Via Email to: Andrea Seidt (Andrea.Seidt@com.ohio.gov); Mark Heuerman (Mark.Heuerman@com.ohio.gov); and (NASAAComments@nasaa.org)

September 12, 2022

North American Securities Administrators Association ("NASAA")
750 First Street, NE Suite 1140
Washington, DC 20002

RE: Proposed Revisions to NASAA Statement of Policy Regarding Real Estate Investment Trusts

Dear Ms. Seidt and Mr. Heuerman:

Cambridge Investment Research, Inc. ("Cambridge") submits this letter in response to the Request for Public Comment regarding the Proposed Revisions to NASAA Statement of Policy Regarding Real Estate Investment Trusts ("REIT Guidelines") dated July 12, 2022 (the "Request"). Cambridge is grateful for the opportunity to provide commentary regarding the Request and asks that NASAA consider the following points when revising the REIT Guidelines.

I. Concerns Regarding the Proposed Standardized Concentration Limit

Per the Request, "NASAA recommends that a 10 percent concentration limit be structured to apply to the issuer, its affiliates, and other non-traded direct participation programs." While Cambridge appreciates NASAA's desire to protect investors and to "reduce the risk of loss from a single investment or investment type," Cambridge believes that a standardized concentration may not address the risks NASAA notes, while potentially frustrating investors' freedom of choice. For this reason, Cambridge requests NASAA consider the following two points.

First, non-traded REITs, BDCs, and direct participation programs offer investors certain advantages and benefits not found in other investment classes, such as tax advantages, cash flow benefits, asset stability and non-correlation to the equity and bond markets. Additionally, there may be a greater potential for capital appreciation. These types of investments provide investors with potential exposure to investments they might not otherwise be able to access on their own. These facts demonstrate that there is a place for non-traded REITs, BDCs, and direct participation programs within a well-diversified investor portfolio.

Second, a uniform concentration cap does nothing to mitigate the concerns NASAA enumerates. In the Request, NASAA states that the proposed concentration limit was chosen as a result of NASAA's "observation that liquidity is restricted in all programs; high fees and expenses, conflicts, and lack of historical operations also predominate these offerings."

For these types of investments to perform within anticipated norms, there necessarily are liquidity limitations. Providing on-demand liquidity compels the maintenance of cash "on hand" to distribute, thus limiting the total amount of capital deployed for investment and thus potential return.

Holding assets outside the investments intended by the REITs, BDCs, or direct participation programs is inconsistent with the particular products' strategies and objectives. For example, if a REIT purchases a building subject to a long-term lease, the lease proceeds provide cash flow to investors. As the owner, the REIT has the obligations of caring for and operating the building, as well as paying expenses. The activities benefit the investor and capital retained for this purpose (as opposed to redeeming investor shares) ensures the stability of the investment.

Lack of liquidity in these types of programs does not necessarily harm investors. Rather, in many instances, investors would gladly trade liquidity for stability and consistent cash flow. Investors should have the option to make this choice, which might be lost in the face of stringent concentration limits.

NASAA also addresses fees and expenses that accompany these investments. To the extent that NASAA characterizes the associated fees as "high," such a term is relative and cannot be evaluated without exploring the mechanics of the underlying product. Actively managed investments, like REITs, require significantly more time and expense to operate, unlike other traditional investments, but offer different benefits and opportunities. It is up to the investor and their financial professional to decide whether the prospective return on their investment is worth the cost. High fees and expenses are a consideration that must be reviewed in comparison with other investments. The issue of concern is the proper disclosure of those facts. When properly disclosed, investors have the opportunity to make choices. When fees and expenses are hidden, investors are harmed. Implementing a standardized cap does nothing to promote greater disclosure of such relevant facts.

NASAA further identifies alleged "conflicts" as risks associated with REITs, BDCs, and direct participation programs. The connection between a concentration limit and potential conflicts is not clear from the Request. However, because the proposed cap would apply to an issuer and its affiliates, one can assume NASAA is referring to the possibility of related-party transactions and other potential conflicts of interest which may exist within an offering.

