



VIA ELECTRONIC MAIL

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Michael Pieciak, Chair of the Corporation Finance Section (Michael.Pieciak@vermont.gov)
Mark Heurman, Chair of Direct Participation Programs Policy Project Group
(mark.heurman@com.state.oh.us)
Anya Coverman, NASAA Deputy Director of Policy and Associate General Counsel
Mark Stewart, NASAA Counsel, at the NASAA Corporate Office (nasaacomment@nasaa.org)

Re: FSI's Comments on NASAA's Direct Participation Programs Policy Project Group's Notice of Request for Public Comment Regarding Proposed Amendments to the NASAA Statement of Policy Regarding Real Estate Investment Trusts

Dear Members of the NASAA Direct Participation Programs Policy Project Group:

On July 27, 2016, the North American Securities Administrators Association (NASAA) published its request for public comments on proposed amendments to the NASAA Statement of Policy Regarding Real Estate Investment Trusts (Proposal).¹ The Proposal would establish a uniform concentration limit of 10% of an individual's liquid net worth, applicable to their aggregate investment in a Real Estate Investment Trust (REIT), its affiliates, and other non-traded REITs. The Proposal provides a carve-out for accredited investors under the income and net worth standards set forth in Regulation D. Lastly, the Proposal states that adhering to the concentration limit does not satisfy the independently required suitability determination under the guidelines, existing administrative rules, or the rules of a self-regulatory organization.

The Financial Services Institute (FSI) appreciates the opportunity to comment on this important Proposal.² In addition, FSI appreciates being included in discussions with the Policy Project Group to provide the perspective of independent firms and their independent financial advisors. FSI's members are strongly committed to working with regulators to help safeguard investors' retirement savings. However, we maintain that creating a subjective concentration limit is not the optimum approach to achieve this goal. We are concerned that the Proposal will result in a number of unintended consequences, such as a lack of regulatory clarity and the potential incentive for investors to seek out alternative investments that are outside the purview of state

¹ Proposed Amendment to the NASAA Statement of Policy Regarding Real Estate Investment Trusts, *available at* <http://www.nasaa.org/40025/notice-request-public-comment-regarding-proposed-amendment-nasaa-statement-policy-regarding-real-estate-investment-trusts>.

² The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

regulators. FSI offers several suggestions to improve the Proposal, including the use of a higher, more flexible uniform limit that we believe better accounts for changing market conditions and specific client needs. We elaborate on our comments and recommendations below.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the U.S., there are approximately 167,000 independent financial advisors, which account for approximately 64.5% producing registered representatives. These financial advisors are self-employed independent contractors, rather than employees of Independent Broker-Dealers (IBD).

FSI member firms provide business support to financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners who typically have strong ties to their communities and know their clients personally. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations and retirement plans with financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their investment goals.

Discussion

A. Introduction

The Proposal amends NASAA's REIT Guidelines in order to create a uniform concentration limit for non-traded REITs. NASAA's Proposal intends to provide additional safeguards for investors by ensuring that investors limit the amount they can place in products that are generally understood to be illiquid, riskier, or more volatile than traditional investments such as stocks, bonds, or cash equivalents. FSI supports the overall intent behind this Proposal and provides the following suggestions to better meet the desired goal without potentially invoking the unintended consequences we outline below.

B. FSI supports efforts to safeguard investor retirement savings but we do not believe that the proposed concentration limits are an optimal solution.

FSI is committed to the goal of safeguarding investors' retirement savings. FSI also understands the value of creating uniform regulations and guidelines to provide clarity for firms and advisors. However, FSI has concerns regarding the creation of an arbitrary cap to limit investments in certain products.

FSI believes that the current regulatory framework adequately addresses the NASAA Policy Group's objectives regarding investor protection. Currently, FINRA imposes and rigorously enforces strict suitability and supervisory requirements on broker-dealers that purchase or sell alternative investments. FINRA Rules 2310 and 2340 already impose suitability requirements for investors to invest in unlisted REITs. The suitability requirements of FINRA Rule 2310(b)(2) require that broker-dealers or financial advisors purchasing or selling an interest in REITs have reasonable grounds to believe that the participant "is or will be in a financial position appropriate to enable

him to realize to a significant extent the benefits described; the participant has a net worth sufficient to sustain the risks inherent in the program; and the program is otherwise suitable for the participant....”³ FSI believes that the Proposal would interfere with the current regulatory framework by effectively making a presumption that more than 10% is inherently unsuitable rather than deferring to the expertise of the financial advisor and the needs of their clients.

Furthermore, we believe that concentration limits as outlined in the Proposal impose a “one size fits all” methodology that fails to consider an investor’s unique profile and needs. Independent financial advisors, who often live and work in the same communities as their clients, are particularly familiar with their clients’ specific situations and goals, including changing cash flow needs that come with life events such as a buying a home, saving for a child’s college education, health issues, or retirement. FSI is concerned the nature of the Proposal would effectively usurp the judgment of the financial advisor in making recommendations to their clients whose situations and goals the independent financial advisor are acutely familiar with. Consequently, we believe the proposed maximum concentration limits would indiscriminately restrict investment choices and make it difficult for financial advisors to make recommendations that truly serve the needs and situations of their clients.

C. FSI is concerned that a 10% limit is too restrictive given specific features of non-traded REITs and the nature of market movement.

