwise made available by the issuer, or otherwise obtained from other reliable sources to calculate performance to the extent such information is not available from a balance sheet in a registration statement or from a prospectus; (B) the life of a municipal fund securities issue should be measured from when the issuer first issues the securities; (C) performance data in advertisements must be calculated as of the most recent calendar quarter ended prior to the submission of the advertisement for publication for which such performance data, or all

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[4] SEC Rule 482 incorporates the calculation methods set forth in Forms N-1, N-3 and N-4 for purposes of calculating the various types of quotations described in the rule. These methods are also incorporated into Rule G-21(e)(ii).

information required for the calculation of such performance data, is available to the dealer;[5] (D) expenses having the same characteristics as those permitted to be paid under Rule 12b-1 adopted by the SEC under the Investment Company Act but not technically accrued under a 12b-1 plan must be treated as 12b-1 expenses for purposes of calculating performance;[6] and (E) in calculating tax-equivalent yields or after-tax returns, the dealer shall assume that any unreinvested distributions are used in a manner that qualifies for any federal tax-exemption or other federally tax-advantaged treatment with respect to such distributions, provided that: (1) the advertisement also provides a general description of how federal law intends such distributions be used and discloses that such yield or return would be lower if distributions are not used in this manner; and (2) if the federal income tax treatment upon which such yield or return is based is subject to lapse or other adverse change without extension or change of federal law, the advertisement must disclose this fact and that such yield or return would be lower if the federal income tax treatment is not extended or otherwise change.

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5 As noted in footnote 12 and accompanying text, *infra*, the MSRB is publishing for comment concurrent with this filing a draft amendment that would modify this clause (C).

6 Thus, asset-based charges paid to the program manager or investment advisor, to the issuer or its agents, or to any other party generally are to be treated as 12b-1 expenses for purposes of calculating performance even if any such charges may not technically be paid under a formal 12b-1 plan. In addition, any 12b-1 expenses incurred in connection with underlying assets of the municipal fund securities also must be treated as 12b-1 expenses of the municipal fund securities to the extent that such expenses are not waived or not included within the asset-based charges described in the preceding sentence.

Performance data included in municipal fund security advertisements are required to be displayed in the manner provided in section (d) or (e) of SEC Rule 482, as appropriate, with respect to prominence and positioning of information.

Disclosures Accompanying Performance Data. New Section (e)(i)(C) of Rule G-21 requires that advertisements that include performance data for municipal fund securities also include certain related legends and disclosures modeled after those required under SEC Rule 482 for mutual funds advertisements that display performance information. These disclosures emphasize that the performance data is historical and does not guarantee future results, that the value of holdings is subject to fluctuation (except where the municipal fund security is held out as having the characteristics of a money market fund and as maintaining a stable net asset value), and that current performance may be different from the performance data included in the advertisement.[7] Advertisements containing performance data also are required to include the maximum amount of any sales load or other nonrecurring fee and, if such load or fee is not reflected in the performance data, to disclose that the load or fee is not so reflected and that performance would be lower if it had been reflected. These nonrecurring fees that are subject to disclosure include such fees imposed not only by the dealer but also by the issuer or any other party to the issuance of the municipal fund securities or the maintenance of investments therein.

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[7] As noted in footnote 12 and accompanying text, *infra*, the MSRB is publishing for comment concurrent with this filing a draft amendment that would modify this provision.

New Section (e)(i)(D) requires that these legends and disclosures be presented in the same format required under SEC Rule 482.

Additional Requirements

The proposed rule change includes in new paragraphs (iii) through (vi) of Rule G-21(e) additional requirements with respect to municipal fund security advertisements, based largely on interpretive guidance provided in the 2002 Notice.

Nature of Issuer and Security. New paragraph (iii) requires that an advertisement: (1) for a specific municipal fund security provide sufficient information to identify the security in a manner that is not false or misleading; (2) that identifies a specific municipal fund security include the name of the issuer (or its marketing name, including state), presented in a manner no less prominent than any other entity identified in the advertisement, and not imply that a different entity is the issuer; (3) not raise an inference that, because municipal fund securities are issued under a government-sponsored plan, investors are guaranteed against investment losses if no such guarantee exists; and (4) that concerns a specific class or category municipal fund securities (*e.g.*, A shares versus B shares; direct sale shares versus advisor shares; in-state shares versus national shares; etc.) clearly disclose this fact in a manner no less prominent than the information provided with respect to such class or category.

Capacity of Dealer and Other Parties. New paragraph (iv) requires an advertisement about services provided with respect to municipal fund securities to clearly indicate the entity providing such services. If any person or entity other than the dealer is named

in the advertisement, it must reflect any relationship between the dealer and such other person or entity. An advertisement soliciting purchases that would be effected by any party other than the dealer that publishes the advertisement (*i.e.*, the issuer or another dealer) must identify which entity would effect the transaction, provided that it may identify one or more such entities in general descriptive terms but must specifically name any such other entity if it is the issuer, an affiliate of the issuer, or an affiliate of the dealer that publishes the advertisement.

Tax Consequences and Other Features. New paragraph (v) requires that any discussion of tax implications or other benefits or features of investments in municipal fund securities included in an advertisement not be false or misleading. If an advertisement includes statements regarding tax or other benefits offered in connection with such municipal fund securities or otherwise offered under state or federal law, it must also state that the availability of such tax or other benefits may be conditioned on meeting certain requirements. If the advertisement describes the nature of specific benefits, such advertisement must also briefly name the factors that may materially limit the availability of such benefits (such as residency, purpose for or timing of distributions, or other factors, as applicable).[8] Such statements of conditions or limitations must be presented in close proximity to, and in a manner no less prominent than, the description of such benefits.

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[8] For example, if an advertisement notes that investors in a particular 529 college savings plan may qualify for scholarships or matching grants, it may also need to state that such scholarships or matching grants are available only for attendance at in-state colleges or to in-state investors, if that is in fact the case.

Underlying Registered Securities. New paragraph (vi) requires that, if an advertisement for a municipal fund security provides specific details of a security held as an underlying asset of the municipal fund security, the details included in the advertisement relating to such underlying security be presented in a manner that would be in compliance with any SEC or NASD advertising rules that would be applicable if the advertisement related solely to such underlying security. Details of the underlying security included in the advertisement must be accompanied by any further statements necessary to ensure that the inclusion of such details does not cause the advertisement to be false or misleading with respect to the municipal fund securities advertised. This provision does not limit the applicability of any rule of the SEC, NASD or any other regulatory body relating to advertisements of securities other than municipal fund securities, including advertisements that contain information about such other securities together with information about municipal fund securities.

Exemption from New Issue Price/Yield Requirement

The proposed rule change exempts municipal fund security advertisements from the provision of Rule G-21(d) relating to advertisements of initial reoffering prices or yields of new issue municipal securities. This provision is designed for advertisements by underwriting syndicates for municipal debt offerings and does not deal with matters relevant to municipal fund securities.

(b) The MSRB believes that the proposed rule change is consistent with Section 15B(b)(2)(C) of the Exchange Act, which provides that the MSRB's rules shall:

> be 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 believes that the proposed rule change is consistent with the Exchange Act because it will further investor protection by raising the standards for advertisements of municipal fund securities and by making information provided in such advertisements comparable for different municipal fund securities investments and between municipal fund securities and registered mutual funds.

B. Self-Regulatory Organization's Statement on Burden on Competition

The MSRB does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act since it would apply equally to all dealers.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

On June 10, 2004, the MSRB published for comment draft rule changes to Rule G-21 with respect to advertisements of municipal fund securities.[9] The MSRB received eight

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[9] *See* MSRB Notice 2004-16 (June 10, 2004).

comment letters.[10] After reviewing these comments, the MSRB approved the draft amendments, with certain modifications, for filing with the SEC. The comments and modifications to the draft amendments are discussed below.

General Disclosures

Summary of Draft Amendment. Draft Rule G-21(e)(i)(A) would require dealer advertisements of municipal fund securities to include generalized disclosure to the effect that investors should consider the securities' investment objectives, risks and charges before investing; that more information about the securities is available in the issuer's official statement;

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[10] Letter from Kenneth B. Roberts, Hawkins Delafield & Wood LLP ("Hawkins"), to Ernesto A. Lanza, Senior Associate General Counsel, MSRB, dated August 20, 2004; letter from Mary L. Schapiro, Vice Chairman, NASD, and President, Regulatory Policy and Oversight, to Ernesto A. Lanza, dated September 9, 2004; letter from Tamara K. Salmon, Senior Associate Counsel, Investment Company Institute ("ICI"), to Ernesto A. Lanza, dated September 10, 2004; letter from David J. Pearlman, College Savings Foundation ("CSF"), to Ernesto A. Lanza, dated September 13, 2004; letter from Elizabeth L. Bordowitz, General Counsel, Finance Authority of Maine ("FAME"), to Ernesto A. Lanza, dated September 13, 2004; letter from Diana F. Cantor, Chair, College Savings Plan Network ("CSPN"), and Executive Director, Virginia College Savings Plan, to Ernesto A. Lanza, dated September 15, 2004; letter from Elizabeth Varley and Michael D. Udoff, Co-Staff Advisers, Securities Industry Association ("SIA") Ad Hoc 529 Plans Committee, to Ernesto A. Lanza, dated September 15, 2004; and letter from Raquel Alexander, PhD, Assistant Professor, and LeAnn Luna, PhD, Assistant Professor, University of North Carolina at Wilmington, to Ernesto A. Lanza, dated September 15, 2004. Most commentators also provided comments on the proposed modification to the MSRB's existing point-of-sale disclosure obligation relating to sales of out-of-state 529 college savings plans, as described in the June notice. The MSRB expects to file with the SEC in the near future a proposed rule change that expands this point-of-sale disclosure requirement under Rule G-17 to also reference the possible existence of other non-tax state benefits. The MSRB will address comments on this subject at that time.

identifies where an official statement can be obtained; and states that the official statement should be read carefully before investing. Advertisements of 529 college savings plans also must advise investors to consider whether their home states offer state tax or other benefits only available for investments in the in-state plans. Further, advertisements for municipal fund securities that are marketed as money market securities would be required to disclose that investments are not insured and, if marketed as maintaining a stable net asset value, it is still possible to lose money. These disclosures would be required to be given emphasis equal to that used in the major portion of the advertisement. In addition, the MSRB sought comment on whether the rule should require that dealers that advertise 529 college savings plans include in their generalized disclosure language the URL of an MSRB-maintained web site where investors can obtain general information about the 529 college savings plan market.

Discussion of Comments. Commentators generally supported the proposed general disclosures, with several providing suggested changes.

- ***State tax and other benefits –*** Three commentators representative of, or generally acting on behalf of, state issuers suggested modifications to the language relating to the potential benefits of investing in an in-state plan. CSPN and FAME stated that the proposed language should reflect that some benefits may be dependent on the designated beneficiary's home state (rather than or in addition to the home state of the investor). Hawkins suggested that if a state's 529 college savings plan is offered solely within that state and an advertisement of

such plan is distributed solely within such state, the advertisement should be exempted from the proposed disclosure regarding potential benefits of investing in an in-state plan.

The MSRB agrees that the general disclosure language in Rule G-21(e)(i)(B)(2) should be modified to include reference to the designated beneficiary when discussing the benefits of in-state investments. However, the MSRB does not believe that the additional changes suggested by the commentators should be made. The MSRB believes that disclosure of potential in-state benefits should apply to all 529 college savings plan advertisements, even if the advertisement for a 529 college savings plan offered solely within a particular state is distributed solely within that state, as this would ensure uniform practices and avoid sometimes difficult factual determinations.

- ***Advertisements with limited information*** – Several commentators (CSF, CSPN, FAME and SIA) suggested that the proposed amendments permit an abbreviated form of the general disclosures for purposes of radio and television advertisements in view of the limited amount of time available in such advertisements to provide all required information. SIA argued that the requirement that equal prominence be given to the general disclosures would result in the advertisement's intended message being lost. CSF stated that the practical consequence of this requirement would quite possibly be that there would be no more radio or television advertisements of 529 college savings plans by dealers. CSF and SIA suggested that a broadcast advertisement that merely presents the dealer's name and address, the name of the 529 college savings plan and the name of the sponsoring state be permitted to substitute an

abbreviated reference to the official statement for further information. SIA further suggested that such a broadcast advertisement urge the investor to read the official statement carefully before investing and state how an investor may obtain the official statement.

The MSRB notes that SEC Rule 135a effectively permits the use of certain types of mutual fund advertisements containing very limited information without including the disclosures required under SEC Rule 482. SEC Rule 135a covers advertisements that include no more than explanatory information relating to mutual funds generally and/or to specific categories of mutual funds, as well as an invitation to inquire for further information. Such advertisements must contain the name and address of the dealer sponsoring the advertisement and whether the dealer is the principal underwriter of any mutual fund with respect to which information will be sent to any investor who asks for more information. However, such advertisements must not specifically refer by name to any mutual fund or fund family.

The suggestion of CSF and SIA would provide for including the name of the 529 college savings plan and its sponsoring state, unlike under SEC Rule 135a. However, their proposal would provide for retaining certain of the general disclosures of the proposal that are not otherwise required under SEC Rule 135a. The MSRB believes that the general disclosure provision should be modified to permit more abbreviated general disclosures, set forth in Rule G-21(e)(i)(A), where an advertisement does not refer by name (including marketing name) to any specific municipal fund security, issuer of municipal fund securities or state or other governmental entity that sponsors the issuance of municipal fund securities, or to any securities

held as assets of municipal fund securities or to any issuer of such securities held as assets. Such disclosures would be limited to statements advising investors to consider the investment objectives, risks and charges of municipal fund securities before investing; that more information about municipal fund securities is available in the issuer's official statement; and that the official statement should be read carefully before investing. Because these disclosures would be considerably shorter than otherwise required, the MSRB does not believe that the equal prominence requirement for such statements should be changed. Further, the MSRB does not believe that dealers should be permitted to identify a specific product in advertisements where only these more abbreviated general disclosures are provided. Any advertisement that specifically identifies a product must also include the general disclosures set forth in Rule G-21(e)(i)(B), as applicable.

- ***Reference to MSRB web site –*** Most commentators stated that the MSRB should not require that 529 college savings plan advertisements include reference to an MSRB-maintained web site on 529 college savings plans, and no commentator supported such a requirement. The MSRB will take no further action with respect to such proposal at this time. However, the MSRB will continue to maintain and update its existing web pages, at http://www.msrb.org/msrb1/mfs, that provide generalized information about municipal fund securities.

- ***Applicability to LGIPs –*** Hawkins suggested that the general disclosure provisions be made inapplicable to advertisements of LGIPs, arguing that the required

references to the official statement are inappropriate because official statements are not typically prepared for LGIPs. The MSRB understands that most LGIPs do in fact prepare official statements (often referred to as information statements), and dealers marketing LGIPs generally are subject to SEC Rule 15c2-12. Therefore, the MSRB has not exempted dealer advertisements of LGIPs from the rule requirements.

Performance Data

Summary of Proposal. Draft Rule G-21(e)(ii) would require advertisements that include performance data to comply with the method of computing and displaying mutual fund performance data provided under SEC Rule 482, with certain modifications. Among other things, the draft amendment would require that performance data shown in an advertisement be calculated as of the most recent calendar quarter for which such data, or all information required to calculate such performance data, is reasonably available to the dealer. SEC Rule 482 requires that such data be shown in mutual fund advertisements as of the most recent calendar quarter but does not make the determination of which calendar quarter is the most recent dependent upon the availability of such data.

In addition, draft Rule G-21(e)(i) would require certain related disclosures for municipal fund securities advertisements that contain performance data. The disclosures emphasize that the performance information is historical and does not guarantee future results, the value of holdings is subject to fluctuation, and current performance may be lower or higher than the performance quoted. Advertisements containing performance data also would be required to

include basic information about sales loads and other nonrecurring fees and note the impact of such loads or fees on performance as shown. The disclosures must be given emphasis equal to that of the performance data itself. These disclosures are required under SEC Rule 482 in mutual funds advertisements that display performance information.

Discussion of Comments. Commentators generally supported the proposed performance data calculation methods and related legends and disclosures, with several providing suggested changes.

- ***Most recent quarterly performance data –*** NASD stated that the difference in the language regarding the timing of quarterly data used in Rule G-21 as compared to the language used in SEC Rule 482 "appears to give dealers latitude" that "may undermine the ability of investors to compare different municipal fund securities programs, or even the same program offered by different dealers who impose varying end dates for their performance calculation. At a minimum, the disparity between the language in Rule 482 and the MSRB's proposal would create confusion for broker-dealers that must comply with both provisions."

The language used in the draft amendment was not designed to give dealers latitude in deciding which timeframes to include in advertisements, nor would it normally lead to a different result under the draft rule as compared to SEC Rule 482.[11] Rather, the language reflects the

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[11] The MSRB notes that SEC Rule 482(g) provides a basic timeliness standard based on the "most recent practicable date considering the type of investment company and the media through which data will be conveyed" that also could be viewed as giving some latitude in deciding which timeframes to include in advertisements.

MSRB's recognition that its rulemaking should not be used to indirectly regulate state issuers in structuring their programs and that a state's structure might result in making compliance with the specific language of Rule 482 impossible without forcing a change in the structure. However, to mitigate the possibility of unintended ambiguity and possible inconsistent application of the rule between different dealers, the MSRB has modified the language of Rule G-21(e)(ii)(C) to provide that calculations must be made as of the most recent quarter for which necessary information is available, rather than when such information is *reasonably* available. Dealers wishing to advertise performance would be tasked with taking all appropriate actions necessary to obtain information that is in fact available for purposes of such calculation.