These conflicts are often addressed by broker-dealers during the performance of a reasonable basis suitability review of the offering and the issuer. Cambridge, for instance, obtains third-party due diligence reports and conducts its own due diligence reviews in order to assess whether any inappropriate conflicts exist within the offering or between the issuer and its affiliates. Prior to approving an offering for sale to its customers, Cambridge determines whether such conflicts exist and, if so, whether they are appropriately disclosed and can be mitigated. If not, then the offering is rejected.

With respect to such conflicts, a predetermined concentration limit on investment with an issuer will not address NASAA's concerns. Rather, NASAA should consider creating guidance applicable to such issuers and addressing these conflicts during the investment registration process – thus eliminating the possibility of any offering having such conflicts in the first place.

Last, NASAA notes a lack of historical operations as a concern warranting a ten percent (10%) concentration limit on the issuer, its affiliates, and other programs. This argument begs the question of whether past performance is an indication of future results. There are numerous instances where historical operations pointed in one direction and reality in another, such as where a highly touted stock reached dizzying heights only to fall to nothing.

Historical operations are meaningless if untrue. Request footnote 14 evidences this fact. In the cases of American Realty Capital and United Development Funding, both issuers began with non-traded programs, only to end with registered, traded funds. As NASAA points out, these issuers engaged in criminal, fraudulent business practices, and made material misrepresentations in their registration documents. The investors most harmed were those who invested in the registered, traded offerings of these issuers.

A concentration limit on non-traded REITs, BDCs, and direct participation programs will not protect investors from fraud or other criminal activity. Rather, ongoing regulatory oversight of the issuers and their offerings would best address the risk of impropriety and fraud.

While Cambridge supports NASAA's goal to protect certain investors from harm and loss of access to needed capital, Cambridge believes that a standardized concentration limit applicable to all investors will not successfully address any of NASAA's concerns, but will only serve to frustrate those investors for whom those investments are acceptable and meet their investment needs.

II. Alternative to a Standardized Concentration Limit

Cambridge believes non-traded REITs, BDCs, and direct participation programs are beneficial to those investors for whom they are appropriate. For this reason, Cambridge asks NASAA to refrain from adopting a standardized concentration limit and instead adopt a format more in alignment with the Securities Exchange Commission's Regulation Best Interest that is more principles-based and tailored to a best interest framework. Rather than the proposed bright-line threshold, Cambridge believes NASAA could establish a set of criteria important for firms to consider when determining whether an investor's concentration in a certain asset class, with a particular issue, or in a particular issuer is too high.

Additionally, per the comments above, a bright-line concentration limit of this type won't prevent customer harms, complaints, or the like. It might, however, decrease the number of non-traded REITs, BDCs, and direct participation programs available to investors, possibly pushing those investors who wish to allocate dollars to such asset classes to registered products not subject to the REIT Guidelines NASAA creates.

Securities regulators, who desire to ensure the investing public is protected from undue risk, fraud, criminal activity, and misrepresentations, are better positioned to protect such investors with respect to the offerings registered within their states rather than those offerings that the states are preempted from qualifying under the National Securities Markets Improvement Act of 1996 – like the later offerings of ARCP and UDF which traded on the NASDAQ.

Thus, Cambridge believes that rather than employing a bright-line rule, it would be more beneficial for NASAA to create tailored guidelines relating to net worth, tax circumstances, investment objective, investment time horizon, risk tolerance, and investor sophistication with such investments and the asset class. Such guidelines would promote the interests of a broader spectrum of investors and ensure that the REIT, BDC, and non-traded direct participation program space survives within the oversight states have today.

III. Conclusion

Cambridge shares NASAA's desire to protect investors and to reduce the undue risks an investor may experience. Cambridge believes, however, that a standardized concentration limit applied uniformly across all investor classes will not actually address the concerns which NASAA expresses, but will rather simply result in a frustrating limitation on many investors and a curtailment of participation by issuers within an entire classification of investment programs. For this reason, Cambridge requests NASAA refrain from employing a bright-line concentration limit applicable to REIT and BDC issuers, their affiliates, and other non-traded direct participation programs in the REIT Guidelines.

Respectfully submitted,

// *Seth A. Miller*

Seth A. Miller
General Counsel
President, Advocacy & Administration