FSI is concerned that the proposed 10% concentration limit would prevent investors from taking advantage of the important aspects of non-traded REITs. First, investors often have the option to reinvest income directly back into their investment. The Proposal would inhibit their ability to do so as investors could find themselves beyond the 10% limit once they reinvested the income directly back into the non-traded REIT. Consequently, investors would lose the ability to take advantage of an earning reinvestment plan to increase their long-term growth potential.

Additionally, during extended periods of low interest rates, investors often seek products offering more attractive yield tax advantages, which non-traded REITs can provide. Limiting investors’ access to non-traded REITs could diminish an investors’ ability to hedge more traditional holdovers with a diversified mix of asset classes.

Lastly, concentration percentages vary with market movement. The practical application of market movement means that one day an investor may fall within the limit of 10% but the next day, due to market movement, their interest could raise above 10%. When this occurs, their holding is no longer compliant with the Proposal without making changes to their portfolio. This constant market movement makes such a hardline rule difficult to apply in practicality, especially when one of the key numbers involved in the calculation fluctuates on a daily basis. The result is that financial advisors and firms will have to impose even stricter standards below the 10% threshold in order to ensure they are compliant with the limit, which will preclude investors from continuing to realize the financial benefits and diversification options available by investing in non-traded REITs.

³FINRA Rule 2310, available at http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=8469.

D. If a uniform concentration limit must be imposed, FSI believes that a 20% concentration limit provides important and necessary flexibility.

FSI member firms that offer alternative investments through their independent financial advisors currently have internal concentration limits and supervisory procedures that address the concern that an advisor would create an over-concentration of alternative investments in their client's portfolio. In fact, FSI cannot conceive of many situations where a firm conducting proper supervision would approve recommendations resulting in a non-Accredited Investor holding more than a 20% concentration of non-traded REITs in their investment portfolio. Therefore, FSI respectfully requests that if a concentration limit is deemed necessary, NASAA consider the higher percentage of 20% due to the fact that it would provide the flexibility necessary for the important reinvestment features and market movement factors discussed above while still limiting the concentration to a reasonable percentage already observed by FSI member firms.

E. The Proposal allows state administrators to arbitrarily change concentration limits which negates the benefit of uniformity.

Uniformity in state regulations is generally preferable to FSI members as it allows them to efficiently and effectively understand and comply with regulatory requirements as opposed to interpreting and applying many different standards. One benefit of the Proposal is that it would create the type of uniformity that FSI members so often seek in state regulation. But while the Proposal establishes a 10% concentration limit, it also explicitly allows a state administrator to make their own determination as to whether the risk associated with a particular REIT would require a different standard (either lower or higher). FSI is concerned that this would essentially extinguish the benefits of true uniformity since administrators could change concentration limits arbitrarily.

FSI fears this would result in a subjective standard that would allow a different determination for each individual product and may subject two products with common characteristics to completely different limits in the same state or even neighboring states. We therefore respectfully request that the language in Section IV.B.1 stating "Unless the ADMINISTRATOR determines that the risks or other factors in IV.A. associated with the REIT would require lower or higher standards..." be struck from any finalized guidelines that result from the Proposal so as to retain the benefit of true uniformity.⁴

F. FSI suggests using net worth instead of liquid net worth.

The Proposal states that a client's liquid net worth (defined as that portion of net worth consisting of cash, cash equivalents, and readily marketable securities) be utilized in calculating the investor's concentration.⁵ FSI notes that the SEC's definition of Accredited Investor takes into account net worth rather than liquid net worth.⁶ We respectfully suggest that in the interest of uniformity and clarity, NASAA apply the net worth standard consistent with that of the SEC's

⁴ Proposed Amendment to the NASAA Statement of Policy Regarding Real Estate Investment Trusts, IV. Concentration Limit of Shareholders, B. Concentration Limit, Subparagraph 1.

⁵ *Id.* at Subparagraph 2.

⁶ Under SEC Regulation D, Rule 501 an individual can qualify as an accredited investor if their net worth exceeds \$1,000,000.

definition of Accredited Investor. We believe this is particularly important in light of the carve-out contained in the Proposal for Accredited Investors.

G. FSI members will face particular challenges based on the Proposal's definition of Affiliate.

The Proposal defines "affiliate" as including any person directly or indirectly owning, controlling, or holding, with power to vote ten percent or more of the outstanding voting securities; or any executive officer, director, trustee or general.⁷ FSI is concerned that the Proposal's definition will be confusing for independent firms and independent financial advisors for the reasons outlined below.

Independent financial advisors are able to offer their clients various products without being beholden to a specific firm or product line. This is one of the major benefits to an investor when working with an independent financial advisor. However, because the independent financial advisor is not captive to a particular firm or product line, they may not have access to all the necessary information to be aware of the REIT sponsorship and affiliate relationships. FSI members are concerned that this lack of information may lead to unintentional violation of the rule by independent financial advisors.

In order to alleviate this predicament, FSI proposes that the definition of "affiliates" be changed so that any other products/programs *under the same sponsor* should be included when calculating the concentration limit as opposed to *all* products/programs. This would speak to the reality of the information independent advisors will have with regards to the variety of products they sell.

Conclusion

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with the Department on this Proposal and other important regulatory efforts.

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 393-0022.

Respectfully submitted,



Robin Traxler, Esq.
Vice President, Regulatory Affairs & Associate General Counsel

⁷ Proposed Amendment to the NASAA Statement of Policy Regarding Real Estate Investment Trusts, I. Introduction, B. Definitions, Subparagraph 5. Affiliate.