- ***Most recent month-end performance data –*** ICI and NASD suggested that the MSRB add a requirement that dealers include in municipal fund security advertisements that contain performance data a phone number or web address where investors may obtain performance data current to the most recent month-end. They stated that this would make the MSRB's advertising rule consistent with the similar requirement established under SEC Rule 482. Rule 482 requires that mutual fund advertisements that show performance data also include a phone number or web site address at which performance data may be obtained that is current to the most recent month, available no later than seven business days after the end of the month. This requirement was not included in draft Rule G-21(e). Concurrent with the filing of this proposed rule change, the MSRB is publishing for industry comment a draft amendment to Rule G-21 that would require inclusion in dealer advertisements that contain performance data

for municipal fund securities of a phone number or web address where investors may obtain performance data current to the most recent month-end.[12]

- ***Affect of federal tax treatment of 529 plans –*** The MSRB sought comment on whether the methods of calculating performance provided under SEC Rule 482, as modified by the draft amendments, were appropriate for municipal fund securities. ICI stated that "the proposed modifications satisfactorily address any disparities that should be taken into account in incorporating the provisions of Rule 482 into Rule G-21." CSPN and FAME strongly supported the effort to develop a uniform method of calculating performance. They suggested that the MSRB establish basic assumptions that 529 college savings plan distributions will be used in a manner that would preserve their tax-exempt nature (with a footnote to the effect that after-tax returns would differ if current law sunsets). In addition, they suggested that after-tax returns should not be required to be shown for 529 college savings plan advertisements since such investments are intended to be tax-exempt.

The MSRB does not believe that such assumptions about the tax-exempt nature of 529 college savings plan investments should apply for all purposes of calculating performance. Thus, the baseline total return calculation would continue to ignore all tax effects. However, in calculating tax-equivalent yields or after-tax returns, the MSRB believes it is appropriate to assume that unreinvested distributions are used for purposes that would maintain any intended

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12 *See* MSRB Notice 2004-43 (December 16, 2004).

federal tax benefit, as set forth in Rule G-21(e)(ii)(E). Such assumption would require that the advertisement include a general description of how federal law intends that such distributions be used to maintain the favorable tax treatment and a disclosure that the tax-equivalent yield or after-tax return would be lower if distributions are not used in such manner. In addition, if the favorable tax treatment is subject to lapse or other adverse change without extension or other change of law, the advertisement must disclose this fact and that such yield or return would be lower if the favorable tax treatment is not extended or otherwise changed.

Further, the MSRB does not believe that the provision requiring the inclusion of after tax-return should be eliminated. The only circumstance in which a dealer would be required to show after-tax return is if the advertisement also includes a performance measure that is adjusted to reflect the effect of taxes (*e.g.*, a tax equivalent return intended to show how the tax benefits of investing in 529 college savings plans compares to other fully taxable investments). Under this circumstance, it is appropriate that the advertisement also include performance that does not include such adjustment.

Additional Requirements

Draft Rule G-21 would incorporate, with certain modifications, several existing interpretive positions from the 2002 Notice. Commentators generally supported the incorporation of these positions into the rule, with several providing suggested changes.

- ***Nature of Issuer and Security*** **–** Draft Rule 21(e)(iii) would require, among other things, that an advertisement that identifies a specific municipal fund security include the

name of the issuer presented in a manner no less prominent than any other entity identified in the advertisement.

CSF argued that, in some cases, providing the name of the legal issuer in connection with 529 college savings plan securities may not help consumers understand the nature of the issuer and may result in confusion since the legal issuer may be an obscure state trust. CSF suggested that it would be more helpful to identify the 529 college savings plan by marketing name, together with the name of the state that establishes and maintains the plan. CSF also suggested that dealers be permitted to include the marketing logo, rather than a logo of the legal issuer, in advertisements, which logo should appear at least as prominently as the dealer's logo. SIA stated that the requirement that the issuer's name be given equal prominence to that of the dealer is unnecessary and subject to second guessing. SIA argued that the policy objective of the proposed rule, which is to prevent investor confusion as to who the issuer of the security is, is satisfied by the other requirements set forth in this section that the issuer be identified and that the advertisement not imply that another entity is the issuer of the security.

The MSRB believes that it is appropriate to permit dealers to use the marketing name and state of a 529 college savings plan in substitution for the legal name of the issuer. However, the MSRB does not agree that such issuer information should be permitted to be presented in a manner that is less prominent than any other entity identified in the advertisement. This provision would also permit the use of the 529 college savings plans logo, so long as such logo is

presented in a manner no less prominent than any other entity's logo included in the advertisement.

- ***Capacity of Dealer and Other Parties –*** Draft Rule 21(e)(iv) would require an advertisement that relates to or describes services provided with respect to municipal fund securities to clearly indicate the entity providing such services. In addition, an advertisement soliciting purchases of municipal fund securities that would be effected by any party other than the dealer that publishes the advertisement (*i.e.*, the issuer or another dealer) must clearly state which entity would effect the transaction.

CSF and SIA argued that many 529 college savings plans are marketed through hundreds of dealers and it would be extremely difficult if not impossible for a primary distributor to list in its advertisement all such dealers. CSF suggested that only dealers that are affiliates of the dealer publishing the advertisement and, if applicable, the issuer itself be required to be identified by name in such advertisements. NASD stated that this provision resembles, but is not identical to, NASD Rule 2210(d)(2)(C), which generally requires that all sales material prominently disclose the name of the member and, if it includes other names, reflect which products or services are being offered by the member.

It was not the intent of the original proposal to require that a primary distributor list its many hundreds of selling dealers used in the 529 college savings plan's distribution channels. The MSRB has modified this provision so that the only parties effecting transactions in municipal fund securities that must be specifically named in an advertisement are the dealer publishing the

advertisement, any other dealer affiliated with such dealer and the issuer, as applicable. In addition, the rule language has been revised to more closely track the NASD requirement that, if any parties other than the dealer is named in a municipal fund securities advertisement, the products or services offered by such parties in connection with such municipal fund securities must be stated.

- ***Tax Consequences and Other Features –*** Draft Rule 21(e)(v) would require, among other things, that an advertisement that includes statements regarding tax or other benefits offered under state or federal law must make clear the nature of such benefits and that the availability of such benefits may be materially limited based upon residency, purpose for or timing of share redemptions, or other factors, as applicable. These limitations would be required to be described in the advertisement in close proximity to, and in a manner no less prominent than, the description of such benefits.

CSF argued that state tax treatment of 529 college savings plans is extremely complex and that not all variations in state treatment will be a benefit to in-state investors. It suggested that the reference in the rule language to "state tax or other benefits" should be changed to "different state tax or other consequences." CSF also expressed concern over the proposal's requirement that an advertisement that includes information about tax or other state benefits must "make clear the nature of such benefits." CSF stated:

> If all that would be required is a general statement that tax and other benefits may be available only through the home-state program, the guidance should so state…. If a laundry list of all potential aspects of differing treatment is required, we are concerned that such a list could not practically be updated to account

for all new state laws, and that even if it could, space limitations would make it impractical or impossible to achieve compliance.

CSPN and Hawkins stated that only general statements of limitation are appropriate where an advertisement contains only general statements of benefits, so long as the investor is directed to the official statement for additional information. Hawkins suggested that the proposed rule language appears to require dealer advertisements that refer in any manner to tax or other benefits to include a detailed description of the nature of, and of limitations applicable to receipt of, such benefits. Hawkins argued that it may be impractical to include such a detailed description within most advertisements without resulting in potentially misleading or incomplete statements.

FAME suggested certain changes to terminology in this provision, stating that references to "shares" are not appropriate for many 529 college savings plans. In addition, CSPN and FAME stated that some state benefits may not be specifically provided for under state law but are created by state entities under general grants of authority.

The MSRB has modified the rule language to more narrowly focus the types of disclosures that would be required to be made in an advertisement that includes descriptions of tax or other beneficial features offered under state or federal law in connection with an investment in municipal fund securities. Thus, the modified language would make clear that general statements regarding the existence of beneficial features would not require an extensive listing of all such features but would require general disclosure that such features may be subject

to limitations. However, as the information about tax matters becomes more detailed, the rule would require comparably detailed discussion of potential limitations. However, the reference to "benefits" has not been eliminated from the rule. The rule already addresses the broader concept of "tax implications" but is also specifically aimed at ensuring that the "hyping" of beneficial treatment is tempered by an equally prominent discussion of potential limitations. Further, certain limited modifications have been made to the rule language to address the concerns regarding use of the term "shares" and reference to benefits provided under state law.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

The MSRB proposes an effective date for the proposed rule change of the first calendar day of the month beginning 90 or more calendar days after SEC approval. Within 35 days of the publication of this notice in the Federal Register or within such longer period (i) as the SEC may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the SEC will:

(A) by order approve the proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning

the foregoing, including whether the proposed rule change is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the SEC Internet comment form (http://www.sec.gov/rules/sro.shtml) or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-2004-09 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-2004-09. This file number should be included on the subject line if e-mail is used. To help the SEC process and review your comments more efficiently, please use only one method. The SEC will post all comments on the SEC's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the SEC, and all written communications relating to the proposed rule change between the SEC and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the SEC's Public Reference Room, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the MSRB's principal office. All comments received will be posted without change; the SEC does not edit personal identifying

information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-MSRB-2004-09 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the SEC by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Jonathan G. Katz
Secretary

EXHIBIT 2

MSRB Notice 2004-16
(June 10, 2004)

Request for Comments on Draft Amendments Relating to Advertisements of Municipal Fund Securities and Draft Interpretive Guidance on Disclosures in Connection with Out-of-State Sales of College Savings Plan Shares

The Municipal Securities Rulemaking Board ("MSRB") has established a number of specific interpretive standards under its advertising rule, Rule G-21, in connection with advertisements used or produced by brokers, dealers and municipal securities dealers ("dealers") relating to municipal fund securities, including in particular advertisements for college savings plans.[1] In addition, the MSRB has provided interpretive guidance regarding dealers' point-of-sale disclosure obligations under the MSRB's basic fair practice rule, Rule G-17, as such obligations apply to the marketing of shares of a state's college savings plan to individuals who are residents of a different state. These and other MSRB rules and interpretive positions are designed, among other purposes, to ensure that material information on the municipal fund securities market (particularly the rapidly evolving and growing college savings plan market) is made available in a meaningful and accurate manner to customers who invest in municipal fund securities through dealers.[2]

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1 Municipal fund securities are defined in Rule D-12 as municipal securities issued by an issuer that, but for the application of Section 2(b) of the Investment Company Act of 1940, would constitute an investment company under the 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. There are two principal forms of municipal fund securities that are marketed by dealers: (i) interests or shares in college savings plans, which are established by states under Section 529(b)(A)(ii) of the Internal Revenue Code of 1986 as "qualified tuition programs" through which individuals make investments for the purpose of accumulating savings for qualifying higher education costs of beneficiaries; and (ii) interests or shares in local government investment pools, which are established by state or local governments as vehicles for the pooled investment of public moneys of participating governmental entities. So-called "pre-paid tuition plans" established by states or higher education institutions under Section 529(b)(A)(i) of the Internal Revenue Code generally are not considered municipal fund securities.

2 Many municipal fund securities are marketed directly to customers by issuer personnel, rather than through dealers. Since the MSRB's rulemaking authority under Section 15B of the Securities Exchange Act of 1934 is limited to dealer transactions in municipal

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In furtherance of the MSRB's statutory mandate to protect investors and the public interest, the MSRB is publishing for industry comment draft amendments to Rule G-21 that would: (i) require that performance data included in advertisements for municipal fund securities be calculated and displayed, together with related legends and disclosures, in the manner required under Securities Act Rule 482 adopted by the Securities and Exchange Commission ("SEC") in connection with mutual fund advertisements, with certain modifications; (ii) require that all advertisements for municipal fund securities include general disclosure language based in part on a similar requirement in SEC Rule 482, with additional language in the case of college savings plan advertisements relating to benefits available solely to state residents; and (iii) incorporate into the rule language the MSRB's previously enunciated interpretive standards, with certain modifications. Furthermore, the MSRB is publishing for industry comment draft interpretive guidance under Rule G-17 that would broaden the existing point-of-sale disclosure obligation relating to out-of-state investments in college savings plans to include disclosures regarding the potential loss of other state benefits (in addition to tax benefits) that may be offered to individuals who invest in their home state college savings plans. The draft amendments and draft interpretive guidance are described more fully below. Comments are due by September 15, 2004.

DRAFT AMENDMENTS TO RULE G-21, ON ADVERTISING

Rule G-21 establishes general ethical standards for dealer advertisements. Under section (b) of the rule, a dealer is prohibited from publishing any advertisement concerning its facilities, services or skills with respect to municipal securities that is materially false or misleading. In addition, a dealer is prohibited under section (c) of the rule from publishing any advertisement concerning municipal securities that it knows or has reason to know is materially false or misleading.[3] Rule G-21 generally does not require that any specific statements or information be included in an advertisement but does require that any statement or information that is included not be materially false or misleading.[4] Advertisements are defined broadly under the rule and

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securities, MSRB rules do not apply to issuers or their personnel who market municipal fund securities directly to customers.

[3] The rule also establishes standards for advertising initial reoffering prices or yields of new issue municipal securities under section (d). This provision is designed for advertisements by underwriting syndicates for municipal debt offerings and does not deal with matters relevant to the municipal fund securities markets. The draft amendments would explicitly exempt municipal fund security advertisements from this provision.

[4] For example, if a dealer makes a statement in an advertisement that explicitly or implicitly refers to a particular feature of a security (*e.g.*, the soundness or safety of an investment in the security), the dealer must include any information necessary to ensure

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generally consist of any materials published or designed for use in the public, including electronic (*e.g.*, Internet web sites, form e-mail messages, scripted telemarketing calls, fax broadcasts), media (*e.g.*, print, television, radio) or promotional literature designed for dissemination to the public, such as notices, circulars, reports, market letters, form letters, telemarketing scripts or reprints or excerpts of the foregoing. However, issuer-prepared disclosure materials such as program disclosure documents produced in connection with college savings plans or information statements produced in connection with local government investment pools are not considered advertisements for purposes of Rule G-21.[5]

In an interpretive notice published in 2002 (the "2002 MSRB Notice"), the MSRB established specific standards for inclusion of certain types of information in municipal fund security advertisements, with emphasis on college savings plan advertisements.[6] Today, the MSRB is proposing draft amendments to Rule G-21 that would incorporate the advertising standards enunciated in the 2002 MSRB Notice, with certain modifications described below. The standards from the 2002 MSRB Notice would be supplemented by specific requirements regarding the calculation and display of performance data in advertisements in a manner consistent with SEC Rule 482. In addition, the draft amendments would include general disclosure requirements regarding municipal fund securities that are similar in most respects to generalized disclosures currently required for mutual fund advertisements under SEC Rule 482. The draft amendments are included at the end of this notice. If the draft amendments are adopted, the MSRB would expect to withdraw the portions of the 2002 MSRB Notice relating to advertisements. The MSRB seeks comments on all aspects of the draft amendments.

Historical Performance Data

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that the advertisement is not materially false or misleading with respect to the feature. *See* Rule G-21 Interpretive Letter – Disclosure obligations, May 21, 1998, *reprinted in* MSRB Rule Book.

5 Program disclosure documents, information statements and other issuer-prepared disclosure materials used in connection with municipal fund securities are referred to as "official statements" under MSRB and SEC rules. *See infra* footnote 13. The MSRB has no regulatory authority over issuer disclosure documents.

6 *See* Rule G-21 Interpretation – Application of Fair Practice and Advertising Rules to Municipal Fund Securities, May 14, 2002, *reprinted in* MSRB Rule Book. The 2002 MSRB Notice also confirmed previous guidance on advertisements of municipal fund securities published in 2001. *See* Rule G-30 Interpretation – Interpretive Notice on Commissions and Other Charges, Advertisements and Official Statements Relating to Municipal Fund Securities, December 19, 2001, *reprinted in* MSRB Rule Book.

Current Standard. Under current Rule G-21 as interpreted in the 2002 MSRB Notice, the use of historical performance data in an advertisement requires a description of the nature and significance of such data to assure that the advertisement is not false or misleading. Further, depending upon the facts and circumstances, a dealer may be required to disclose information on fees or other charges that may have a material effect on the advertised performance data if necessary to ensure that the advertisement is not materially false or misleading. An advertisement that includes performance data must make clear that such information relates to past performance, which may not be indicative of future investment performance.

Except as described in the preceding paragraph, the MSRB has not specified that dealers must calculate or display performance data contained in municipal fund security advertisements in any particular manner. This contrasts with existing regulation of mutual fund advertisements that include performance data. SEC Rule 482 sets forth detailed requirements on how such data, if included in mutual fund advertisements, must be calculated and displayed, in part by reference to the registration statements used for registration of mutual funds and variable annuities.[7] Thus, performance data presented by a dealer in a mutual fund advertisement generally must be consistent with performance data presented by the mutual fund itself in its registration statement.

In the case of municipal fund securities, however, issuers are not subject to the registration requirements of the Securities Act of 1933 under Section 3(a)(2) or the Investment Company Act of 1940 under Section 2(b). Thus, there are no mandated methods for issuers of municipal fund securities to calculate performance, nor is there any requirement for such issuers to make such calculations or to present performance data in any document available to investors or others. The methods of computing mutual fund performance under SEC rules are based in part on the assumption that mutual funds are structured in accordance with the limitations imposed by the Investment Company Act. Because issuers of municipal fund securities are exempt from the Investment Company Act and most other federal securities laws, they may act in their best judgment in widely divergent manners in structuring their programs and securities. Some of these structures may introduce variants on the traditional mutual fund models that can result in the SEC calculation methods to be not ideally suited, without modification, for calculating performance of these municipal fund securities.

