September 12, 2022

Via electronic submission to NASAAComments@nasaa.org
cc: Andrea.Seidt@com.ohio.gov, and Mark.Heuerman@com.ohio.gov

NASAA Corporation Finance Section
Commissioner Andrea Seidt, Section Chair
Mark Heuerman, Project Group Chair
North American Securities Administrators Association, Inc. (NASAA)
750 First Street, N.E., Suite 1140
Washington, D.C. 20002

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

Dear NASAA, Commissioner Seidt and Mr. Heuerman:

The undersigned associations are writing to express concern about NASAA's proposed additions to its Statement of Policy Regarding Real Estate Investment Trusts (REITs) (the "Proposal").[1] We are equally concerned about NASAA's stated intention to apply these revisions to future Guidelines and products.[2] Our organizations represent a broad spectrum of businesses and investment professionals across the financial services sector. For the reasons discussed below, we urge NASAA to withdraw the Proposal.

We recognize NASAA's important investor protection role across the states and the need for appropriate standards of conduct and rules for professionals who work with investors. We have long supported the creation of a workable best interest standard for financial professionals. However, in light

[1] The Statement of Policy is out of date and does not reflect the current structure of non-listed REITs. NASAA adopted the Statement in 1996 and has never updated it except for minor revisions in 2007.

[2] If adopted, these revisions have the potential to influence updates to other sets of Guidelines that are under development, including those for the Omnibus Guidelines, Asset-Backed Securities, Commodity Pools, Equipment Leasing, Mortgage Programs and Real Estate Programs (other than REITs). These updates will also permit the NASAA Business Organizations and Accounting Project Group to move forward with its proposal for inaugural guidelines applicable to business development companies. Request for Public Comment, Proposed Revisions to NASAA Statement of Policy Regarding Real Estate Investment Trusts, July 12, 2022, available at https://www.nasaa.org/wp-content/uploads/2022/07/Request-for-Public-Comment-on-Amendments-to-NASAA-REIT-Guidelines-2022.pdf

of significant developments regarding Regulation Best Interest and the evolution of the REIT industry, we believe the Proposal would unjustifiably restrict investor choice, undermine an investor's achievement of his or her financial goals, interfere with the compliance responsibilities of regulated firms, negatively impact our economic recovery, and harm small businesses. Moreover, it would present a legal risk for state regulators who adopt it. For example, the Investment Advisers Act of 1940, the Investment Company Act of 1940, and the Employee Retirement Income Security Act (ERISA) would likely preempt adoption of the Proposal by any state administrator. The Proposal's incorporation into state law also would violate state securities registration statutes.

We appreciate NASAA's willingness to grant a 30-day extension to its original 30-day comment period.

1. The Proposal Would Limit Investor Choice

At this time of market volatility, investors need the ability to diversify their portfolios away from the stock and bond markets. Many retail investors attain portfolio diversification by investing in non-listed REITs, which provide long-term investment in geographically diverse opportunities across a range of property types, from retail to office and industrial, thus gaining exposure to a wide variety of real estate. These highly federally-regulated vehicles can also provide an inflation hedge and a source of income. The proposed concentration limits and increased net worth and gross income standards will deprive investors of these benefits. NASAA has provided little data and no economic, cost-benefit analysis for the Proposal.[3]

The Proposal would interfere with the relationship between a retail customer and her broker or investment adviser, who must act in the customer's best interest under federal law and who best understands his or her client's financial situation, liquidity needs, and investment objectives. Many retirees need to diversify their investments, which may be held in 401K or other qualified plans that are heavily concentrated in the stock market. They also may need a hedge against inflation and a source of income. The proposed 10% concentration, net worth and gross income requirements would arbitrarily and severely limit the ability of federally-regulated brokers and investment advisers to help their customers meet these diversification, hedging and income needs. Moreover, while ambiguous, the Proposal could be interpreted to impose an obligation on issuers that states have no ability to effectively regulate.

2. The Proposal Would Undermine Investor Protection

The Proposal would limit investor choice without enhancing investor protection. Indeed, the Proposal would undermine it. Broker-dealers and investment advisers are already under a comprehensive system of federal regulation. Broker-dealers must comply with the Securities and Exchange Commission's (SEC) Regulation Best Interest (Reg BI) and supervisory and sales practice rules under the Securities Exchange Act of 1934 and Financial Industry Regulatory Authority (FINRA) rules, as approved by the SEC. Federally registered investment advisers are subject to a fiduciary duty to their customers and must comply with the Investment Advisers Act of 1940 and SEC rules.

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[3] The Proposal cited in large part NASAA's Regulation Best Interest surveys and reports. A recent analysis of the reports by Dr. Matthew Greenwald, a recognized expert in survey research, uncovered significant deficiencies by NASAA, including the failure to follow eight well-established and critical survey research practices. ANALYSIS OF NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION'S (NASAA) REG BI SURVEYS Prepared by Greenwald Research FEBRUARY 2022, available at https://greenwaldresearch.com/wp-content/uploads/2022/02/Analysis-of-NASAA-Surveys-on-Reg-BI-Greenwald-Research-2.22.pdf.

