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Aug. 31, 2011

Ronald W. Smith
Corporate Secretary
MSRB
1900 Duke Street
Suite 600
Alexandria, VA 22314

RE: MSRB Notice 2011-33, Request for Comment on Plan to Collect Information on 529 College Savings Plans

Dear Mr. Smith:

Thank you for the opportunity to comment on the MSRB's potential plans to collect additional information on 529 college-savings plans. More Americans each year choose states' 529 plans for their college savings, and these 529 investments are critical tools that families use to meet their educational and financial goals. That's why Morningstar believes 529 plans should be subject to the same type of transparency and oversight as alternative choices for college savings, such as savings accounts, stocks, bonds, or mutual funds. The MSRB can lead the way in this effort by requiring more disclosure and, in turn, help college savers make the best choices for their hard-earned dollars.

Morningstar, Inc. is a leading provider of independent investment research in North America, Europe, Australia, and Asia. We provide data on approximately 400,000 investment offerings, including stocks, mutual funds, and similar vehicles, and we have operations in 26 countries.

Morningstar has gathered 529 data for more than eight years, primarily by approaching each plan individually, collecting and storing the data submitted to Morningstar, and then publishing this information through Morningstar's software designed for individual investors, financial advisors, and institutional researchers.

Morningstar's fund analysts also scrutinize this data to help determine forward-looking Analyst Ratings on more than 50 of the largest 529 plans. A summary of this research is often the most widely read article on Morningstar.com each year. Morningstar also publishes an annual study of the 529 industry, studying trends in 529 investment management, portfolios, performance, fees, and stewardship practices.

Public and Private Data

Morningstar collects much of the plans' basic information through required public documents available today on MSRB's EMMA, including the plans' offering statements. But other critical data we receive privately, including performance and portfolio data. The plans have plenty of business incentive to send their data to Morningstar because our firm broadly distributes it to the plans' target customers, individuals and advisors. Even so, not all plans contribute their data to Morningstar, and those that do aren't always timely or thorough in their disclosure. This

uneven disclosure makes comparing 529 plans and their investment options very difficult for both seasoned securities analysts and for the laypeople who invest in the plans.

About half of the industry's 4,000 529 investment options provide daily net asset values to Morningstar, for example, but others report NAVs monthly, and even some of the nation's largest plans do not consistently report their data to Morningstar within 15 days of the prior month's end. As analysts of and investors in 529 plans, we find this lack of basic performance disclosure concerning, especially when other investment choices have much higher disclosure standards. If 529 college-savings plans want to earn investors' trust and confidence, they must provide the same level of transparency as the other investments available to college savers.

Level the Playing Field

Morningstar maintains that 529 plans should be required to disclose and the MSRB should collect the following details on each investment option within the plans:

- benchmark index (or combination of indexes)
- quarterly portfolio holdings
- daily net asset value
- past performance net of fees relative to its benchmark over standard shorter- and longer-term periods, such as year-to-date, one year, three years, five years, and 10 years

This disclosure would make it easier for college savers to understand their investment options and would hold the plans more accountable for good performance. By making these details public, the plans also would ease the states' and MSRB's regulatory burden because it would be easier to determine whether the plans are meeting their performance and portfolio goals.

Such reporting standards should not create an undue burden or expense on the plans. Certainly every state overseeing these plans demands such performance reporting from the plans' program managers as part of their ongoing fiduciary review process. By making the data public, individual investors and regulators would have access to the same details.

Standard Fee Disclosure

Morningstar also urges the MSRB to reconsider 529 investment options' fee disclosure. It will be difficult for the MSRB to present 529 fee data in a clear way when the fee structure isn't uniform. Some plans have very low asset-based expense ratios but charge annual fixed account fees of \$10 to \$25. Others have eliminated an annual account fee but have higher expense ratios. Some plans have low investment expenses but very high program-management fees, and some advisor-sold plans have 5.75% sales loads while others charge 3.50%. Making dollars-and-cents sense of this litany of fees causes many veteran Morningstar analysts to scratch their heads, so we assume college savers are doing the same. Perhaps the 529 industry would be best served by clear and consistent fee accounting standards so parents and grandparents are better-equipped to assess these investments.

Filling the Gaps on Asset Data

Finally, Morningstar applauds the MSRB's plan to collect data on aggregate assets held in 529

plans, information on the types of investment options available, the total assets invested in each portfolio, as well as the quarterly contributions and withdrawals to each portfolio. Morningstar already ascertains or determines much of this information, but there are a few important gaps that the MSRB could help fill.

For example, the MSRB could suggest that plans clearly identify which assets are associated with age-based investment options and which are associated with static investment options, where the asset allocation does not change over time. In the past, some 529 plans have double-counted some assets in their reports to Morningstar, particularly in cases when a plan's age-based options invest in the static options. A 529 plan might report, for example, that its age-based options constitute \$100 million of assets and its static options represent \$150 million of assets but neglect to point out that those age-based assets actually are invested in constituent static options. So, the plan's total assets under management is \$150 million--not \$250 million, the sum of the age-based and static options. Clear reporting guidelines from the MSRB could eliminate this potential for double-counting.

Second, the MSRB should collect not just cumulative contributions and withdrawals, but also specific asset flows for each 529 investment option so it's easier to track investor behavior and guard against asset bloat in investment strategies that may be capacity-constrained because of investments in less-liquid securities.

To best track these flows, however, the MSRB would need to define what constitutes a contribution or withdrawal. Morningstar has found it very difficult to track flows of so-called "fixed" age-based options, where plans physically move investors' assets from one age-based option to another as children get older. ("Progressive" age-based options, which are less common in the 529 industry but standard among target-date mutual funds, do not move their participants' assets from option to option to change their asset allocation. Rather, progressive options alter their asset mix as the beneficiaries age.) Assets moving in or out of an option based on a child's birthday doesn't strike Morningstar as a contribution or a withdrawal, so it's important to clearly define these terms so that regulators, researchers, and individuals know what drives changes in the options' assets.

We certainly appreciate the MSRB's efforts to improve transparency for 529 college-savings plan investors. Thank you for considering our comments.

Sincerely,

Laura Pavlenko Lutton
Editorial Director
Fund Research Group
Morningstar, Inc.