The 2002 MSRB Notice did not include guidance on performance calculations and other matters covered by SEC Rule 482 since the provisions of that rule were then subject to change as a result of the publication for comment by the SEC of proposed amendments to Rule 482

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7 SEC Rule 482 references Form N-1A (registration statement for open-end management investment companies), Form N-3 (registration statement for variable annuities registered as investment companies) and Form N-4 (registration statement for variable annuities registered as unit investment trusts).

simultaneously with the publication of the 2002 MSRB Notice.[8] The 2002 MSRB Notice did confirm previous guidance in which the MSRB had stated that a municipal fund security advertisement that would be compliant with the SEC and NASD mutual fund advertising rules, if applied to the municipal fund security advertisement as if municipal fund securities were shares of a registered mutual fund, also would be in compliance with MSRB Rule G-21. Thus, a dealer wishing to include performance data in an advertisement could electively use the methods required by the SEC for mutual fund advertisements under SEC Rule 482 with the assurance that the advertisement would be in compliance with the MSRB's advertising rule. However, dealers are not required to use these SEC methods and currently are permitted to display performance in ways that diverge from the standards that exist in the mutual fund industry, so long as the performance data is not false or misleading. The lack of specific required computational and presentation standards could result in significantly less comparability between different municipal fund security advertisements than currently exists for mutual fund advertisements.

Draft Amendments. Proposed new section (e)(ii) of Rule G-21 would require dealer advertisements of municipal fund securities that include performance data to comply with the method of computing and displaying performance data for mutual funds as prescribed in section (d) or (e) of SEC Rule 482, with certain modifications. The modifications included in the draft language reflect the fact that certain items of information that exist in the mutual fund industry – such as the registration statement and the specific items of information required to be disclosed in the prospectus and statement of additional information – do not exist for municipal fund securities. In particular, the draft language provides that: (A) a dealer can use information provided in the issuer's official statement, otherwise made available by the issuer, or otherwise obtained from other reliable sources to calculate performance to the extent such information is not available from a balance sheet in a registration statement or from a prospectus; (B) the life of a municipal fund securities issue should be measured from when the issuer first issues the securities; (C) performance data in advertisements must be calculated as of the most recent calendar quarter ended prior to the submission of the advertisement for publication for which such performance data, or all information required for the calculation of such performance data, is reasonably available to the dealer; and (D) expenses having the same characteristics as those permitted to be paid under Investment Company Act Rule 12b-1 but not technically accrued under a 12b-1 plan must be treated as 12b-1 expenses for purposes of calculating performance.[9]

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[8] *See* Investment Company Act Release No. 25575 (May 17, 2002), 67 FR 36712 (May 24, 2002). The proposed amendments were ultimately adopted by the SEC, with limited modifications, in September 2003 and became fully effective for mutual fund advertisements submitted for publication after March 31, 2004. *See* Investment Company Act Release No. 26195 (September 29, 2003), 68 FR 57760 (October 6, 2003).

[9] Thus, asset-based charges paid to the program manager or investment advisor, to the issuer or its agents, or to any other party generally would be viewed as being treated as 12b-1 expenses for purposes of calculating performance even if any such charges may not

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In addition, the draft language confirms that these provisions of Rule G-21 would apply solely to the calculation of performance relating to municipal fund securities and not to the calculation of performance for any security (such as a mutual fund) held as an underlying asset of the municipal fund securities.

Proposed Rule G-21(e)(ii) would effectively provide that, for municipal fund securities other than those that are held out by the issuer as having the characteristics of a money market fund, quotations of performance in an advertisement would be limited to the average annual total return, current yield (but only if accompanied by average annual total return), tax-equivalent yield (but only if accompanied by average annual total return and current yield), after-tax return (but only if accompanied by average annual total return), or other non-prescribed performance measures (but only if accompanied by average annual total return and, if adjusted to reflect the effects of taxes, after-tax return), as provided in SEC Rule 482(d). In the case of municipal fund securities that are held out by the issuer as having the characteristics of a money market fund, quotations of performance in an advertisement would be limited to the current yield, effective yield (but only if accompanied by current yield), tax-equivalent yield or tax-equivalent effective yield (but only if accompanied by current yield), or total return (but only if accompanied by current yield), as provided in SEC Rule 482(e).[10] Performance data included in municipal fund security advertisements would be required to be displayed in the manner provided in section (d) or (e) of SEC Rule 482, as appropriate, with respect to prominence and positioning of information.

The MSRB understands that it is possible that, even with the modifications described above, the methods of calculating performance prescribed under SEC Rule 482(d) or (e) may not be well suited for certain municipal fund security structures. The MSRB seeks specific, detailed comments addressing any shortcomings in the proposed calculation methods for particular structures (including descriptions of the specific features of such structures that cause the proposed calculation methods to be deficient) and what further modifications, deletions or

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technically be paid under a formal 12b-1 plan. In addition, any 12b-1 expenses incurred in connection with underlying assets of the municipal fund securities also must be treated as 12b-1 expenses of the municipal fund securities to the extent that such expenses are not waived or not included within the asset-based charges described in the preceding sentence.

10 As noted above, SEC Rule 482 incorporates the calculation methods set forth in Forms N-1, N-3 and N-4 for purposes of calculating the various types of quotations described in the rule. The MSRB seeks comments on whether, as the draft amendment to Rule G-21(e)(ii) is formulated, it would be clear which SEC registration form would be applicable to each type of municipal fund security structure in existence or whether any of the specified registration forms should be excluded for purposes of draft section (e)(ii).

additions would be needed to make such calculation methods produce meaningful information for investors that is not misleading.

In addition, the draft amendments include in new Section (e)(i)(B) certain related legends and disclosures currently required under SEC Rule 482 for mutual funds advertisements that display performance information. These disclosures emphasize that the performance data is historical and does not guarantee future results,[11] that the value of holdings is subject to fluctuation, and that current performance may be different from the performance data included in the advertisement. Pursuant to the draft amendments, advertisements containing performance data also would be required to include the maximum amount of any sales load or other nonrecurring fee and, if such load or fee is not reflected in the performance data, to disclose that the load or fee is not so reflected and that performance would be lower if it had been reflected.[12] The MSRB views the nonrecurring fees that would be the subject of this disclosure as including such fees imposed not only by the dealer but also by the issuer or any other party to the issuance of the municipal fund securities or the maintenance of investments therein. New Section (e)(i)(C) would require that these legends and disclosures be presented in the same format required under SEC Rule 482.

General Disclosures

SEC Rule 482 requires that most mutual fund advertisements include generalized disclosure that investors should consider the fund's investment objectives, risks and charges before investing; that the prospectus contains this and other information about the fund; that the prospectus should be read carefully before investing; and identifying where a prospectus can be obtained. In the case of a money market fund, Rule 482 also requires disclosure that investments are not insured and, if the fund seeks to maintain a stable net asset value, it is still possible to lose money. Such disclosures are not currently required under MSRB Rule G-21 for municipal fund security advertisements.

The draft amendments would include in section (e)(i)(A) of Rule G-21 a provision modeled after these SEC general disclosure requirements, with certain modifications. The modifications recognize the difference between the prospectus required for mutual funds and the official statement indirectly required for municipal fund securities under Exchange Act Rule 15c2-12 adopted by the SEC.[13] In addition, new section (e)(i)(A)(1) would require that

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11 The 2002 MSRB Notice already requires this disclosure, as described above.

12 Under the 2002 MSRB Notice, similar disclosures might be required depending on the facts and circumstances, as described above.

13 SEC Rule 15c2-12 provides, among other things, that the underwriter for most primary offerings of municipal securities must obtain and review the issuer's near-final official

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advertisements of college savings plans include a statement that advises investors to consider whether their home states offer tax or other benefits that are only available when investing in their home states' college savings plan.[14] New section (e)(i)(C) would require that these general disclosures be presented in the same format required under SEC Rule 482.

The MSRB observes that municipal fund securities consisting of interests in college savings plans are oriented exclusively to retail investors and entail a number of features with which most potential investors may not be familiar. In addition, the perception that college savings plan interests and mutual fund shares are substantially the same investment product may not reflect reality and may lead many investors to believe that the same rules and structures apply in the college savings plan market as in the mutual fund market. The MSRB currently provides general information regarding college savings plans and certain information for investors at its web site.[15] The MSRB seeks comment on whether the proposed general disclosure language required under new section (e)(i)(A)(1) for advertisements of college savings plans also should include specific reference to an MSRB-maintained web site where generalized information of

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statement before purchasing or offering the securities, contract with the issuer to receive copies of the final official statement within specified timeframes after the final agreement to purchase or offer the securities, and distribute copies of the official statement to potential customers upon request. For purposes of the rule, 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.

14 This is similar to the disclosure that is required on a customer-by-customer basis pursuant to the 2002 MSRB Notice under a dealer's Rule G-17 point-of-sale disclosure obligation in the case of sales to a customer of college savings plan interests issued by a state other than the customer's home state, as more fully described below. However, it is broadened to refer not only to state tax benefits but also to other benefits that may be provided under state law (*e.g.*, lower fees, matching grants, scholarships to state colleges, or other financial benefits). As described below, the MSRB is proposing to expand the point-of-sale disclosure requirement to also reference the possible existence of other non-tax state benefits.

15 Product information is provided at www.msrb.org/msrb1/mfs/mfs529csp.asp and information for investors is provided at www.msrb.org/msrb1/mfs/ruleinfo.asp.

this nature would be provided and, if so, the extent to which the information currently provided on the MSRB web site described above should be included, modified, supplemented or deleted.[16]

Additional Amendments Based on 2002 MSRB Notice

The 2002 MSRB Notice provides guidance with respect to a number of other elements that may appear in municipal fund security advertisements. These relate to the nature of the issuer and the securities, the capacity of the dealer and other parties, tax consequences, and information about the mutual funds in which municipal fund security assets are invested. The draft amendments would include new paragraphs (iii) through (vi) of section (e) that would codify into the rule language these interpretive positions, with limited modifications noted below.

Nature of Issuer and Security. Draft section (e)(iii) would require that an advertisement: (i) for a specific municipal fund security provide sufficient information to identify the specific security in a manner that is not false or misleading; (ii) that identifies a specific municipal fund security include the name of the issuer, presented in a manner no less prominent than any other entity identified in the advertisement, and not imply that a different entity is the issuer of the municipal fund security; (iii) not raise an inference that, because municipal fund securities are issued under a government-sponsored plan, investors are guaranteed against investment losses if no such guarantee exists; and (iv) that concerns a specific class or category of an issuer's municipal fund securities (*e.g.*, A shares versus B shares; direct sale shares versus advisor shares; in-state shares versus national shares; etc.) clearly disclose this fact in a manner no less prominent than the information provided with respect to such class or category.[17]

Capacity of Dealer and Other Parties. Draft section (e)(iv) would require an advertisement that relates to or describes services provided with respect to municipal fund securities to clearly indicate the entity providing such services. In addition, an advertisement soliciting purchases of municipal fund securities that would be effected by any party other than the dealer that publishes the advertisement (*i.e.*, the issuer or another dealer) must clearly state which entity would effect the transaction.

Tax Consequences and Other Features. Draft section (e)(v) would require that any discussion of tax implications or other benefits or features of investments in municipal fund

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16 For example, the general disclosure for a college savings plan advertisement might include a statement that general information about investing in college savings plans is available on-line at http://about529s.msrb.org.

17 The draft amendment would modify the existing interpretive guidance by requiring that the disclosure that an advertisement concerns a specific class of securities be presented in the specified manner.

securities included in an advertisement not be false or misleading.[18] In the case of an advertisement that includes statements regarding tax or other benefits offered under state or federal law, the advertisement must make clear the nature of such benefits and that the availability of such benefits may be materially limited based upon residency, purpose for or timing of share redemptions, or other factors, as applicable, which limitations must be described in the advertisement and presented in close proximity to, and in a manner no less prominent than, the description of such benefits.[19]

Underlying Registered Securities. Draft section (e)(vi) would require that, if an advertisement for a municipal fund security provides specific details of a security held as an underlying asset of the municipal fund security, the details included in the advertisement relating to such underlying security be presented in a manner that would be in compliance with any SEC or NASD advertising rules that would be applicable if the advertisement related solely to such underlying security. However, details of the underlying security so included in the advertisement must be accompanied by any further statements relating to such details necessary to ensure that the inclusion of such details does not cause the advertisement to be false or misleading with respect to the municipal fund securities advertised.[20] Further, the draft rule language would make clear that this provision does not limit the applicability of any rule of the SEC, NASD or any other regulatory body relating to advertisements of securities other than municipal fund

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18 The draft amendment would modify the existing interpretive guidance by extending the applicability of the language to discussions of other benefits or features in addition to tax-related matters.

19 The draft amendment would modify the existing interpretive guidance by providing specific examples of certain limitations on benefits. For example, if an advertisement notes that investors in a particular college savings plan may qualify for scholarships or matching grants, the advertisement may also need to state that such scholarships or matching grants are available only for attendance at in-state colleges or to in-state investors, if that is in fact the case. The draft amendment also would modify the existing interpretive guidance by requiring that such limitations be presented in the specified manner.

20 The draft amendment would modify the existing language of the interpretive guidance to explicitly state that further clarifying information may need to be included to ensure that the advertisement is not false or misleading. Because Rule G-21 already requires that advertisements not be false or misleading, this would not be a new principle under the rule.

securities, including advertisements that contain information about such other securities together with information about municipal fund securities.[21]

DRAFT INTERPRETIVE GUIDANCE ON DISCLOSURE OF IN-STATE BENEFITS UNDER RULE G-17

The MSRB has interpreted Rule G-17 to require a dealer to disclose to its customer at or prior to the time of trade (*i.e.*, at the point-of-sale) all material facts about the transaction known by the dealer, as well as material facts about the security that are reasonably accessible to the market.[22] In the 2002 MSRB Notice, the MSRB stated that Rule G-17 also obligates a dealer that sells to a customer an out-of-state college savings plan interest to disclose 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.[23] The obligation to disclose the potential loss of state tax benefits could be met if the required disclosure is included in the official statement delivered to the customer, appearing in a manner reasonably likely to be noted by an investor. This disclosure is required in all transactions effected by a dealer with a customer investing in an out-of-state college savings plan, regardless of whether the dealer has made a recommendation to the customer.

In addition to state tax benefits, some states offer some or all of their residents, if they invest in their in-state college savings plan, other benefits such as scholarships to in-state colleges, matching grants into their college savings plan accounts, or reduced or waived program fees, among other benefits. In some cases, the value of these other benefits can be considerably higher than the state tax benefits offered by some states. This can be particularly true for those benefits that the state may specifically target toward its lower-income residents. The nature of

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21 This language, which does not appear in the existing interpretive language, recognizes that other regulatory organizations may apply their own rules to the extent of their regulatory jurisdiction. *See, e.g.*, NASD Special Notice to Members 03-17 – Sales Material for Municipal Fund Securities, March 25, 2003.

22 *See* Rule G-17 Interpretation – Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts, March 20, 2002, *reprinted in* MSRB Rule Book.

23 Since dealers could not reasonably be expected to become expert in state tax laws throughout the country, the MSRB noted that such disclosure, coupled with a suggestion that the customer consult a tax adviser about any state tax consequences of the investment, would provide adequate notice of the potential loss of in-state tax benefits. The MSRB observed, however, that if the dealer proceeded to provide information about state tax consequences, it must ensure under Rule G-17 that the information is not false or misleading.

these other benefits can vary from state to state even more than state tax benefits and may be even less well understood by the general investing public.

Thus, the MSRB is publishing for comment draft interpretive guidance that would broaden the existing Rule G-17 point-of-sale disclosure interpretation to include reference to other potential benefits offered solely in connection with in-state investments. The guidance would clarify that such disclosure made through the issuer's official statement is effective for purposes of the Rule G-17 point-of-sale disclosure obligation only if the official statement is provided to the customer at or prior to the time of trade and would strengthen the minimum standards for prominence in the official statement required to satisfy the disclosure obligation by means of the official statement.

The draft interpretive language is set forth below:

In the case of sales to a customer of out-of-state college savings plan interests, Rule G-17 requires a dealer to disclose, at or prior to 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 or other benefits offered under state law in connection with investing in college savings plans may be available only if the customer invests in a college savings plan offered by the customer's home state. The dealer also must suggest to such customer that he or she consult with a qualified adviser or contact his or her home state's college savings plan to learn more about any state tax or other benefits that might be available in conjunction with an investment in that state's college savings plan.

This disclosure obligation may be met if the disclosure appears in the official statement, so long as the official statement has been delivered to the customer by the time of trade and the disclosure appears in the official statement in a manner that is reasonably likely to be noted by an investor. A presentation of this disclosure in the official statement in close proximity and with equal prominence to the first presentation of information regarding other federal or state tax-related consequences of investing in the college savings plan, and in close proximity and with equal prominence to each other presentation of information regarding state tax-related consequences of investing in the college savings plan, would be deemed to satisfy this requirement. However, the MSRB has no authority to mandate inclusion of any particular items in the official statement. Thus, if the issuer has not included this information in the official statement in the described manner, the dealer would remain obligated to disclose such information separately to the customer under Rule G-17.

Of course, should the dealer proceed to provide information about state tax or other benefits available to an out-of-state investor, it must ensure that the information is not false or misleading. For example, a dealer would violate Rule

G-17 if it were to inform a customer that investment in the college savings plan of the customer's own state did not provide the customer with any state tax or other benefit when the dealer knows or has reason to know that such benefit likely would be available. A dealer also would violate Rule G-17 if it were to inform a customer that investment in the college savings plan of another state would provide the customer with the same tax or other 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.

If the draft interpretive guidance is adopted, the MSRB would expect to withdraw the portions of the 2002 MSRB Notice relating to such Rule G-17 point-of-sale disclosure obligation. The MSRB seeks comments on all aspects of the draft interpretive guidance.

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Comments from all interested parties are welcome. Comments should be submitted no later than September 15, 2004 and may be directed to Ernesto A. Lanza, Senior Associate General Counsel, or Jill C. Finder, Assistant General Counsel. Written comments will be available for public inspection.

June 10, 2004

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TEXT OF DRAFT AMENDMENTS TO RULE G-21[24]

Rule G-21. Advertising.

(a)-(c) No change.