Apparently presuming that Reg BI, standing alone, is not enough, the Proposal would enact an array of state-enforced conduct mandates. Some would be borrowed from federal law and some would be created whole-cloth by NASAA as "suitability," "appropriateness," and state "best interest" standards. This mass of inconsistent standards would sow confusion in the compliance offices of broker-dealers and investment advisers. Financial intermediaries would have new obligations under state law, subject to state by state and court by court interpretation. These varying regulatory standards would create a cross stitch of inconsistent, conflicting, or duplicative rules that would significantly impair an investor's access to valuable financial products and professional guidance on whether, when, and how to use those products. If this Proposal moves forward, many investors will lose access to a wide variety of products available to help them achieve their financial goals.

While it is ambiguous, the Proposal could be interpreted to require sponsors to supervise broker-dealer and investment adviser compliance with all of these conduct standards. By inserting sponsor supervision into broker-dealer and investment adviser compliance programs, the Proposal would undermine the ability of these federally-regulated financial intermediaries to comply with SEC and FINRA requirements and serve their customers. Specifically, net asset value (NAV) REIT sponsors lack the control over distributing broker-dealers and investment advisers and the customer information that would be necessary to supervise these independent financial advisers.

3. The Proposal Would Undermine Economic Recovery

In 2021, the NAV REIT industry raised over $36.5 billion and in the first half of 2022 raised another $21.3 billion. Recent surveys of publicly registered, non-traded REITs indicated that approximately 63% of their investments in multifamily housing support workforce housing, defined as multifamily housing with rent less than 25% of mean family income in the surrounding area.

The Proposal would stifle this capital investment. Moreover, it not only would affect NAV REITs but could limit capital investment by other highly regulated investment vehicles offered by premier asset management companies that support real estate and the broader economy, including the sponsors of mutual funds, exchange-traded funds, interval funds, tender offer funds, and business development companies. In particular, the concentration limits would apply to any "affiliate" of a NAV REIT sponsor, potentially including these other investment vehicles managed by the sponsor. Additionally, the Proposal extends to "direct participation programs" (DPP) that typically include business development companies but have never been defined by NASAA or state law. In fact, FINRA's definition of DPP specifically excludes REITs.[4]

By impeding the ability of NAV REITs and other investment vehicles such as business development companies to raise capital, the Proposal would harm local economies and small businesses. By applying it broadly to include affiliates and BDCs, it would limit access to capital for small and mid-sized American companies, including minority-owned, women-owned, and veteran-owned businesses that may not have access to traditional sources of capital. Many of those businesses lack access to the deep capital markets that finance the activities of large corporations. The investment vehicles that would be negatively affected by the Proposal can provide a critical source of capital to these firms and other small businesses, allowing them to expand and grow with terms more flexible than those offered by traditional bank loans.

Finally, the Proposal would create a flat prohibition against using gross offering proceeds to fund distributions, which is tantamount to creating both a new federal and state law. Federal regulation and state corporation law permit this practice, if approved by a REIT's board of directors, which has a fiduciary duty to the shareholders, and with significant investor disclosure. For example, Ohio recently

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[4] *See* FINRA Rule 2310(a)(4).

acknowledged the appropriateness of using gross offering proceeds to fund distributions as long as there is sufficient disclosure.[5] Importantly, a flat prohibition would restrict a REIT's ability to comply with the REIT tax rules and thereby potentially create unintended consequences to the REIT and its shareholders.[6]

The Proposal would limit investor choice, interfere with investors' achievement of their retirement and other investment goals, undermine broker-dealer and investment compliance, and impede economic recovery. We respectfully urge NASAA to withdraw the Proposal.

Thank you for the opportunity to share our views on this important subject,

American Investment Council
American Securities Association
Coalition for Business Development
Defined Contribution Alternatives Association
Financial Services Institute
Florida Securities Dealers Association
Institute for Portfolio Alternatives
Insured Retirement Institute
National Association of Insurance and Financial Advisors
Small Business Investor Alliance
Securities Industry and Financial Markets Association (SIFMA)
U.S. Chamber of Commerce

[5] *See* Ohio Division of Securities Letter to Anthony Chereso, President & CEO, Institute for Portfolio Alternatives, January 27, 2021:

> [W]e do not foreclose the possibility that a case for compliance could be made and will, therefore, withdraw and discontinue comments that seek to prohibit this practice outright. . . Along those lines, the Division will turn towards enhanced disclosure in the prospectus, increase our scrutiny of any misleading marketing practices in this area, and undertake broker-dealer education and oversight.

[6] Under I.R.C. § 857(a)(1), a REIT must distribute 90% of its taxable income to maintain REIT status from a U.S. federal income tax perspective. If a REIT has taxable income but no cash available to make distributions (created by cancelation of debt income or original issue discount), a REIT may incur debt, raise equity, or sell assets it otherwise would hold on a long-term basis because non-compliance with the 90% distribution requirement could lead to the REIT losing its REIT status. A flat prohibition against using gross offering proceeds to fund distributions effectively eliminates one of these alternatives and, thus, is not in the best interest of the REIT and the REIT shareholders.