

The Commonwealth of Massachusetts
Secretary of the Commonwealth
State House, Boston, Massachusetts 02133

William Francis Galvin
Secretary of the Commonwealth

September 12, 2016

Mike Rothman, Esq.
NASAA President
Commissioner
Minnesota Department of Commerce
85 East 7th Place
Suite 500
St. Paul, MN 55101

William Beatty, Esq.
Department of Financial Institutions
Securities Division
150 Israel Road, SW
Tumwater, WA 98501

Mark Heuerman, Esq.
Ohio Securities Commission
77 South High Street
Columbus, OH 43215

Re: Public Comments from the Commonwealth of Massachusetts on the NASAA
Proposed Investor Concentration Limit for Non-Traded REITs

Dear President Rothman, Mr. Beatty and Mr. Heuerman:

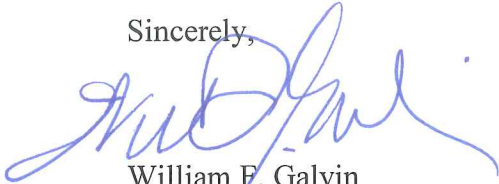
This letter is to make public the comments from the Office of the Secretary of the Commonwealth on the proposed revisions to the NASAA REIT Guidelines that create an investor concentration limit.¹ We are taking the step of sending comments to NASAA in the public comment period because we remain adamantly opposed to the proposal as drafted and because the interests of retail investors are at stake. I have enclosed a copy of the letter that I submitted to NASAA on these issues on April 1, 2016. Our concerns about direct participation programs and the sales practices relating to those programs have only increased since that letter was written.

¹ Notice of Request for Public Comment Regarding a Proposed Amendment to the NASAA Statement of Policy Regarding Real Estate Investment Trusts, July 27, 2016.

We urge NASAA to effectively protect retail investors by replacing the proposal with a strong standard that will protect Mom and Pop investors from being over-concentrated in risky direct participation programs.

Please contact me or Bryan Lantagne, Director of the Massachusetts Securities Division, if you have questions or we can assist in any way.

Sincerely,



William F. Galvin
Secretary of the Commonwealth
Massachusetts Securities Division

cc: Michael Pieciak, Chair of the Corporate Finance Section; Anya Coverman, NASAA Deputy Director of Policy and Associate General Counsel; Mark Stewart, NASAA Counsel



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William Francis Galvin
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April 1, 2016

Mark Heuerman, Chair
NASAA Direct Participation Program Policy Project Group
c/o Ohio Division of Securities
77 South High Street, 22nd Floor
Columbus, OH 43215-6131

**Re: Solicitation of NASAA Member Comment on Investor Concentration Limit Language
For the NASAA REIT Guidelines**

Dear Mr. Heuerman and Members of the Project Group:

The Office of the Secretary of the Commonwealth, Massachusetts Securities Division submits the following comments on the Project Group's proposed amendment to the REIT Guidelines that would apply a concentration limit to sales of non-traded REITs. We understand that the Project Group has worked hard on the challenging technical issues relating to this policy and has also worked to try to reconcile the positions of the various states on the concentration limit issue.

The proposal would apply a 10% of investor liquid net worth concentration standard to sales of a particular non-traded REIT, and to non-traded REITs as a category. The proposal also includes an exception for individuals who are accredited investors.

I am adamantly opposed to the proposal and urge that the draft concentration standard should not be adopted as proposed. Instead, the standard should be strengthened to protect retail investors from demonstrated harm in the direct participation program category of investments. I firmly believe that if the current standard is adopted, it will lead to investor harm.

The Proposed 10% Limit on Sales of Non-Traded REITs Allows Customers to Be Improperly Concentrated in Direct Participation Programs.

The 10% concentration limit should apply to all illiquid DPPs, not just non-traded REITs. This is because the various types of DPPs are actually very similar, and they present similar risks. These include:

- High selling commissions (8% - 10%);
- Material conflicts of interest (these programs are usually advised by an affiliate of the sponsor, with other affiliates typically providing other services as well);
- Illiquidity (this makes DPPs a particularly inappropriate choice for senior investors); and
- An array of misleading and detrimental practices, such as paying periodic “distributions” (which look like dividends) that are paid from new capital contributions and/or from program borrowings, rather than cash flow or earnings.

The incomplete concentration limit currently proposed may do nothing to protect investors from the risks listed above. A 10% standard that applies only to non-traded REITs could permit a broker to recommend that a customer be concentrated heavily in DPPs. For instance, the broker could recommend a portfolio that is 40% DPPs if it were composed of: 10% non-traded REITs; 10% oil and gas programs; 10% equipment programs; and 10% business development companies. If each set of NASAA DPP Guidelines were revised to include the kind of limited cap that is now proposed for the REIT Guidelines, NASAA could end up promoting this kind of portfolio concentration. And we anticipate that, in the context of an arbitration hearing, a broker may seek to defend this kind of unsuitable concentration by asserting that it had followed NASAA’s concentration guidance for each DPP product category, and that broker should therefore not be in trouble for following the rules.