(d) *New Issue Advertisements*. In addition to the requirements of section (c), all advertisements for new issue municipal securities **(other than municipal fund securities)** shall ~~also~~ be subject to the following requirements:

(i)-(ii) No change.

(e) **[NEW SECTION]** *Municipal Fund Security Advertisements*. In addition to the requirements of section (c), all advertisements for municipal fund securities shall be subject to the following requirements:

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[24] Underlining signifies insertions; strikethrough signifies deletions.

(i) *Required disclosures.* Each advertisement for municipal fund securities:

(A) must include a statement that advises an investor to consider the investment objectives, risks, and charges and expenses associated with the municipal fund securities before investing; explains that more information about the securities is available in the issuer's official statement; identifies a source from which an investor may obtain an official statement; and states that the official statement should be read carefully before investing. In addition, the following disclosures must be included, as applicable:

(1) if the advertisement relates to municipal fund securities issued by a qualified tuition program under Internal Revenue Code Section 529, a statement that advises an investor to consider, before investing, whether the investor's home state offers any state tax or other benefits that are only available for investments in such state's qualified tuition program.

(2) if the advertisement is for a municipal fund security that the issuer holds out as having the characteristics of a money market fund, statements to the effect that an investment in the security is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency (unless such guarantee is provided by or on behalf of such issuer) and, if the security is held out as maintaining a stable net asset value, that although the issuer seeks to preserve the value of the investment at $1.00 per share or such other applicable fixed share price, it is possible to lose money by investing in the security.

(B) that includes performance data must include:

(1) a legend disclosing that the performance data included in the advertisement represents past performance; that past performance does not guarantee future results; that the investment return and the value of the investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost; and that current performance may be lower or higher than the performance data included in the advertisement; and

(2) if a sales load or any other nonrecurring fee is charged, the maximum amount of the load or fee and, if the sales load or fee is not reflected in the performance data included in the advertisement, a statement that the performance data does not reflect the deduction of the sales load or fee and that the performance data would be lower if such load or fee were included.

(C) must present the statements required by clauses (A) and (B) of this paragraph, when in a print advertisement, in a type size at least as large as and of a style different from, but at least as prominent as, that used in the major portion of the advertisement,

provided that when performance data is presented in a type size smaller than that of the major portion of the advertisement, the statements required by clause (B) of this paragraph may appear in a type size no smaller than that of the performance data. If an advertisement is delivered through an electronic medium, the legibility requirements for the statements required by clauses (A) and (B) of this paragraph relating to type size and style may be satisfied by presenting the statements in any manner reasonably calculated to draw investor attention to them. In a radio or television advertisement, the statements required by clauses (A) and (B) of this paragraph must be given emphasis equal to that used in the major portion of the advertisement. The statements required by clause (B) of this paragraph must be presented in close proximity to the performance data and, in a print advertisement, must be presented in the body of the advertisement and not in a footnote unless the performance data appears only in such footnote.

(ii) *Performance data.* Each advertisement that includes performance data relating to municipal fund securities must present performance data in the format, and calculated pursuant to the methods, prescribed in paragraph (d) of Securities Act Rule 482 (or, in the case of a municipal fund security that the issuer holds out as having the characteristics of a money market fund, paragraph (e) of Securities Act Rule 482), provided that:

(A) to the extent that information necessary to calculate performance data is not available from an applicable balance sheet included in a registration statement, or from a prospectus, the broker, dealer or municipal securities dealer shall use information derived from the issuer's official statement, otherwise made available by the issuer or its agents, or (when unavailable from the official statement, the issuer or the issuer's agents) derived from such other sources which the broker, dealer or municipal securities dealer reasonably believes are reliable;

(B) if the issuer first began issuing the municipal fund securities fewer than one, five, or ten years prior to the date of the submission of the advertisement for publication, such shorter period shall be substituted for any otherwise prescribed longer period in connection with the calculation of average annual total return or any similar returns;

(C) performance data shall be calculated as of the most recent calendar quarter ended prior to the submission of the advertisement for publication for which such performance data, or all information required for the calculation of such performance data, is reasonably available to the broker, dealer or municipal securities dealer as described in clause (A) of this paragraph;

(D) where such calculation is required to include expenses accrued under a plan adopted under Investment Company Act Rule 12b-1, the broker, dealer or municipal securities dealer shall include all such expenses as well as any expenses having the same characteristics as expenses under such a plan where such a plan is not required to be

adopted under said Rule 12b-1 as a result of Section 2(b) of the Investment Company Act of 1940;

(E) notwithstanding any of the foregoing, this paragraph shall apply solely to the calculation of performance relating to municipal fund securities and does not apply to, or limit the applicability of any rule of the Commission, NASD or any other regulatory body relating to, the calculation of performance for any security held as an underlying asset of the municipal fund securities.

(iii) *Nature of issuer and security.* An advertisement for a specific municipal fund security must provide sufficient information to identify such specific security in a manner that is not false or misleading. An advertisement that identifies a specific municipal fund security must include the name of the issuer, presented in a manner no less prominent than any other entity identified in the advertisement, and must not imply that a different entity is the issuer of the municipal fund security. An advertisement must not raise an inference that, because municipal fund securities are issued under a government-sponsored plan, investors are guaranteed against investment losses if no such guarantee exists. If an advertisement concerns a specific class or category of an issuer's municipal fund securities (*e.g.*, A shares versus B shares; direct sale shares versus advisor shares; in-state shares versus national shares; etc.), this must clearly be disclosed in a manner no less prominent than the information provided with respect to such class or category.

(iv) *Capacity of dealer and other parties.* An advertisement that relates to or describes services provided with respect to municipal fund securities must clearly indicate the entity providing those services. An advertisement soliciting purchases of municipal fund securities that would be effected by a broker, dealer or municipal securities dealer or any other entity other than the broker, dealer or municipal securities dealer that publishes the advertisement must clearly state which entity would effect the transaction.

(v) *Tax consequences and other features.* Any discussion of tax implications or other benefits or features of investments in municipal fund securities included in an advertisement must not be false or misleading. In the case of an advertisement that includes statements regarding tax or other benefits offered under state or federal law, the advertisement must make clear the nature of such benefits and that the availability of such benefits may be materially limited based upon residency, purpose for or timing of share redemptions, or other factors, as applicable, which limitations must be described in the advertisement and presented in close proximity to, and in a manner no less prominent than, the description of such benefits.

(vi) *Underlying registered securities.* If an advertisement for a municipal fund security provides specific details of a security held as an underlying asset of the municipal fund security, the details included in the advertisement relating to such underlying security must be presented in a manner that would be in compliance with any Commission or NASD advertising rules that would be applicable if the advertisement related solely to such underlying security; provided that details of the underlying security must be accompanied by any further statements relating to such details as are necessary to ensure that the inclusion of such details does not cause the

advertisement to be false or misleading with respect to the municipal fund securities advertised. This paragraph does not limit the applicability of any rule of the Commission, NASD or any other regulatory body relating to advertisements of securities other than municipal fund securities, including advertisements that contain information about such other securities together with information about municipal securities. **[END NEW SECTION]**

(f) ~~**(e)**~~ No change.

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The text of SEC Rule 482 is available at http://www.sec.gov/rules/final/33-8294.htm.
SEC Form N-1A is available at http://www.sec.gov/about/forms/formn-1a.pdf.
SEC Form N-3 is available at http://www.sec.gov/about/forms/formn-3.pdf.
SEC Form N-4 is available at http://www.sec.gov/about/forms/formn-4.pdf.

Alphabetical List of Comment Letters

1. College Savings Foundation: Letter to Ernesto A. Lanza, MSRB, from David J. Pearlman (September 13, 2004)

2. College Savings Plans Network: Letter to Ernesto A. Lanza, MSRB, from Diana F. Cantor, CSPN Chair and Executive Director, Virginia College Savings Plan (September 15, 2004)

3. Finance Authority of Maine: Letter to Ernesto A. Lanza, MSRB, from Elizabeth L. Bordowitz, General Counsel (September 13, 2004)

4. Hawkins Delafield & Wood LLP: Letter to Ernesto A. Lanza, MSRB, from Kenneth B. Roberts (August 20, 2004)

5. Investment Company Institute: Letter to Ernesto A. Lanza, MSRB, from Tamara K. Salmon, Senior Associate Counsel (September 10, 2004)

6. NASD: Letter to Ernesto A. Lanza, MSRB, from Mary L. Schapiro, Vice Chairman and President, Regulatory Policy and Oversight (September 9, 2004)

7. Securities Industry Association: Letter to Ernesto A. Lanza, MSRB, from Elizabeth Varley and Michael D. Udoff, Co-Staff Advisers, SIA Ad Hoc 529 Plans Committee (September 15, 2004)

8. University of North Carolina at Wilmington: Letter to Ernesto A. Lanza, MSRB, from Raquel Alexander, PhD, Assistant Professor, and LeAnn Luna, PhD, Assistant Professor (September 15, 2004)

CSF
CollegeSavings
FOUNDATION

1101 17th Street, NW

Suite 703

Washington, DC 20036

September 13, 2004

Mr. Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street
Suite 600
Alexandria, VA 22314-3412

Re: Notice 2004-16

Dear Mr. Lanza:

I am writing to you today on behalf of the College Savings Foundation ("CSF"). CSF is a 501(c)(6) organization dedicated to the advancement of 529 college savings programs. CSF's mission is to help American families achieve their education savings goals by working with public policy makers, media representatives and financial services industry executives in support of education savings programs. CSF's members include many of the country's leading financial services firms, and collectively manage approximately $10 billion in savings-type qualified tuition programs, representing over one-third of the dollars in such programs. CSF also includes associate members that are governmental and non-profit agencies and individuals who support CSF and its mission.

CSF serves the education savings industry as a central repository of information and an expert resource for its members and for representatives of state and federal government, institutions of higher education and other related organizations and associations. The primary focus of CSF is building public awareness of and providing public policy support for 529 plans - an increasingly vital college-savings vehicle.

This letter is in response to MSRB Notice 2004-16 (the "Notice"), which requests comments on proposed amendments to Rule G-21, which addresses advertisements, and Rule G-17, which addresses conduct of municipal securities activities. CSF supports the principles of improved disclosure set forth in the Notice but believes that a few of the specifics of the proposals in the Notice warrant comment.

General Disclosures in Advertisements

MSRB Website Reference

The Notice seeks comment on whether the proposed general disclosure language required for 529 advertisements should include a specific reference to information about 529 programs maintained on the MSRB's website, and if so, to what extent the information currently provided there should be included, modified, supplemented or deleted.

We commend the MSRB's willingness to undertake the work that would be involved in maintaining information on its website, but we do not believe it is advisable or practical in a 529 advertisement to include a reference to information on the MSRB website, for several reasons.

First, many issuers and program administrators maintain extensive consumer websites, which contain 529 product, industry, and educational information.

Second, the 529 marketplace has several third-party websites that provide consumers with an abundance of industry and program information.

Third, if dealers are expected to furnish information to the MSRB to populate its website, the administrative burdens on dealers (and perhaps issuers) is likely to be substantial, particularly if such information is to be updated simultaneously with changes in 529 programs.

Fourth, for the most part, 529 advertisements are in print and are subject to space limitations. Television and radio advertisements are even more constrained. Advertisements are and will continue to be subject to lengthy disclosure requirements, and the addition of this item would further diminish the ability of an advertisement to communicate substantive information.

For all the foregoing reasons, we respectfully request that this proposal be withdrawn.

Disclosures Modeled on SEC Rule 482

The Notice proposes that 529 advertisements include lengthy general disclosure requirements modeled upon the requirements found in Rule 482 of the U.S. Securities and Exchange Commission. We support this concept but respectfully note that there simply would not be enough time to include all of the required disclosures in a radio or television advertisement, with the practical consequence that there would quite possibly be no more 529 radio or television advertisements.

We note that it is not possible to purchase directly from a radio or television advertisement, and that before purchase, a consumer would be presented with appropriate information and disclosures. Therefore, we suggest that for radio and television advertisements that mention a 529 program by name but do not contain such content as to raise the advertisement to the level of an offer under federal securities laws, abbreviated general

disclosures should be acceptable. We believe that presenting the member firm's name and address, the name of the 529 program, the name of the state that establishes and maintains the program, and an abbreviated form of the offering legend that refers consumers to the Official Statement should be sufficient.

Nature of Issuer and Security

The Notice proposes that a 529 advertisement that identifies a specific municipal fund security include the name of the issuer, presented in a manner no less prominent than any other entity identified in the advertisement, and not imply that a different entity is the issuer of the municipal fund security.

We believe that the purpose of the proposal is to make it clear that a state, state agency or state instrumentality is the issuer, not any private sector administrator that may be hired to provide services to the program, and we believe that any communications should say so. However, providing the name of the legal issuer may not help consumers understand this point, and indeed may result in additional confusion. The legal issuer is often an obscure state trust, whose name is not mentioned outside of some descriptive material in the Official Statement for the program. Further, the same issuer may be involved in more than one program. We submit that it would be more helpful to identify the program by marketing name, together with the name of the state that establishes and maintains the program.

Consider, for example, the two programs established and maintained by the State of New Hampshire. Each program consists of a number of investment portfolios grouped under a marketing name, but the portfolios are all part of the same issuer, a special purpose trust established by the State for the purpose of segregating the program's assets from other dollars the State may handle. Providing consumers with the name of the trust will not help them understand which program they are being offered although identifying the program and the State would help.

We note further that there are situations, such as in New Hampshire, where the issuer itself does not have a logo, but the program does, and we suggest that in any advertisements or other materials it be the program's logo, not the issuer's, that should appear at least as prominently as the member's logo.

Capacity of Dealer and Other Parties

The Notice proposes that an advertisement soliciting purchases of municipal fund securities that would be effected by any party other than the dealer that publishes the advertisement must clearly state which entity would effect the transaction.

Many 529 programs are intermediary sold programs. For some programs, transactions are effected through several hundred dealers. It would be very onerous and impractical to identify each selling institution in a print advertisement, and impossible to do so in a radio or television advertisement. We suggest that the entities required to be identified under this

proposal be limited to dealers that are affiliates of the dealer publishing the advertisement and, if applicable, the issuer itself.

Tax Consequences and Other Features

The Notice contains proposed modifications to Rule G-21 and draft interpretive guidance under Rule G-17, which we discuss together here because they share a common subject matter, the information to be provided to consumers concerning the consequences under state laws of choosing to invest in the program of one state rather than another.

The Notice would require 529 advertisements to include statements regarding the nature of tax or other benefits offered under state or federal law, and proposes to broaden the existing Rule G-17 point-of-sale disclosure to include reference to other potential benefits offered solely in connection with investments in an in-state 529 program. As part of the Rule expansion, the Notice states that the point of sale obligation to disclose the state benefits available to consumers only through an investment in an in-state 529 program would be satisfied if it is included in an offering statement in a manner reasonably likely to be noted by an investor.

We have concerns about the proposals contained in the Notice, both from a content standpoint and a procedural standpoint.

Content

The area of variations in state treatment is full of complexity. We believe the Notice may lead to firms' providing disclosure in advertisements and at the point of sale that may be less than complete, and indeed might possibly be misleading. We believe that a better approach would be to remind the public to carefully review the Official Statements of their home-state programs.

We also believe that it is crucial for the public to understand that not all differences in state treatment will be of benefit to an individual who invests in the program established and maintained by the state where they reside. Thus, we feel that the phrase "state tax or other benefits" should be changed to "different tax or other consequences".

There are a number of ways in which investing in a home-state program may be disadvantageous. For example, one state that provides a substantial tax deduction to its residents only if they invest in the state's own program also provides that rollovers to other states' programs will be treated as taxable distributions under state law, notwithstanding the fact that federal law would treat the rollover as tax free. This state and others also recapture state tax deductions previously taken if an account holder rolls over to another 529 program. Matching grants and scholarships may also be taken back by states as the result of leaving the home-state program. It may be prudent for an individual to choose an out-of-state program, and thus forego a tax deduction or other benefits offered by their home state, rather than be locked into a program that may impose a financial penalty on the individual should they later move to another, possibly more suitable, program. Portability may be particularly important for parents of younger

children, who are more likely to move from one state to another before their children reach college age.

Another factor to be considered is whether benefits may be available only in connection with a program that is not offered by the state in which the account owner resides. For example, consider an account where the owner resides in State A, and the beneficiary ultimately attends school in State B. State B may have a matching grant program that is available only to beneficiaries of the 529 program of State B, so consideration of where the beneficiary may ultimately attend school may outweigh any advantages of the program offered by State A, particularly if, as noted above, State A places tax burdens on rollovers to the program offered by State B.

Given the complexity in today's environment, we suggest that any requirement concerning tax and other benefits reflect the concept that not all consequences of investment in an in-state program are necessarily favorable. We also suggest that while it is appropriate to suggest to consumers that they seek help from their own advisor, it is not appropriate to suggest that they seek help from the state in which they reside. For one thing, such a suggestion may result in liability to a dealer if the home-state program (or its service provider) provides information that is not entirely complete and accurate. For another, it may result in a situation where the consumer is presented with a sales pitch rather than disinterested information. Finally, the home state may not be aware of potential disadvantages to the consumer that will result from investment in the home-state program.

Additionally, we are concerned about the language in the Notice that says "the advertisement must make clear the nature of such benefits". Benefits of investing in a home-state program may currently include one or more of the following: two-tiered investment pricing, i.e. a less expensive class of units or shares for in-state individuals, and a more expensive class for out-of-state individuals, but both investing in the same underlying pool of assets; lower administrative fees; deductibility of contributions; favorable income tax treatment upon distribution; protection from creditors (which might be only during bankruptcy proceedings, or in wider circumstances); availability of matching educational grants; special status under financial aid statutes; and preferential Medicaid treatment. There may be additional current benefits of which we are unaware, and states may add other benefits in the future.

If all that would be required is a general statement that tax and other benefits may be available only through the home-state program, the guidance should so state. Some Official Statements of programs distributed by CSF members already contain such statements. One reads "Some states offer favorable tax treatment or other state benefits to their residents only if they invest in their own state's plan. Before making any investment decision, you may want to consult with a qualified adviser to learn more about the benefits or consequences of investing in a plan offered by your own state". Another reads "By investing in a 529 plan outside of the state in which you pay taxes, you may lose any tax benefits offered by that state's plan". We believe that such simple statements are sufficient to put individuals on notice that they should learn more.

If a laundry list of all potential aspects of differing treatment is required, we are concerned that such a list could not practically be updated to account for all new state laws, and that even if it could, space limitations would make it impractical or impossible to achieve compliance. The outcome, even from efforts made with the best of intentions, is likely to be investor confusion and inaccurate, incomplete or misleading disclosure. Consider, for instance, an individual who values one ancillary benefit, perhaps creditor protection, as being extremely valuable. If the description of creditor protection provided to that individual is less than comprehensive and completely accurate, the individual may make a decision that they later come to regret.

Finally, we are very concerned that an overemphasis on state variations may detract from more fundamental considerations, including whether a qualified tuition program is the right way for an individual to save for college, and whether the investments offered through a particular program are suitable for the individual. The more detail about state variations that an individual sees, the more likely they are to believe that state variations are more important than other factors.

Procedure

The Notice provides that a dealer may meet its obligation to disclose information about the consequences of investments in a home-state program if appropriate disclosure appears in the Official Statement in a location "reasonably likely to be noted by an investor". We note that typically consumers are required to certify that they have read the entire Official Statement before executing an application, and believe that there should be a presumption that placement anywhere in the Official Statement should constitute acceptable notice. One can only imagine the potential conflicts among hundreds of dealers, each pressuring an issuer to place disclosure in its preferred place in the Official Statement, if the proposal contained in the Notice is adopted. We respectfully request that there be no requirements concerning the location of this information in the Official Statement. We do not mean to suggest that obscuring such information is acceptable, only to suggest that it should be a matter for each dealer to determine whether the issuer's choice in placement of such information is sufficient. We also suggest that the draft interpretive guidance under Rule G-17 be modified in light of the foregoing.

We thank you for your efforts in drafting the Notice and for the opportunity to present these comments. I would be happy to discuss with you the comments above and any other issues related to the Notice. Please do not hesitate to call me at 817-474-8298 if you believe we can be of further help.

Sincerely,

David J. Pearlman

College Savings Plans Network

September 15, 2004

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

Re: Notice 2004-16 (June 10, 2004) Request for Comments on the Amendments to Advertisements of Municipal Fund Securities and Draft Interpretative Guidance on Disclosure in Connection with Out-of-State Sales of College Savings Plan Shares

Dear Mr. Lanza:

The College Savings Plan Network ("CSPN"), the national organization of states that establish and administer Section 529 Plans, respectfully submits the following comments in response to the captioned Notice, released by the Municipal Securities Rulemaking Board ("MSRB") on June 10, 2004 (the "Notice"). In these comments, proposed additions to language appearing in the Notice are shown as underscored and proposed deletions are stricken through.

1. The Notice specifically requests comments on the proposed method of calculating performance to appear in advertisements as set forth in the proposed new Rule G-21(e)(ii). CSPN strongly supports the effort to develop a uniform method of calculating performance.

To assure that the methodology for calculating performance is consistent across Section 529 college savings plans, CSPN suggests that the MSRB consider establishing the following assumptions to be used when calculating returns for a Section 529 college savings plan investment:

a) That the distribution will be used for qualified higher education expenses;

b) That the distribution is tax exempt with a footnoted acknowledgement that the distribution will be taxable and the after-tax return would differ, if the current law sunsets.

Additionally, since the purpose of Section 529 college savings plan investments is to save for qualified higher education expenses which would be eligible for tax-free distributions under current law, CSPN suggests that proposed Rule G-21(e)(ii) should clarify that an after-tax return for a Section 529 college savings plan investment does not need to be

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presented in accordance with SEC Rule 482/Form N-1A , which anticipates a taxable investment.

2. Proposed new subsection G-21(e)(i)(A)(1) fails to take into account that many state programs offer specific benefits to both the investor and the account designated beneficiary. CSPN proposes that the referenced subsection read:

> 1) " If the advertisement relates to municipal fund securities issued by a qualified tuition program[1] under Internal Revenue Code Section 529, a statement that advises an investor to consider, before investing, whether the investor's or designated beneficiary's home state offers any state tax or other benefits that are only available for investments in such state's qualified tuition program."

3. In addition to the specific proposed subsection G-21(e)(i)(A)(1), the Notice asks for comment on whether the proposed language should require a reference in advertisements of qualified tuition plans to a web site maintained by the MSRB for more information, and, if so, what information should be required. CSPN believes that it is not necessary to require advertisements to include a reference to the MSRB web site for additional information. Currently, the CSPN web site includes links to the web sites of all qualified tuition programs, where each state issuer can maintain appropriate information. CSPN plans to enhance its current web site to invite state issuers to include program materials directly on the CSPN web site. CSPN believes that voluntary placement of materials prepared by the state issuers is the most appropriate manner of creating a general information center for these materials. CSPN does not believe, even when such a site is fully operational, that it will be appropriate to mandate a reference to that site in advertisements.

4. Proposed new Subsection Rule G-21(e)(i)(C) requires that the disclaimers required by Subsections (e)(i)(A) and (B) be included in radio and television advertisements and given equal emphasis to and placed in close proximity to the performance data. CSPN requests that the MSRB consider the brief run time (15 – 30 seconds) of radio and television advertisements and allow advertisers to include disclaimers that take into account the time the advertisement will run and allow adequate disclaimers consistent with the proposed rule.

5. Proposed new Subsection (e)(v) appears to impose a significant disclaimer burden on what may be minimal language referring in a general way to a state tax or other benefit offered by a college savings program. CSPN believes that for general statements of benefits, general statements of limitation are appropriate, provided that the investor is

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[1] Although the proposed Subsection references a qualified tuition program, CSPN understands that the Interpretive Guidance and rule proposals in the Notice would be applicable only to college savings programs and not prepaid programs, which are not municipal fund securities. CSPN requests that this understanding be made explicit in the definition of a municipal fund security.

directed to the applicable disclosure document for additional information. CSPN also notes that some state benefits may not be specifically created under state law, but implemented by the state entity administering the college savings program under a general grant of authority. CSPN suggests the following modifications to the second section of proposed Rule G-21(e)(v):

> "In the case of an advertisement that includes statements regarding tax or other benefits offered ~~under state or federal law~~ by a qualified tuition program, the advertisement must make clear ~~the nature of such benefits and~~that the availability of such benefits may be materially limited based upon residency, purpose for or timing of, ~~share redemption~~ withdrawals, or other factors, as applicable, and must refer the investor to the official statement for full descriptions of, and any limitation on, the receipt of such benefits, which reference ~~limitations~~ must be ~~described in the advertisement and~~ presented in close proximity to, and in a manner no less prominent than, the reference to ~~description of~~ such benefits. "

6. The Notice seeks comment on a Draft Interpretive Guidance on Disclosure of In-State Benefits under Rule G-17. CSPN has addressed the concern raised by the Draft Interpretive Guidance in its Voluntary Disclosure Principles Statement No. 1, released in draft form in May 2004 ("CSPN Disclosure Principles"). We believe that the formulation with regard to tax or other benefits set forth in the CSPN Disclosure Principles is an appropriate standard to include in the Draft Interpretive Guidance. CSPN urges the adoption of the language previously proposed in the comment submitted by *Hawkins, Delafield & Wood LLP* on this point, and also suggests that the first sentence of the first paragraph of the Interpretive Guidance be revised to read:

> "In the case of sales to a customer of out-of-state college savings plan interests, Rule G-17 requires a dealer to disclose, at or prior to the time of trade, that college savings plan interests offered by other states may offer tax or other benefits to taxpayers or residents of those states that are not available with regard to the offered interest in the out-of-state college savings plan and that taxpayers or residents of those states should consider such state tax treatment and other benefits, if any, before making an investment decision." ~~that depending upon the laws of the customer's home state, favorable state tax treatment for investing in a college savings plan or other benefits offered under state law in connection with investing in college savings plans may be available only if the customer invests in a college savings plan offered by the customer's home state.~~

7. The second paragraph of the Draft Interpretive Guidance is tantamount to prescribing what must be included in an Official Statement, as well as where and how it must be placed. While the Draft Interpretive Guidance acknowledges that the MSRB has no authority to mandate inclusion of any particular items in an Official Statement, the Draft Interpretive Guidance language effectively does that. CSPN objects to the inclusion of language in the Interpretive Guidance specifying any requirement in the Official Statement.

Thank you for your consideration of these comments. Representatives of CSPN would be pleased to elaborate on, or discuss with you, any matters raised in these comments or in the Notice.

Sincerely,

Diana F. Cantor
Chair, College Savings Plans Network
Executive Director, Virginia College Saving Plan

FINANCE AUTHORITY OF MAINE

Business & Education at Work for Maine

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September 13, 2004

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

Re: Notice 2004-16 (June 10, 2004) Request for Comments on the Amendments to Advertisements of Municipal Fund Securities and Draft Interpretative Guidance on Disclosure in Connection with Out-of-State Sales of College Savings Plan Shares

Dear Mr. Lanza:

The Finance Authority of Maine (the "Authority"), an independent agency of the State of Maine responsible for the administration of numerous commercial and education finance programs including the Maine College Savings Program which is known as the NextGen College Investing Plan®, respectfully submits the following comments in response to the captioned Notice, released by the Municipal Securities Rulemaking Board ("MSRB") on June 10, 2004 (the "Notice"). In these comments, proposed additions to language appearing in the Notice are shown as underscored and proposed deletions are stricken through.

1. The Notice specifically requests comments on the proposed method of calculating performance to appear in advertisements as set forth in the proposed new Rule G-21(e)(ii). The Authority strongly supports the effort to develop a uniform method of calculating performance.

To assure that the methodology for calculating performance is consistent across Section 529 college savings plans, the Authority suggests that the MSRB consider establishing the following assumptions to be used when calculating returns for a Section 529 college savings plan investment:

a) That the distribution will be used for qualified higher education expenses;

b) That the distribution is tax exempt, with a footnoted acknowledgement that the distribution will be taxable and the after-tax return would differ, if the current law sunsets.

Additionally, since the purpose of Section 529 college savings plan investments is to save for qualified higher education expenses which would be eligible for tax-free distributions under current law, the Authority suggests that proposed Rule G-21(e)(ii) should clarify that an after-tax return for a Section 529 college savings plan investment does not need to be presented in accordance with SEC Rule 482/Form N-1A, to the extent that it anticipates a taxable investment.

2. Proposed new subsection G-21(e)(i)(A)(1) fails to take into account that many state programs offer specific benefits to both the investor and the account designated beneficiary. The Authority proposes that the referenced subsection read:

> 1) " If the advertisement relates to municipal fund securities issued by a qualified tuition program[1] under Internal Revenue Code Section 529, a statement that advises an investor to consider, before investing, whether the investor's or designated beneficiary's home state offers any state tax or other benefits that are only available for investments in such state's qualified tuition program."

3. In addition to the specific proposed subsection G-21(e)(i)(A)(1), the Notice asks for comment on whether the proposed language should require a reference in advertisements of qualified tuition plans to a website maintained by the MSRB for more information, and, if so, what information should be required. The Authority believes that it is not necessary to require advertisements to include a reference to the MSRB website for additional information. Currently, the CSPN website includes links to the websites of all qualified tuition programs, where each state issuer can maintain appropriate information. The Authority understands that CSPN plans to enhance its website to invite state issuers to include program materials directly on the CSPN website. The Authority believes that voluntary placement of materials prepared by the state issuers is the most appropriate manner of creating a general information center for these materials. The Authority does not believe, even when such a site is fully operational, that it will be appropriate to mandate a reference to that site in advertisements.

4. Proposed new Subsection Rule G-21(e)(i)(C) requires that the disclaimers required by Subsections (e)(i)(A) and (B) be included in radio and television advertisements and given equal emphasis to and placed in close proximity to the performance data. The Authority requests that the MSRB consider the brief run time (15 – 30 seconds) of radio and television advertisements and allow advertisers to include disclaimers that take into account the time the advertisement will run and allow adequate disclaimers consistent with the proposed rule.

5. Proposed new Subsection (e)(v) includes references to "shares" that are not appropriate for many qualified tuition programs. The Authority also notes that some state benefits may not be specifically created under state law, but implemented by the state entity administering the college savings program under a general grant of authority. The Authority suggests the following modifications to the second sentence of proposed Rule G-21(e)(v):

> "In the case of an advertisement that includes statements regarding tax or other benefits offered ~~under state or federal law~~ by a qualified tuition program, the advertisement must make clear ~~the nature of such benefits and~~ that the availability of such benefits may be

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[1] Although the proposed Subsection references a qualified tuition program, the Authority understands that the Interpretive Guidance and rule proposals in the Notice would be applicable only to college savings programs and not prepaid programs. The Authority requests that this understanding be made explicit in the definition of a municipal fund security.

materially limited based upon residency, purpose for or timing of, ~~share redemption~~ withdrawals, or other factors, as applicable, which limitations must be described in the advertisement and presented in close proximity to, and in a manner no less prominent than, the reference to ~~description of~~ such benefits. "

6. The Notice seeks comment on a Draft Interpretive Guidance on Disclosure of In-State Benefits under Rule G-17. CSPN has addressed the concern raised by the Draft Interpretive Guidance in its Voluntary Disclosure Principles Statement No. 1, released in draft form in May 2004 ("CSPN Disclosure Principles"). The Authority believes that the formulation with regard to tax or other benefits set forth in the CSPN Disclosure Principles is an appropriate standard to include in the Draft Interpretive Guidance. The Authority urges the adoption of the language previously proposed in the comment submitted by *Hawkins, Delafield & Wood LLP* on this point, suggesting that the first sentence of the first paragraph of the Interpretive Guidance be revised to read:

> "In the case of sales to a customer of out-of-state college savings plan interests, Rule G-17 requires a dealer to disclose, at or prior to the time of trade, that college savings plan interests offered by other states may offer tax or other benefits to taxpayers or residents of those states that are not available with regard to the offered interest in the out-of-state college savings plan and that taxpayers or residents of those states should consider such state tax treatment and other benefits, if any, before making an investment decision." ~~that depending upon the laws of the customer's home state, favorable state tax treatment for investing in a college savings plan or other benefits offered under state law in connection with investing in college savings plans may be available only if the customer invests in a college savings plan offered by the customer's home state.~~

7. The second paragraph of the Draft Interpretive Guidance is tantamount to prescribing what must be included in an Official Statement, as well as where and how it must be placed. While the Draft Interpretive Guidance acknowledges that the MSRB has no authority to mandate inclusion of any particular items in an Official Statement, the Draft Interpretive Guidance language effectively does that. The Authority objects to the inclusion of language in the Interpretive Guidance specifying any requirements in the Official Statement.

Thank you for your consideration of these comments. I would be pleased to elaborate on, or discuss with you, any matters raised in these comments or in the Notice.

Sincerely,

Elizabeth L. Bordowitz
General Counsel

cc: John C. Witherspoon, CEO

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August 20, 2004

Ernesto A. Lanza
Senior Associate General Counsel
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1900 Duke Street - Suite 600
Alexandria, Virginia 22314

Re: Notice 2004-16 (June 10, 2004) Request for Comments on Draft Amendments Relating to Advertisements of Municipal Fund Securities and Draft Interpretive Guidance on Disclosure in Connection with Out-of-State Sales of College Savings Plan Shares

Dear Mr. Lanza:

The following comments in response to the captioned Notice released by the Municipal Securities Rulemaking Board on June 10, 2004 (the "Notice") are respectfully submitted by Hawkins Delafield & Wood LLP. Our firm regularly acts as counsel to state and local governments and their instrumentalities with respect to securities, tax and contractual matters in connection with public programs involving the issuance of securities or application of public funds. In this capacity, we have represented public entities in several States in connection with the establishment and administration of their respective college savings plans. We have also represented public entities in a number of States who administer, invest in or borrow from local government pools. In these comments, proposed additions to language appearing in the Notice are shown underscored and proposed deletions are shown within square brackets.

1. The proposing notice requested comments on whether disclosure language for advertisements of college savings plans should be required to include a reference to a website maintained by the Municipal Securities Rulemaking Board ("MSRB"). The College Savings Plan Network ("CSPN") maintains a website which includes links to the official websites of each State-administered qualified tuition program. We understand that CSPN is currently undertaking to modify this website to permit it to make directly available to users current disclosure documents as provided to CSPN by State administrators with respect to their respective programs. We question whether any required reference to the MSRB or the CSPN website is necessary. Moreover, any such required reference should be phrased to advise investors of the respective types of information available on the CSPN, as well as the MSRB, websites. The value of including such a reference in advertisements must be evaluated in light of the limited

verbal capacity of most advertisements. In view of the other statements required to be included in college savings plan advertisements, taking into account the other proposals included in the Notice, it may be impractical to include a complete and accurate reference within most advertisements.

2. The following comments refer to the draft interpretive language included in the Notice under the caption "DRAFT INTERPRETIVE GUIDANCE ON DISCLOSURE OF IN-STATE BENEFITS UNDER RULE G-17".