Over-concentration in DPPs is not a hypothetical concern. Because these products pay high selling commissions, brokers and agents have strong incentives to sell them, even when they are not appropriate for the customer. And, as we have mentioned in prior comments, Massachusetts has found brokers concentrating their customers in DPP offerings, even when the prospectuses have specifically prohibited such concentration. Actions by my Securities Division against 6 broker-dealers returned over \$21 million to mom and pop investors who were over-concentrated in these high-risk securities.¹

We also urge you to evaluate this issue in light of the severe ethical problems we have seen in the DPP industry. DPP industry leader Leo Wells was barred from the securities industry for a year due to flagrant sales practice violations. Very recently, my office filed a complaint against industry leader American Realty Capital and its affiliated broker-dealer Realty Capital Securities for proxy solicitation fraud.² This action was the culmination of multiple scandals relating to those firms. At this time, we are also aware of at least two other DPP sponsors that are under active regulatory investigation.

Based on recent experience, it is clearly foreseeable that the DPP industry and selling brokers will act to evade the goals of a concentration limit. New FINRA rules (Regulatory

¹ *In the Matter of Ameriprise Financial Services, Inc.*, Docket No. E-2013-0045; *In the Matter of Commonwealth Financial Network*, Docket No. E-2013-0046; *In the Matter of Lincoln Financial Advisors Corp.*, Docket No. E-2013-0047; *In the Matter of Royal Alliance Associates*, Docket No. E-2013-0044 (<http://www.sec.state.ma.us/sct/archived/sctfive/fiveidx.htm>); and *In the Matter of LPL Financial, LLC*, Docket No. E-2012-0036 (<http://www.sec.state.ma.us/sct/archived/sctlpl/lplidx.htm>).

² *In the Matter of Realty Capital Securities, Inc.* Docket No. E-2015-0034, (<http://www.sec.state.ma.us/sct/current/sctrealtycapital/realtycapitalidx.htm>).

Notice 15-02) require the DPP industry and selling brokers to take simple steps to disclose the impact of front-end costs on customer account statements. Some supporters of the FINRA rules hoped that this improved disclosure would lead to lower fees. The DPP industry's response to the FINRA rulemaking was to restructure selling commissions by creating new share classes that pay trail commissions ("T shares"). Selling commissions were not reduced; instead they were made payable over several years, which made them harder for investors to see. This outcome was the opposite of the transparency that FINRA was trying to promote. With the advent of T shares, the disclosure mandated by FINRA actually became misleading, because the value assigned to DPP investments reflects only the low initial commission payable for these products in the first years. We can expect the same kind of bad faith approach to compliance if NASAA adopts a DPP concentration limit that is easily evaded.

The Accredited Investor Standard Is Not an Appropriate Threshold for Removing the Concentration Limit.

The proposal would also remove any concentration limit for sales to accredited investors. The threshold for this exception is simply too low. In Massachusetts and in many metropolitan areas, it is quite possible for a non-wealthy and unsophisticated investor to have a net worth (exclusive of home) exceeding \$1 million. We have seen examples of widows and retirees who meet this standard based on funds in a retirement account, proceeds of a spouse's life insurance, and/or proceeds from the sale of a home. Specifically, my Securities Division successfully settled an action against Securities America for sales of Medical Capital notes, and in many instances, the customers who were sold those notes were middle class savers who met the accredited investor standard.³

These investors are not in a position to fend for themselves in the financial markets. At a minimum, any high net-worth exclusion from the concentration limit should be high enough to exclude middle class investors. The language of the guideline should be adjustable (upward) at the discretion of a particular state to match the characteristics of the economy and investors in that state.

Investor Protection Must Be Our First Priority.

We recognize that the DPP industry is strongly opposed to concentration limits and that they are prepared to fight for their position. These products are very lucrative for DPP sponsors and for the brokers that sell DPPs, so it is no surprise that they want to protect the way they do business. It is vitally important that NASAA stand its ground on this issue because the interests of retail investors are at stake.

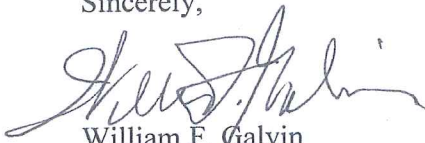
We note that there are many *liquid* investments and stocks that can provide retail investors with exposure to asset classes such as real estate, energy, early-stage companies, and commodities. Despite what the industry suggests, DPPs are not the only investments in these asset classes. The liquid investments charge lower selling commissions and involve fewer conflicts than DPPs. A strong DPP concentration limit will protect investors from financial harm, not deprive them of good investment opportunities.

³ *In the Matter of Securities America, Inc.*, Docket No. E-2009-0085.

The heart of our job as regulators is investor protection. You now have the opportunity to limit the impact of low-quality and conflict-ridden investments on retail investors by adopting a meaningful and effective concentration limit. I urge you to stand up for vulnerable investors and savers by adopting a strong and effective concentration limit that applies to all direct participation programs.

Thank you for this opportunity to provide comments. Please contact me or Bryan Lantagne, Director of the Massachusetts Securities Division, if you have questions or we can assist in any way.

Sincerely,

A handwritten signature in dark ink, appearing to read "William F. Galvin", written in a cursive style.

William F. Galvin
Secretary of the Commonwealth
Commonwealth of Massachusetts

cc: Judith M. Shaw, Esq., NASAA President; Michael Picciak, Esq., NASAA Corporate Finance Section Chair