(a) The first sentence of the first paragraph appears to be based upon implicit assumptions that: (i) the State in which the out-of-State customer resides or pays taxes offers tax or other benefits as inducements to participation in that State's qualified tuition program; and (ii) the out-of-State customer is aware of, and has been induced to participate in a college savings program in part on the basis of, his or her awareness of these benefits. As proposed, the requirement appears to address only the possibility that the out-of-State customer may be mistaken in assuming that he or she will receive all benefits offered by his or her home State in connection with his or her participation in another State's college savings plan. In contrast, the formulation included in Section 3(B) of the CSPN Voluntary Disclosure Principles Statement No. 1 (the "CSPN Principles") would clearly advise the out-of-State customer both of the possibility that such home State sponsored benefits exist and of the further possibility that they may be offered only with respect to participation in the home State's program. We would respectfully suggest that the MSRB should adopt the CSPN Principles formulation and that the first sentence of the first paragraph should be revised to read:

> *In the case of sales to a customer of out-of-state college savings plan interests, Rule G-17 requires a dealer to disclose, at or prior to the time of trade, that college savings plan interests offered by other states may offer tax or other benefits to taxpayers or residents of those states that are not available with regard to the offered interests in the out-of-state college savings plan and that taxpayers or residents of those states should consider such state tax treatment and other benefits, if any, before making an investment decision [that, depending upon the laws of the customer's home state, favorable state tax treatment for investing in a college savings plan or other benefits offered under state law in connection with investing in college savings plans may be available only if the customer invests in a college savings plan offered by the customer's home state].*

(b) Because no generally recognized standard of qualification for advisers who might assist customers in assessing non-tax benefits exists, it would be preferable for dealers to suggest that customers contact the programs with respect to such benefits. We would respectfully suggest that the second sentence of the first paragraph should be revised to read:

> *The dealer also must suggest to such customer that he or she consult with a qualified adviser or contact his or her home state's*

> *college savings plan to learn more about state tax [or other] benefits that might be available in conjunction with an investment in that college savings plan and contact that college savings plan to learn more about other benefits that might be available in conjunction with such an investment.*

(c) The proposed specification of the manner in which disclosure of the potential availability of tax or other benefits through participation in the customer's home State's program must appear in a college savings plan disclosure document in order to permit dealers to satisfy this disclosure obligation through timely delivery of the disclosure document is both overly rigid and unnecessarily intrusive with respect to the development by State entities of tuition savings program disclosure. Additionally, it would result in unnecessary repetition of a formulaic legend. In contrast, Section 3(B) of the CSPN Principles recognizes as an acceptable qualified tuition program issuer disclosure practice the inclusion in disclosure documents of a statement in bold type addressing this point, but does not attempt to determine the precise location or frequency of inclusion of the statement in the disclosure document. We would respectfully suggest that the second sentence of the second paragraph should be revised to read:

> *A presentation of this disclosure in the official statement in close proximity to and with no less [and with equal] prominence than [to] the first presentation of substantive information regarding other federal or state tax-related consequences of investing in the college savings plan[,] and the inclusion of a reference to this disclosure in close proximity to and with no less [and with equal] prominence than [to] each other presentation of substantive information regarding state tax-related consequences of investing in the college savings plan, would be deemed to satisfy this requirement.*

(d) It would be preferable to define the phrase "have reason to know", as used in the third paragraph, in order to render compliance more ascertainable. We would respectfully suggest that this paragraph be modified through the addition, following the existing language, of a new sentence reading:

> *A dealer would be deemed to have reason to know facts concerning benefits offered by different states if in the ordinary course of due diligence, including review of the applicable official statement, the dealer would have discovered such facts.*

3. The following comments refer to the draft amendment to Rule G-21.

(a) As proposed, the new Section (e) of Rule G-21 would generally apply to all dealer advertisements with respect to interests in local government investment pools as well as to advertisements with respect to interests in college savings plans and assumes the existence of an official statement, with the apparent result that dealers would not be able to advertise these securities unless an official statement was prepared by the issuer.

This seems anomalous with respect to local government investment pools. Typically, investment in these pools is open only to governmental entities and, we believe, no official statement is typically prepared. We would respectfully suggest that the section be revised to apply solely to dealer advertisements with respect to interests in college savings plan.

(b) As proposed, new Subsection (e)(i)(A)(1) of Rule G-21 appears to be based upon the implicit assumption that all municipal fund securities arising under college savings plans are offered and marketed on an interstate basis. This, however, is not always the case. We would respectfully suggest that this Subsection should be revised to read:

> (1) If the advertisement relates to municipal fund securities issued by a qualified tuition program under Internal Revenue Code Section 529, except for advertisements for municipal fund securities that are distributed, whether by print or broadcast media, only within the state that has authorized the issuance of the municipal fund securities and that relate only to municipal fund securities that are offered exclusively to residents of that state, a statement that advises an investor to consider, before investing, whether the investor's home state offers any state tax or other benefits that are only available for investments in such state's qualified tuition program.

(c) As proposed, new Subsection (e)(v) would appear to require any dealer advertisement with respect to interests in college savings plans that refers in any manner to tax or other benefits to include a detailed description of the nature of, and of limitations applicable to receipt of, such benefits. Again, the value of invariably including such a detailed description in advertisements must be evaluated in light of the limited verbal capacity of most advertisements. In view of the other statements required to be included in college savings plan advertisements, taking into account the other proposals included in the Notice, and in view of the nature and variety of such college savings plan benefits and of the limitations applicable to such benefits, it may be impractical to include such a detailed description within most advertisements without resulting in potentially misleading or incomplete statements. We would respectfully suggest that the MSRB should permit the inclusion in dealer advertisements of general references to college savings plan benefits that are accompanied by references to the applicable disclosure document for detailed information concerning such benefits and their applicable limitations and that the second sentence of this Subsection should be revised to read:

> In the case of an advertisement that includes statements referring to [regarding] tax or other benefits offered under state or federal law, the advertisement must make clear [the nature of such benefits and] that the availability of such benefits may be materially limited based upon residency, purpose for or timing of withdrawals [share redemptions], or other factors, as applicable, and must refer to the applicable official statement for full descriptions of the nature of, and any limitations upon the receipt of, such benefits, which reference [limitations] must be

[described in the advertisement and] presented in close proximity to, and in a manner no less prominent than, the reference to [description of] such benefits. If the advertisement includes substantive descriptions of any such benefits, the advertisement must make clear the nature of the benefits described and must make clear the nature of any limitations upon the receipt of such benefits, which description of limitations must be presented in close proximity to, and in a manner no less prominent than, the description of the benefits.

Thank you for your consideration of these comments. We would be happy to have the opportunity to discuss with you any of the issues raised or to be of any other assistance to you in connection with the matters addressed in the Notice.

Very truly yours,

HAWKINS DELAFIELD & WOOD LLP

Kenneth B. Roberts

KBR/jy

INVESTMENT COMPANY INSTITUTE

September 10, 2004

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

Re: MSRB Notice 2004-16 Relating to Advertising of Municipal Fund Securities and Guidance on Disclosure in Connection with Out-of-State Sales of 529 Plan Shares

Dear Mr. Lanza:

The Investment Company Institute[1] appreciates the opportunity to express its views in support of the proposals set forth in Municipal Securities Rulemaking Board Notice 2004-16.[2] The MSRB's Notice proposes to: (1) provide greater consistency between the MSRB's advertising rule, Rule G-21, with the rule of the Securities and Exchange Commission applicable to mutual fund performance advertisements; and (2) revise and update the interpretive guidance the MSRB issued in 2002 on the application of MSRB Rule G-17, relating to fair dealing with customers, to sales of 529 plan securities to out-of-state investors.[3]

Tailoring the MSRB's advertising rule to provide for consistency of regulation of performance advertising between 529 plan securities and mutual fund shares will better serve the investing public and municipal securities dealers. Investment company securities and municipal fund securities share many common features in their offer and sale, including in the manner in which they are advertised to investors. Subjecting these common features to similar standards of regulation reduces both the confusion to investors that might result from disparate

[1] The Investment Company Institute is the national association of the American investment company industry. More information is available about the Institute at the end of this letter.

[2] *See* MSRB Notice 2004-16, *Request for Comments on Draft Amendments Relating to Advertisements of Municipal Fund Securities and Draft Interpretive Guidance on Disclosures in Connection with Out-of-State Sales of College Savings Plan Shares* (June 10, 2004) (the "MSRB's Notice").

[3] *See Rule G-21 Interpretation – Application of Fair Practice and Advertising Rules to Municipal Fund Securities* (May 14, 2002) (the "MSRB's 2002 Interpretive Guidance").

regulation as well as the burdens that conflicting regulatory requirements would impose upon persons offering and selling both types of securities. Moreover, inasmuch as the NASD is charged with inspecting securities firms for compliance with the rules of the MSRB and the SEC, including the advertising rules, uniform standards should facilitate the NASD's ability to conduct such inspections. As such, the Institute again commends the MSRB for its efforts to revise its rules governing the offer and sale of municipal fund securities to be consistent with the regulation applicable to the offer and sale of registered investment company securities under the Federal securities laws, to the extent practicable.

To provide even greater consistency between the MSRB's rules and those applicable to mutual fund performance advertisements, we recommend, as discussed in detail below, that the MSRB further revise Rule G-21 to protect investors from inappropriate reliance on stale performance information. In the interest of consistency of regulation, we also recommend that the MSRB conform its interpretation of any provisions added to Rule G-21 to relevant SEC interpretations. As regards the compliance date for the revised rule, we recommend that the MSRB provide an appropriate transition period for compliance with any revisions adopted to Rule G-21. With respect to the proposed Interpretive Guidance, for the reasons set forth below, we recommend that its discussion relating to the location of disclosure of state tax and other benefits in an issuer's Official Statement be revised to avoid unduly redundant disclosure.

I. PROPOSED REVISIONS TO MSRB RULE G-21, RELATING TO ADVERTISING

The MSRB has proposed to substantially revise Rule G-21 as it applies to municipal fund securities. In particular, the MSRB has proposed to supplement the rule's general anti-fraud standard with specific disclosure standards. These new standards, which are largely based on the MSRB's 2002 Interpretive Guidance and consistent with Rule 482 under the Securities Act of 1933,[4] would add to the rule more specific standards governing the computation, disclosure, and display of performance information in advertisements.[5] The new standards are intended to provide enhanced information to investors and greater uniformity in the computation and display of performance information for municipal fund securities, thereby addressing concerns with the lack of comparability of this information.

For the reasons noted above, the Institute is pleased that the MSRB's proposed revisions to Rule G-21 seek to track the requirements of Rule 482. As recognized in the MSRB's Notice, certain items of information that exist in the mutual fund industry – such as the information disclosed in a mutual fund's registration statement, prospectus, or statement of additional information – do not exist for municipal fund securities. Accordingly, it was necessary for the MSRB's proposal to make certain modifications to the provisions of Rule 482 when incorporating its substance into Rule G-21. The MSRB's Notice requests comment on these proposed modifications. In our view, the proposed modifications satisfactorily address any

[4] As discussed in the MSRB's Notice, Rule 482 governs advertisements by investment companies, including those containing performance information.

[5] According to the MSRB's Notice, if the amendments to Rule G-21 are adopted, the MSRB would expect to withdraw the portions of the 2002 Interpretive Guidance relating to advertisements. The Institute supports such withdrawal.

disparities that should be taken into account in incorporating the provisions of Rule 482 into Rule G-21. We therefore support the MSRB's proposed changes to Rule G-21.

A. Currentness of Performance Information

There is one area of Rule 482 that the MSRB Notice has not proposed to incorporate into Rule G-21. In particular, Subsection (g) of Rule 482 requires an advertisement that includes performance data to provide a website or toll-free or collect telephone number where an investor can obtain more current month-end information. Such website or telephone number must provide the investor performance information on the security advertised that is current to the month ended seven business days prior to the date of use of the advertisement. This provision was added to Rule 482 to address concerns that advertisements containing performance information that was current as of the most recent quarter end before the advertisement was submitted for publication could confuse or mislead investors, particularly if the fund's performance had declined significantly since the period reflected in the advertisement.[6] Adding this new requirement to Rule 482 was intended to ensure that investors who view advertisements highlighting a mutual fund's performance would be alerted to the fact that the fund's current performance may differ from that advertised and have ready access to performance data that is current to the most recent month-end.[7]

The Institute supported the addition of this requirement to Rule 482.[8] We believe the same concerns it was intended to address also exist in the context of municipal fund security performance advertisements. Therefore, the Institute strongly encourages the MSRB to revise Rule G-21 to require advertisements subject to the rule that include performance information to provide a source where investors may obtain, at no charge, performance information current to the month ended seven business days prior to the date of use of an advertisement. Not only would this ensure that investors contemplating a transaction in a municipal fund security have access to more current performance information, it would also provide for even greater uniformity between the MSRB's advertising requirements and those imposed on mutual funds under Rule 482.

B. Consistency of Implementation of Advertising Regulation

Along the lines of providing greater consistency between the advertising requirements of the MSRB and those of the Commission, the Institute recommends that the MSRB conform its interpretation of any provisions added to Rule G-21 based on Rule 482 to relevant SEC

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[6] *See Proposed Rule: Proposed Amendments to Investment Company Advertising Rules* SEC Release Nos. 33-8101, 34-45953, and IC-25575 (May 17, 2002) at p. 7.

[7] *See Final Rule: Amendments to Investment Company Advertising Rules,* SEC Release Nos. 33-8294, 34-48558, and IC-26195 (Sept. 29, 2003) (the "SEC's Adopting Release") at p. 7.

[8] *See* Letter from Amy B.R. Lancellotta, Senior Counsel, Investment Company Institute, to Mr. Jonathan G. Katz, Secretary, SEC, dated July 31, 2002. As noted in the Institute's comment letter, the Commission's proposal was largely consistent with recommendations the Institute submitted to the Commission in July 2001. *See* Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Mr. Paul F. Roye, Director, SEC Division of Investment Management, dated July 18, 2001.

interpretations. The MSRB should clarify in the notice adopting the revisions to Rule G-21 that a municipal securities dealer advertising a municipal fund security may rely upon any guidance provided by the SEC (*e.g.*, in its release adopting the amendments to Rule 482) or by the National Association of Securities Dealers relating to the implementation of Rule 482.[9]

C. Disclosure of Source Containing Generalized Information

As proposed to be amended, Rule G-21(e)(i)(A)(1) would require an advertisement for a municipal fund security to include a statement that advises an investor to consider, before investing, whether the investor's home state offers any state tax or other benefits that are only available for investments in that state's qualified tuition program. The MSRB's Notice seeks comment on whether this disclosure should also include a reference to an MSRB-maintained website where generalized information on municipal fund securities would be provided and, if so, the extent to which the information currently provided on the MSRB website should be included, modified, supplemented, or deleted. The Institute recommends that the disclosure not be required to include such a reference. We believe that there is sufficient information available in the marketplace concerning 529 plan securities to enable an investor contemplating an investment in such securities readily to obtain both general information and information about specific features of individual states' programs. As such, we do not believe it necessary that advertisements also be required to disclose a source where generalized information about such securities can be obtained. We note that we are not aware of any other investment product whose advertisements are required by law to include a source where generalized information about the type of investment product can be obtained.

II. DRAFT INTERPRETIVE GUIDANCE ON DISCLOSURES RELATING TO OUT-OF STATE PLANS

As mentioned above, in addition to proposing amendments to Rule G-21, the MSRB has proposed to enhance its 2002 Interpretative Guidance relating to the application to municipal fund securities of Rule G-17, which governs fair dealing with customers. In particular, the MSRB proposes to require a municipal securities dealer to disclose that, "depending upon the laws of the customer's home state, favorable state tax treatment for investing in a college savings plan or other benefits offered under state law in connection with investing in college savings plans may be available only if the customer invests in a college savings plan offered by the investor's home state."[10] The interpretive guidance would also require the dealer to "suggest" that the customer consult with a qualified adviser or contact his or her home state's

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[9] For example, as revised, Rule 482 requires that mutual fund advertisements include: (1) a statement that past performance does not guarantee future results; (2) a statement that current performance may be lower or higher than the performance data quoted; and (3) a toll-free or collect telephone number or website where an investor may obtain more current performance information. Although not expressly stated in the Rule, the SEC's Adopting Release clarifies that an advertisement may combine these required statements in a single sentence provided that each of the required disclosures is "clear and easy to understand." *See* SEC Adopting Release at p. 11.

[10] Examples cited in the MSRB's Notice of these non-tax benefits include "lower fees, matching grants, scholarships to state colleges, and other financial benefits." MSRB Notice at fn. 14.

college savings plan to find out more about such benefits.[11] As proposed, this disclosure would be required to be provided to an investor "at or prior to the time of trade."[12]

The Institute supports the MSRB's proposed enhancements to the 2002 Interpretive Guidance. We agree that it is important to alert investors to benefits that may only be provided to them by their home state's college savings plan program. The proposed disclosures should help ensure that an investor contemplating the purchase of an out-of-state plan makes an investment decision on the basis of more complete information. We recommend, however, that a minor revision be made to the language in the Interpretive Guidance relating to the location of the disclosure of state tax and other benefits in an issuer's Official Statement. As proposed, the Interpretive Guidance would deem the disclosure obligations of Rule G-17 to be satisfied if this disclosure appears in an Official Statement "in close proximity and with equal prominence" (1) to the first presentation of information regarding other federal or state-tax related consequences of investing in the college savings plan *and* (2) to each other presentation of information regarding state-tax related consequences. While we fully support (1), with respect to (2), we recommend that the Official Statement not be required to incorporate this disclosure in every mention of the state-tax consequences of investing in the plan. Instead, such disclosure should only be required where it would be relevant to the issue being discussed.

III. TRANSITION PERIOD

The Institute recommends that the MSRB provide an appropriate transition period for compliance with the revisions to Rule G-21. The proposed revisions to Rule G-21 will require substantial changes, not only to advertisements, but to phone systems and websites,[13] each of which will necessitate the expenditure of considerable time and resources to ensure compliance with the new requirements. We note that when similar changes were made to Rule 482 by the SEC in 1988, the Commission's proposed compliance date of 90 days from adoption was extended to 210 days to accommodate the changes necessitated by the revised rule. We believe the process municipal securities dealers will have to go through to achieve full compliance with the proposed revisions to Rule G-21[14] will be comparable to that experienced by mutual funds

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[11] While the dealer would not be required to provide the investor specific information about state tax or other benefits available to an out-of-state investor, to the extent the dealer does so, it must ensure that the information is not false or misleading.

[12] Under the MSRB's proposal, though this requirement could be satisfied if the disclosure is included in an official statement provided to the investor prior to the trade. If the disclosure is included in the official statement, it must appear in a manner that is reasonably likely to be noted by the investor, as discussed in more detail in the proposed revisions to the guidance.

[13] This is particularly true if the MSRB adopts the Institute's recommendation to require that investors have access to more current performance information.

[14] While the rule only applies to advertisements by municipal securities dealers, due to the nature of the 529 plans, it is likely to expect the state issuers of such plans to be involved with any advertisements placed by the dealer advertising the plan, which adds complexity to this process that does not arise in connection with mutual fund advertisements.

when Rule 482 was substantially revised in 1988.[15] Therefore, we recommend that the MSRB provide a 210-day transition period prior to enforcing compliance with the revised rule.

* * * *

The Institute appreciates having the opportunity to provide these comments on the MSRB's proposal. If you have any questions concerning these comments, please do not hesitate to contact the undersigned by phone at (202) 326-5825 or by e-mail at tamara@ici.org.

Sincerely,

Tamara K. Salmon
Senior Associate Counsel

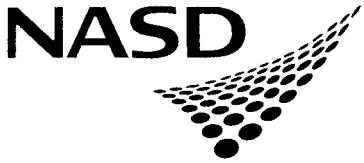
cc: Jill C. Finder, Assistant General Counsel

[15] We additionally note that, when the revisions to Rule 482 were adopted by the Commission in September 2003, the Commission provided a compliance date of March 30, 2004, approximately 180 days after adoption.

About the Investment Company Institute

The Investment Company Institute's membership includes 8,600 open-end investment companies ("mutual funds"), 630 closed-end investment companies, 135 exchange-traded funds and 5 sponsors of unit investment trusts. Its mutual fund members manage assets of about $7.351 trillion. These assets account for more than 95% of assets of all U.S. mutual funds. Individual owners represented by ICI member firms number 86.6 million as of mid 2003, representing 50.6 million households. The Investment Company Institute is the national association of the American investment company industry. Many of the Institute's investment adviser members render investment advice to both investment companies and other clients. In addition, the Institute's membership includes 231 associate members, which render investment management services exclusively to non-investment company clients. These Institute members and associate members manage a substantial portion of the total assets managed by registered investment advisers.

Mary L. Schapiro
Vice Chairman, NASD
President, Regulatory Policy and Oversight



September 9, 2004

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

Re: Request for Comments on Draft Amendments Relating to Advertisements of Municipal Fund Securities and Draft Interpretive Guidance on Disclosures in Connection with Out-of-State Sales of College Savings Plan Shares (MSRB Notice 2004-16) (June 10, 2004) ("MSRB Notice")

Dear Mr. Lanza:

I am writing on behalf of the NASD staff to express our views concerning the above-referenced proposal. The comments provided in this letter are solely those of the NASD staff; they have not been reviewed or endorsed by the Board of Governors of NASD or by the Board of Directors of NASD Regulation.

1. Summary of the NASD Staff's Comments

The NASD staff appreciates the opportunity to comment on the MSRB's proposed revisions to its advertising rule, Rule G-21, and the MSRB's proposed interpretive guidance on point-of-sale disclosure.[1] We strongly support the goals of the MSRB's proposals, to ensure that investors receive adequate disclosure concerning 529 plans, including disclosure about the mutual funds available through 529 plans.

As the MSRB is aware, 529 plans commonly use mutual funds as their primary investment vehicle.[2] While 529 plans do carry specific benefits associated with their status as municipal securities, investors may perceive a 529 plan as a mutual fund with a municipal security "wrapper." In fact, 529 plans present all of the potential suitability, disclosure and other sales practice issues as mutual funds. Moreover, their very benefits, such as in-state tax deductions and fee reductions, present additional disclosure and other

[1] In light of the Securities and Exchange Commission's proposed new Rules 15c2-2 and 15c2-3, the MSRB recently withdrew a proposed interpretive notice concerning point-of-sale disclosure in the workplace. MSRB Notice 2004-25 (August 2, 2004). However, we understand that the MSRB has not withdrawn the proposed point-of-sale disclosure guidance in the MSRB Notice that is a subject of this comment letter.

[2] In this letter, the terms "529 plan" and "municipal fund security" are intended to refer to college savings plans established under Section 529(b)(A)(ii) of the Internal Revenue Code of 1986 as "qualified tuition programs." The terms are not intended to include pre-paid tuition plans or local government pools.

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sales practice issues. For that reason, every SEC and NASD sales practice standard that applies to the distribution of mutual funds to retail investors also should apply to the sale of mutual funds through 529 plans, and these standards should be supplemented by additional sales practice requirements to address the unique characteristics of 529 plans.[3]

As to the MSRB's specific proposals, the NASD staff generally supports the proposed amendments to Rule G-21. In particular, we support the requirement that any advertisement for an underlying mutual fund comply with the SEC and NASD advertising rules.

With respect to the advertisement of the municipal fund securities themselves, the MSRB's proposal would emulate various provisions of the SEC and NASD advertising rules. We support this approach, but recommend that whenever possible, Rule G-21 should use precisely the same language as the pertinent provisions of the SEC and NASD advertising rules. The proposed amendments contain several differences that may cause unnecessary confusion. In addition, the MSRB should clarify that SEC and NASD interpretations of our advertising rules would apply to the similar provisions of Rule G-21. This clarification would better ensure that the SEC, NASD and MSRB consistently apply the rules and that mutual fund investors receive full protection from sales practice abuse – whether they purchase their funds through 529 plans or through other distribution channels.

The NASD staff also supports the objectives of the proposed amendments to Rule G-17 – but we recommend that the MSRB go even farther. In particular, we recommend that the MSRB mandate point-of-sale disclosure concerning the fees and expenses associated with a 529 plan and the forms of compensation that dealers receive in connection with the sale of such a plan. We have enclosed a proposed disclosure statement that would effect our recommendation.

Part 2 of our letter presents our comments to the proposed amendments to Rule G-21, concerning advertising, and Part 3 presents our comments to the proposed interpretative statement on Rule G-17, concerning point-of-sale disclosure.

2. *Proposed Amendments to Rule G-21*

A. The NASD Staff Generally Supports the Proposed Amendments

The NASD staff generally supports the proposed amendments to Rule G-21. As the MSRB is aware, NASD is responsible for enforcing compliance with Rule G-21 with respect to our members. Moreover, in Special Notice to Members ("NtM") 03-17, NASD

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[3] In a separate letter to the MSRB, we support the MSRB's decision to take a similar approach with respect to non-cash compensation arrangements. **[CITE]**

clarified the treatment of sales material for municipal fund securities, including Section 529 college savings plan securities. In NtM 03-17, we clarified the following points:

- Sales material for municipal fund securities must comply with NASD and SEC advertising rules to the extent that the sales material refers to certain key aspects of an underlying investment company.

- Members must file with NASD municipal fund security sales material that refers to the underlying investment company securities, just as members must file any sales material concerning registered investment companies.

- Sales material for municipal fund securities also must comply with applicable MSRB rules.

The MSRB's proposed amendments to Rule G-21 appear to take a similar approach to the regulation of the sales material for municipal fund securities. In particular, proposed Rule G-21(e)(vi) would provide that if an advertisement for a municipal fund security provides specific details of a security held as an underlying asset of the municipal fund security, the presentation of the details must comply with the SEC and NASD advertising rules.

We support the proposed approach. The MSRB's proposal recognizes that Section 529 plans often market the underlying mutual fund securities. Investors who are the subject of such marketing efforts deserve the same level of protection as other mutual fund investors.

B. Whenever Possible, MSRB Should Rely Verbatim on SEC and NASD Rule Language

The proposal also would provide specific standards applicable to the advertisement of the municipal fund securities themselves. We understand that these provisions would only apply to the portion of sales material that promotes the municipal fund security. As discussed above, we understand that the portion of the sales material concerning the underlying mutual funds would be subject to SEC and NASD advertising rules.

Several provisions of the proposal emulate the SEC and NASD advertising rules. We appreciate that restating applicable provisions, with some modification, may be necessary because those rules regulate the advertisement of mutual funds rather than municipal fund securities. Nevertheless, to the extent possible, the MSRB should adopt verbatim the language in the applicable provisions of the SEC and NASD advertising rules -- even as to the advertisement of municipal fund securities. In addition, the MSRB should clarify that SEC and NASD interpretations of our advertising rules would apply to the similar provisions of Rule G-21. This approach will better ensure that the SEC, NASD and

MSRB consistently apply the rules and that mutual fund investors receive full protection from sales practice abuse.

The proposal presents several inconsistencies with applicable provisions of the SEC and NASD advertising rules. For example:

- Paragraph (e)(i)(B)(1) of the MSRB's proposal attempts to restate Rule 482 (b)(3)(i), word for word. Yet the restatement does not include the recently adopted language in Rule 482(b)(3)(i) concerning month-end performance data. Consequently, investors would not have ready access to current performance data for municipal fund securities, while they would have access to such data for mutual funds whose sales material is subject to Rule 482(b)(3)(i).

- Paragraph (e)(ii)(C) of the MSRB's proposal attempts to restate Rule 482(d)(3)(ii). Yet the provisions are different in at least one important respect. Rule 482 requires that performance data "be current to the most recent calendar quarter ended prior to the submission of the advertisement for publication." The MSRB's proposal would require that performance data "be calculated as of the most recent calendar quarter ended prior to submission of the advertisement for publication *for which such performance data, or all information required for the calculation of such performance data, is reasonably available to the broker, dealer or municipal securities dealer . . .*" (emphasis supplied). The proposed language appears to give dealers latitude as to the end date that they use for calculation of standardized returns. This latitude may undermine the ability of investors to compare different municipal fund securities programs, or even the same program offered by different dealers who impose varying end dates for their performance calculation. At a minimum, the disparity between the language in Rule 482 and the MSRB's proposal would create confusion for broker-dealers that must comply with both provisions.

- Paragraph (e)(iv) of the MSRB's proposal would require that an advertisement that relates to or describes services "indicate the entity providing those services" and that an advertisement that solicits the purchase of municipal fund securities "clearly state which entity would effect the transaction." This provision resembles, but is not identical to our Rule 2210(d)(2)(C), which generally requires that all sales material prominently disclose the name of the member and, if it includes other names, reflect which products or services are being offered by the member. The differences between the two provisions would cause confusion concerning whether compliance with Rule 2210(d)(2)(C) would constitute compliance with the paragraph (e)(iv) of the MSRB's proposal.

We strongly recommend that the MSRB, whenever possible, use precisely the same language as the SEC and NASD advertising rules, and clarify that our interpretations of

those rules would similarly apply to the interpretation of the Rule G-21 amendments. We are available to assist the MSRB staff in this effort.

3. Proposed Amendments to Rule G-17

A. NASD Staff Supports the Objectives of the MSRB Proposal

The MSRB has interpreted Rule G-17 to require a dealer to disclose to its customers at point of sale all material facts concerning the transaction and the security known by the dealer. The MSRB proposes interpretive guidance to broaden the existing Rule G-17 point-of-sale disclosure requirement, to include reference to all potential benefits offered solely in connection with in-state investments. The guidance would provide that disclosure made through the official statement of the municipal fund securities issuer would suffice if the official statement is provided to the customer by the time of trade and the disclosure appears in the official statement in a manner that is reasonably likely to be noted by an investor.

The NASD staff supports the requirement that dealers disclose the fact that certain benefits are offered only to in-state customers. Failure to make this disclosure may mislead customers concerning the relative benefits of a particular 529 plan.

B. The MSRB Also Should Require Disclosure of Fees and Compensation

We also recommend that the MSRB go farther. In particular, we recommend that the MSRB mandate point-of-sale disclosure concerning all of the fees and expenses associated with a 529 plan, and the forms of compensation that the dealers receive in connection with the sale of such a plan. This disclosure would better inform customers concerning the costs associated with their investment and the potential conflicts associated with the sale of these products. Moreover, a requirement that each dealer provide such a statement with respect to every 529 plan that the dealer offers would facilitate the comparison of different plans.

Such an approach would implement many of the recommendations offered by House Financial Services Chairman Oxley in his July 15th letter to SEC Chairman Donaldson. Chairman Oxley expressed concern about "the lack of consistent transparency of fees" relating to 529 plans. As Chairman Oxley said,

> I strongly believe that if investors are able to discern and compare the fees associated with these plans, market forces will work to reduce those fees – so long as states do not discriminate against investors who would like to select out-of-state plans. Without adequate transparency and uniform treatment the benefits of robust competition will not be realized.

Chairman Oxley therefore urged the development of "a standardized format for describing fees," disclosure of fee amounts in dollar terms as well as percentages, and disclosure concerning the allocation of fees.

We enclose for the MSRB's consideration a prototype disclosure document that would accomplish all of these suggestions. As the MSRB is aware, the Securities and Exchange Commission has proposed Securities Exchange Act Rules 15c2-2 and 15c-3, concerning confirmation and point-of-sale disclosure with respect to investment companies, variable annuities and 529 plans. In commenting on this proposal, the NASD staff submitted a prototype disclosure document that would meet the SEC's objectives while providing concise disclosure to investors.

The enclosed version of this prototype would be especially suitable for 529 plans. This prototype would present the fees and expenses associated with the 529 plan and the forms of compensation to the dealers for the sale of the 529 plans. Moreover, the prototype would state that investment in an in-state 529 plan may provide favorable state tax treatment, reduced plan expenses and other benefits. The prototype would encourage investors to review the official statement for the in-state plan for more information.

We recommend that the SEC and the MSRB consider requiring that all dealers present this disclosure document to investors at point-of-sale, either in writing or by reference to the dealer's Website. This disclosure document would enhance disclosure to investors and help ensure that investors make well-informed investment decisions.

* * *

Thank you again for the opportunity to comment on the MSRB's important proposals. Feel free to contact us if you have any questions.

Sincerely,

Mary L. Schapiro
Vice Chairman, NASD
President, Regulatory Policy and Oversight

Enclosures

cc: Thomas Selman
NASD Investment Companies Reg.

XXX Variable Annuity

What You Pay

This table shows fees and expenses you would pay as a contract owner in the ***XXX Variable Annuity***. Certain charges decline over time. Please see the Annuity's prospectus for more information.

Contract Owner Fees–Paid By You

Maximum Charges ***(per $10,000)***

For Purchases	$XX
For Withdrawals	XX
For Transfers	XX

Annual Contract Expenses
(per $10,000 Investment over 12 months)

Annual Contract Fees	$XX
Mortality & Expense Fees	$XX
Administrative Fees	$XX
Maximum Riders & Guarantees Fees	$XX

Underlying Fund Fee Ranges

Management Fees	XX% - XX%
12b-1 Fees	XX% - XX%
Other Fees	XX% - XX%

What We Receive

This table shows the compensation that we receive when you invest in the ***XXX Variable Annuity*** through XYZ Broker.

Out of the Total Purchase Payments that You Make, We Receive: *(per $10,000 investment)*

- $XX in Sales Commissions at the Time of the Purchase
- $XX of Trail Commissions (over 12 months)
- $XX in Revenue Sharing Payments from the Contract's Issuer
- $XX - $XX in Rule 12b-1 Fees from the Underlying Funds (over 12 months)

Our compensation varies depending upon the underlying funds you choose.
Please note the following:

- Revenue sharing payments are cash payments from the contract's issuer to us, in order to assist us in covering operating expenses and encourage us to bring the variable annuity contract to your attention.
- Your registered representative receives higher compensation for the sale of the XXX Variable Annuity than for the sale of similar variable annuity contracts.
- You may also pay a state premium tax at the time a payment is made, which will vary by state.

Information current as of the contract prospectus dated XXX.
See XYZbroker.com for comparable information about other variable contracts.

State of X 529 Plan – Growth Portfolio

What You Pay

This Table shows the total fees and expenses that you would pay as a unit holder in the ***Growth Portfolio***, including the fees imposed on the underlying mutual funds in the Portfolio. Certain charges decline over time. Please see the disclosure document furnished by the State of X 529 Plan for more information.

Account Holder Transaction Fees–Paid Directly By You

Maximum Charges (per $10,000 contribution)

529 Plan Application Fee	$XX
Purchase Charges	XX
Withdrawal Charges	XX

Annual Account Expenses–Deducted from Account Assets

(per $10,000 contribution over 12 months)

529 Plan Account Maintenance Fee	$XX
529 Plan Program Management Fee	XX
Underlying Fund Fees	
Management Fees	XX
12b-1 Fees	XX
Other Fees	XX

What We Receive

This Table shows the compensation that we receive when you invest in the ***Growth Portfolio*** through XYZ Broker.

Out of the Total Fees and Expenses that You Pay, We Receive:

- XX% of all Maximum Charges
- XX% of Program Management Fee
- $XX in Revenue Sharing Payments (per $10,000 investment over 12 months)
- $XX in Rule 12b-1 Fees from the Underlying Funds (per $10,000 investment over 12 months)

Our compensation varies depending upon which Portfolio you choose.
Please note the following:

- Revenue sharing payments are cash payments from the distributor of the State of X 529 Plan to us, in order to assist us in covering operating expenses and encourage us to bring the Plan to your attention.
- Your registered representative receives higher compensation for the sale of the State X 529 Plan than for the sale of similar 529 plans.
- Investment in an in-state 529 plan may provide favorable state tax treatment, reduced plan expenses, and other benefits. Please review the in-state plan's disclosure document for information.

Information current as of plan disclosure document dated XXX.
See XYZBroker.com for comparable information about other Portfolios in the 529 Plan.

Securities Industry Association
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September 15, 2004

Ernesto A. Lanza
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street
Suite 600
Alexandria, VA 22314-3412

Re: Notice 2004-16, Draft Amendments Relating to Advertisements of Municipal Fund Securities and Draft Interpretive Guidance on Disclosures in Connection with Out-of-State Sales of College Savings Plan Shares

Dear Mr. Lanza:

On behalf of the Securities Industry Association, (SIA)[1] we are writing in response to Notice 2004-16, which seeks comments on modifications to the rules governing advertisements and disclosures relating to college savings plans ("529 plans"). SIA is generally supportive of the objective of the subject Notice and we appreciate the opportunity to provide specific comments on potential areas of concern.

Reliance on Official Statements

Notice 2004-16 proposes an expansion to the disclosure requirements related to sales of out-of state 529 plans to other state features, such as special financial aid considerations. Under the proposal, the obligation to disclose the potential loss of state tax benefits could be met if the required disclosure is included in the official statement delivered to the customer, appearing in a manner reasonably likely to be noted by an investor.

[1] The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of nearly 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. According to the Bureau of Labor Statistics, the U.S. securities industry employs 780,000 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift and pension plans. In 2003, the industry generated an estimated $209 billion in domestic revenue and $278 billion in global revenues. (More information about SIA is available on its home page: www.sia.com).

SIA is concerned about the standard "reasonably likely to be noted by an investor" and the potential for an adverse decision if the placement of the disclosure is questioned. SIA believes that there should be a presumption that the placement and adequacy of the disclosure in offering materials is reasonable. Broker-dealers should not be in the position to supplant their judgment over that of the state, particularly since the issuer is a governmental entity. In general, states will have approval over the types of information – including the broker-dealers own marketing material – and will dictate by contract, how this information is delivered to investors. SIA recommends this condition be deleted from the guidance.

MSRB Internet Information

Notice 2004-16 also requests comment on whether the MSRB should require disclosure of Internet-based material maintained by the MSRB. SIA is concerned about mandating this type of disclosure on broker-dealers. SIA applauds the MSRB for putting forward a proposal to enhance investor information and education. However, there are a number of Internet sites that include this type of information and other sites will soon be under development. The Securities and Exchange Commission (SEC) and the National Association of Securities Dealers (NASD) have extensive website information on a variety of products but do not require brokers to disclose the availability of information.

Many SIA members have developed Internet material for their customers and invest significant resources to keep this information current. If broker-dealers are also required to refer to an MSRB website they would bear an added burden to monitor the information on the MSRB website to ensure that it is current and accurate. SIA, however, has no concern if the MSRB moves forward with this proposal but does not require disclosure by member firms. If the MSRB pursues this option, SIA would be pleased to work with you to provide information or other material. SIA maintains extensive information on college savings plan on our investor education website: www.pathtoinvesting.com and has produced a brochure for investors interested in 529 plans.

Enhanced Disclosure With Respect to State Tax "Benefits"

While we appreciate the objectives which MSRB is pursuing, it is not clear that it is in the best interest of investors to elevate disclosure about state tax and other state "benefits" above other significant disclosure issues worthy of investor consideration. But to the extent such disclosure is mandated, one must carefully consider the complexity of the underlying issues so that the disclosure given is meaningful to the investor.

There are countless and rather complex differences in state treatment that may affect investor choice. The complexity of the state variances presents challenges to those attempting to disclose them. The appropriate place for disclosure is in the program description and referring investors to such disclosure may be the best course of action, given the challenges when trying to "summarize" such information. It is not clear whether, due to the complexities, cursory disclosure about these state issues would allow for adequate capture of the considerations that need to be made. Telling an investor about state "benefits," without mentioning at least the existence of potential consequences associated therewith seems inadequate.

To give you a sense for the complexity of summarizing state tax treatment variation, consider the following discussion (which is not intended to be all-inclusive):

States with upfront deductions offer such deductions in various amounts to residents, and in some cases, non-resident, taxpayers. The requirements for these deductions vary. Some deductions are per taxpayer, some are per account, some are per beneficiary and some deductions have differing amounts depending on whether you are filing as a single person or married filing jointly, and some deductions are a combination of these and other requirements.

Further, some states have carry-forward provisions of varying amounts (up to an unlimited amount) that allow investors to spread upfront deductions over a period of years. These deductions are, however, contingent upon an investor having taxable income in the applicable state in the current and following years from which to deduct contributions.

Importantly, states also have provisions that require repayment in full under certain circumstances ("recapture") of 529-related state tax deductions previously taken. New York goes even further and characterizes certain qualified withdrawals as non-qualified, thereby, taxing such withdrawals. Lastly, the tax treatment of qualified withdrawals also varies among states..

In general, we believe that the characterization of state tax treatments solely as "benefits" is misleading. Use of the terms "consequences" or "variances" (vs. "benefits") more accurately describes the true nature of such treatments, and is a fairer and more accurate characterization.

Other State "Benefits"

Other state "benefits" vary greatly as does the population to which they are "available". As with the state tax treatment variances noted above, these variations present challenges to those attempting to "summarize" them. States offer benefits to prospective account owners who are in-state residents, non-resident taxpayers, and in some cases non-residents who have beneficiaries who are residents of the state. These "benefits" include, among other things, fee waivers or reductions, matching grants, eligibility for scholarships and preferential in-state financial aid treatment.

State laws affecting protection of assets vary greatly too. State treatment with respect to creditor protection, divorce, and Medicaid eligibility also vary.

State program rules vary greatly as well and the complexity lies in the details. For example, many states have holding period requirements and all states have maximum investment limits, which vary in amount and style (some programs employ a balance test and others, a contribution test), to determine whether the maximum has been reached.

Other Issues

We are also taking this opportunity to comment on a number of other matters addressed in the proposal. Whenever possible, we identify the particular rule number and/or page of the proposing Notice where the item is addressed:

It should be clarified that "at or prior to the time of sale" refers to the initial sale, and that there is no obligation to provide the disclosure at/or prior to every subsequent investment. SIA would be troubled (due to the number of participants participating in automated systematic contributions and the frequency with which SIA members receive unsolicited additional lump-sum contributions) if disclosure were required each time.

G-17 (point of sale disclosure interpretation): It is difficult for dealers to become familiar with attributes of 529 programs they do not sell. Given the complexities noted above and given the fact that dealers who have not entered into distribution agreements likely would not have current (or any) offering documents from such programs, they may be challenged to provide information or to determine what information needs to be provided. In an attempt to "do the right thing," they may inadvertently provide inadequate disclosure about the "home state" program, doing a disservice to the investor and exposing themselves to liability.

G-21 Required Disclosures (draft section (e)(i)): An abbreviated form of disclosure should be allowed for radio and television ads, as the standard length of most commercials would not permit the required disclosures to be included. Additionally, the requirement for "equal emphasis" for required disclosure would result in the commercial's intended message being lost. It may be sufficient for certain forms of advertising (like short television and radio commercials) to inform an investor to obtain the program description and read it carefully before investing. It could also be required that the state program be named, as well as a source from which to obtain the program description of the program that is being promoted through the ad. It is difficult to meaningfully summarize complex distinctions in an advertisement. The appropriate place for disclosure is in the program description (and the need to obtain and read the program description should be referenced in the ad).

G-21 Capacity of Dealer and other Parties (draft section (e)(iv)): Some 529 programs effect transactions through many broker-dealers. It would be difficult (if not impossible in some cases) to list in an advertisement each dealer associated with a program.

We also believe that the requirement in subsection (e)(iii) of Rule G-21 that advertisements give equal prominence to the name of the issuer is unnecessary, and subject to second guessing. The policy objective of the proposed rule, which is to prevent investor confusion as to who the issuer of the security is, is satisfied by the other requirements set forth in (e)(iii) that the issuer of the security be identified and that the advertisement not imply that another entity is the issuer of the security. Introducing an "equal prominence" rule creates interpretive questions for marketing and compliance personnel that are unnecessary in light of the other requirements in (e)(iii).

The MSRB's Notice, "Application of Fair Practices and Advertising Rules in Municipal Fund Securities", dated May 14, 2002, set forth a similar requirement that a marketing piece

clearly identify the issuer and not imply that another entity is the issuer of the security. However, that Notice did not have an "equal prominence" requirement. There is no evidence of any kind that the existing rule set forth in the May, 2002 Notice is not working, or that investors have been confused as to who the issuers of these securities are.

The attached markup of (e)(iii) is consistent with the approach taken by the MSRB in its prior interpretive notice, and we propose that this modified version be included in any final rule:

"An advertisement for a specific municipal fund security must provide sufficient information to identify such security in a manner that is not false or misleading. An advertisement that identifies a specific municipal fund security must clearly identify the name of the issuer, and must not imply that a different entity is the issuer of the municipal fund security. To the extent an advertisement identifies an entity other than the issuer of the municipal fund security, such advertisement must clearly describe such entity's role with respect to the municipal fund security."

We trust you will find our comments helpful and constructive, and we share your interest is assuring that 529 plan investors receive all appropriate disclosure in a clear and balanced manner. Questions regarding this letter should be directed to either Mike Udoff (212-618-0509) or Liz Varley (202-216-2032) of SIA staff.

Sincerely,

Elizabeth Varley

Michael D. Udoff
Co-Staff Advisers
SIA Ad Hoc 529 Plans Committee

THE UNIVERSITY OF NORTH CAROLINA AT WILMINGTON

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

September 15, 2004

Re: MSRB Notice 2001-16

Dear Mr. Lanza and MSRB Boardmembers:

Thank you for allowing us to comment on the draft amendments relating to advertisements of municipal fund securities and the draft interpretive guidance on disclosures in connection with out-of-state sales of college savings plan shares.

We would like to bring to your attention the results of a study conducted on the tax and non-tax factors that influence investors' choice of state sponsored §529 college saving plans. We discuss our study below, followed by our recommendations for disclosures of state tax benefits, fees, and historical returns.

Study Overview

We examine investments in state-sponsored §529 plans for quarters ending 12/31/01 through 9/30/03. During this time period, §529 plan investments tripled from $13.6 to $45.8 billion as investors opened an additional 3.7 million accounts. Our results demonstrate that §529 plans with higher fees have more accounts. Surprisingly, the amount of state tax deductions from plan contributions is *negatively* related to number of accounts; the states providing the largest state income tax deduction for residents' contributions are likely to have the smallest number of accounts. These findings are consistent with Congressional concerns that advisor fees are driving investment recommendations, not state income tax benefits or low fees, which should lead to higher expected returns for these investments. No statistically significant results are reported for other plan features such as amount or type of investment choices or for other tax features such as tax treatment upon distribution.

Study Background

Our study tests whether investors are choosing plans offering the greatest estimated return (i.e., lowest fees and greatest tax benefits) or those with lower search costs (i.e., recommended by an

DEPARTMENT OF ACCOUNTANCY AND BUSINESS LAW
CAMERON SCHOOL OF BUSINESS

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advisor or part of a well-known fund family). It is well documented that investors make purchase decisions based upon prior returns.[1] However, §529 plan investors relied upon other information as plan returns were not publicly available and traditional investment resources (e.g., Morningstar) did not begin §529 plan coverage until fall 2003. This paper examines the trade-off between tax and non-tax features in a setting in which traditional resources and historical data are absent.

Data

Our empirical analysis is carried out using a panel model with random effects representing each §529 plan across the U.S. over eight quarters. We used information on 77 §529 plans offered to the public for the quarters ending December 31, 2001 through December 31, 2003.[2] For each fund, our database contains the total assets under management, the number of accounts by quarter, and the date established. We supplement this data with state tax information, fees, distribution channels, investment choices and distributors' assets under management.

The absence of return data precludes us from isolating inflows from investment appreciation. Thus, we define our dependent variable as the number of accounts in each §529 plan. We model the demand for the §529 plan by regressing the number of accounts on various characteristics of the plans. In general, investors may choose a plan because of low fees, a favorable impression of the plan manager, the efforts of commissioned sales representatives, tax advantages, and various attractive plan features. We test for each of these and present the major findings on taxes and fees below.

Tax Benefits

§529 plans are touted because unique tax benefits make them desirable investments for many people.[3] At the federal level, they are similar to a Roth IRA: contributions are not federally tax deductible, but earnings and withdrawals are tax-exempt if used for qualified expenses. At the state level, net returns vary because of differences in tax treatment of contributions and withdrawals and differences in state marginal tax rates. Assuming a constant interest rate across states and a state income tax deduction upon contribution, a 10,000 investment, at a 5% state tax rate would equate to a $10,526 investment with tax-free growth.

Thus, it is reasonable to assume that funds in states that provide deductions or credits for contributions and exempt qualified distributions will have more investors, than those state plans with less favorable tax rules, all else equal. However, we found the opposite. The sign for our tax variable is negative and statistically significant. This result indicates that the higher the tax deduction permitted for residents that participate in resident plans, the fewer the number of accounts opened. This is a surprising result, because a tax deduction for contributions has an unambiguous positive effect on the ending amount available for education. Despite an unlimited

1Sirri, Erik R. and Peter Tufano. 1998. "Costly search and mutual fund flows." *Journal of Finance* 53: 1589-1622. Ippolito, R. 1992. "Consumer reaction to measure of poor quality: Evidence from the mutual fund industry." *Journal of Law and Economics* 35: 45-70.

2 Several states have more than one plan.

3 Turgesen, Anne. 2004. "The 529 ate my tax break." *BusinessWeek*. August 16.

deduction for contributions to an in-state §529 plan, investors are choosing other plans, given all other factors are constants.

Fees/Marketing Efforts

To make purchase decisions, investors face a "costly search" process in which information is gathered about tax benefits, fees, plan features, and the fund family. Investors frequently use rating services (i.e., Morningstar) and financial literature to assist in the decision-making process. Consumer research would define the §529 plan investment decision as difficult.[4] Specifically, there are many alternatives (77 plans) and plan attributes (over 20 per plan). Further, some plan attributes are difficult to process (i.e., fee structure) or to assign a value (i.e., portability of benefits). Therefore, it is not surprising that a survey of households saving for college reports that 68% of §529 consumers relied upon advisor provided information.[5]

There is reason to believe that rational consumers seeking to maximize expected returns would choose low fee funds. Our results, instead, support the notion that investors are relying upon advisors' recommendations to reduce their search costs. The "fees" variable is positive and statistically significant, indicating that §529 plans with *high* fees have a greater number of accounts.

Other Results

The next table presents summary statistics by account quintile. On average, the funds with the most accounts have higher fees, have been in existence longer and are part of the largest fund families. Conversely, the funds with the fewest accounts have the lower fees, shorter tenure, and smaller fund families.

Means for Select Variables by Account Quintile

Quintile	Plan Accounts Mean	Plan Assets Mean	Fees Mean	Plan Length (quarters) Mean	Distributor Assets under Management Mean
1	1,577	8,453,448	0.510	1.548	15,810,000,000
2	6,904	32,238,068	0.873	3.500	101,700,000,000
3	17,380	94,492,135	1.427	5.946	223,500,000,000
4	40,376	245,800,000	2.179	8.880	321,400,000,000
5	170,931	1,205,000,000	2.711	14.404	828,600,000,000
Average	47,434	317,400,000	1.570	7.434	312,900,000,000

4 Bettman, James R., Eric Johnson, and John W. Payne. Consumer decision making. In Handbook of Consumer Behavior eds. Thomas S. Robertson and Harold H. Kassarjian, pg 50-84.

5 Investment Company Institute. 2003. "Profile of households saving for college." Investment Company Institute Research Series.

Selected statistics by quarter are presented in the table below. The number of accounts and plan assets have increased during this short time frame. Also of note is that the percentage of funds that can only be purchased through a broker nearly doubled from 17% to 32 %.

Descriptive Statistics by Quarter

Variable		4Q01 (n=40)	1Q02 (n=46)	2Q02 (n=50)	3Q02 (n=55)	4Q02 (n=60)	1Q03 (n=64)	2Q03 (n=65)	3Q03 (n=60)
Plan Accounts	Mean	32,499	38,025	42,635	44,723	46,803	50,138	53,979	61,744
	min	48	149	187	240	800	56	317	443
	max	217,000	287,000	326,000	352,000	399,652	424,450	452,465	478,079
Plan Assets	Mean	204,000,000	248,000,000	275,000,000	263,000,000	304,000,000	320,000,000	385,000,000	468,000,000
	min	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	2,000,000
	max	1,530,000,000	2,070,000,000	2,250,000,000	2,240,000,000	2,660,000,000	2,790,000,000	3,360,000,000	4,000,000,000
Broker Required? 1=yes, 0= no	Mean	0.175	0.239	0.240	0.309	0.300	0.313	0.308	0.317

Our Conclusions/Recommendations

During this start-up phase with limited investment choices and few plan administrators, §529 markets may be inefficient. §529 plan investors appear to be choosing high fee/broker sold funds rather then the lower fee, direct investment options. The federal and state tax governments are providing subsidies in the form of tax-exemption of earnings and withdrawals and state income tax deductions. However, the benefits of these subsidies are accruing to the mutual fund distributors, rather than to the plan owners. We support efforts to require uniform fee and performance disclosures. As investors become more able to make meaningful comparisons between funds, market forces will reduce the fees that brokers can extract from investors.

Our results also demonstrate that investors appear to be ignoring state tax benefits. However, data limitations preclude us from determining why this may be the case. We can not assess whether brokers are concealing state tax benefits or whether investors knowingly forgo these state tax deductions when selecting an out-of-state §529 plan. We support efforts to require disclosure of state-tax benefits.

As noted above, our study did not include return variables because this information was not generally available during this time period. Some return information is now available through commercial services such as Morningstar and savingforcollege.com and in plan documents. However, comparisons of returns are still impossible. Some plans report returns for underlying funds without disclosing the percentages invested in each fund. Others report returns for each static or age-adjusted portfolio offered without presenting results for each underlying fund. Each return disclosure should include the following: historic returns for each static or age-based portfolio, historic returns for the underlying funds in each portfolio, and the percentage that each underlying fund comprises each portfolio for each period presented.

Thank you for allowing us to provide these comments. If you have any questions, please feel free to contact Raquel Alexander at 910-962-4259 or LeAnn Luna at 910-962-7632.

Sincerely,

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