FINANCIAL SERVICES INSTITUTE | VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL
NASAAComments@NASAA.org

September 12, 2022

Andrea Seidt, Corporation Finance Section Chair
Mark Heuerman, Direct Participation Programs Project Group Chair
North American Securities Administrators Association, Inc.
750 First Street NE, Suite 990
Washington DC 20002

Re: FSI's Comments on NASAA's Proposed Revisions to the NASAA Statement of Policy Regarding Real Estate Investment Trusts

Dear NASAA Members, Commissioner Seidt, and Chair Heuerman:

On July 12, 2022, the North American Securities Administrators Association, Inc. ("NASAA") published its request for public comment on the Proposed Revisions to the NASAA Statement of Policy Regarding Real Estate Investment Trusts ("Proposal").[1] NASAA's stated goals for the Proposal are to (i) update the conduct standards for brokers selling non-traded REITs; (ii) increase the income and net worth financial figures in the suitability section of the Statement of Policy; (iii) add a new standardized concentration limit; and (iv) add a prohibition against using gross offering proceeds in non-traded REITs.

The Financial Services Institute[2] ("FSI") appreciates the opportunity to comment on this important Proposal. However, we note that prior to NASAA's similar proposal to amend the Statement of Policy Regarding Real Estate Investment Trusts in 2016 (the "2016 Proposal") there was significant industry engagement and opportunity to discuss proposed changes with the Committee and Project Group members. We believe the Committee and Project Group could benefit from a similar exercise here through round table or forum discussions in addition to the written comment process. FSI's members are strongly committed to working with regulators to help safeguard investors' retirement savings and choices. At this time, and in accordance with our

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[1] NASAA subsequently extended the comment period from August 11, 2022 to September 12, 2022. FSI appreciates the consideration of allowing the additional 30 days to comment on this Proposal. *See* Notice of Request for Public Comment on Amendments to NASAA REIT Guidelines, *available at* https://www.nasaa.org/wp-content/uploads/2022/07/Request_for_Public_Comment_on_Amendments_to_NASAA_REIT_Guidelines_Extended-1.pdf

[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.

comments on the 2016 proposal,[3] we are concerned that the updated standards of care create duplicative, overlapping, and confusing regulatory requirements for brokers selling these products. Furthermore, the 10% concentration limit is overly restrictive on investors, should not include issuers in disclosure and regulatory requirements, and will result in a number of unintended consequences for non-traded REITs ("NTR"). As this Statement of Policy is a stepping stone to further state rulemakings,[4] any determinations made here by the Committee and NASAA will have wide reaching effects in the financial markets.

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 US, there are more than 160,000 independent financial advisors, which account for approximately 52.7 percent of all producing registered representatives.[5] These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker Dealers (IBD).[6]

FSI's IBD member firms provide business support to independent 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 and job creators with strong ties to their communities. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include 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 Main Street Americans with the affordable financial advice, products, and services necessary to achieve their investment goals.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate $35.7 billion in economic activity. This activity, in turn, supports 408,743 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly $7.2 billion annually to federal, state, and local government taxes.[7]

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[3] 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 Trusts, September 12, 2016, *available at* https://www.nasaa.org/wp-content/uploads/2016/10/FSI-Comment-Letter-on-NASAA-Concentration-Limit-Proposal-September-12-2016.pdf (the FSI 2016 Letter).

[4] Proposal at 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."). While it is not particularly unusual to have model rules affect future planned legislation, we believe a better approach here would be to include all changes to these platforms in a single proposal, as opposed to a piecemeal approach to sweeping changes.

[5] Cerulli Associates, Advisor Headcount 2016, on file with author.

[6] The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a registered representative of a broker dealer, an investment adviser representative of a registered investment adviser firm, or a dual registrant. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

[7] Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2020).

Discussion

FSI appreciates the opportunity to comment on NASAA's Proposal with a focus on selected provisions. As we note below, we believe the financial services industry, including FSI and its members, share a common interest in safeguarding investors' retirement savings and furthering the goals of efficient capital markets. We offer our comments, discussed in greater detail below, with the goal to address concerns with certain of the Proposal's aspects, align to other standards and requirements, and maximize the impact on investor protection. Unfortunately, at this time, we cannot support the Proposal as drafted.

I. NASAA Should Reconsider the Expansive Inclusion of Multiple Federal Standards of Care Applicable to Intermediaries in a State Level Statement of Policy Focused on a Specific Product.

A. Introduction

FSI members (whether firms or individual financial advisors) participate in the sale of and facilitate the investment in NTRs, direct participation programs ("DPP") as described in the Proposal,[8] and other investment opportunities as part of a balanced portfolio. We recognize that NTRs hold a unique position in the market as non-covered securities with registration requirements at the Federal, SRO, and State level. This multilevel registration regime has generated some confusion on issuer disclosure requirements and standards in offering documents. The intermediaries through which NTRs are made available to investors, however, are all regulated through the Securities and Exchange Commission's ("SEC") (for Broker Dealers and larger Investment Advisers), the Financial Industry Regulatory Authority ("FINRA")(for Broker Dealers), and state regulators (for Broker Dealers and smaller Investment Advisers). The standards applicable to these entities by their respective regulators should be applied without incorporation in this Statement of Policy.

B. Investment Advisers and Broker Dealers Are Already Subject to Federal and SRO Rules and Requirements.

FSI notes that the Proposal would apply the following conduct standards: [9]

- Compliance with the SEC Regulation Best Interest;
- Undefined Suitability Obligations under Federal and State law;
- Requirements under the Employment Retirement Income Security Act of 1974 or Internal Revenue Code of 1986 (referred to herein as "ERISA");
- Self-Regulatory Organization Standards; and
- Undefined Federal or State fiduciary duties.

[8] DPPs are not specifically defined and could cover a number of products. References herein to NTRs should be read to cover any investments contemplated under the Proposal.
[9] The Proposal also leaves open "any other updated conduct standards that are adopted by the NASAA jurisdictions as applied to brokers recommending securities." Proposal at 2.

The SEC approved Regulation Best Interest ("Reg BI") in June 2019, with a June 2020 effective date. While the SEC has begun enforcing Reg BI,[10] there are still relatively few precedents that interpret the regulation at the federal level. We believe it is necessary to point out that the SEC is still issuing interpretive guidance[11] and at least two more staff bulletins are scheduled to be released this year. We also note that *SEC v. Western International Securities et. al* is currently in litigation and will result in precedential case law, as will any future Reg BI litigation from the Commission. ERISA has a much longer history. However, similar to the 2016 Proposal, the Department of Labor ("DOL") is currently "reviewing issues of fact, law, and policy related to PTE 2020-02 *[Improving Investment Advice for Workers & Retirees*], and more generally, its regulation of fiduciary investment advice." [12] The DOL is planning to take further regulatory action, likely resulting in new or amended rules.[13] Finally, FINRA has several rules regarding appropriate disclosure, transparency, and pricing requirements for non-traded REITs and DPPs. [14]

FSI believes that, given the ongoing work from these federal agencies and SROs, it is premature for NASAA to incorporate these new and still developing standards of care into a formal Statement of Policy. By proposing to codify the conduct standards in Section I(B)(8) of the Statement of Policy, NASAA is stating that each of these standards, or more adopted at the enacting jurisdiction's discretion, will apply to every REIT transaction. The Proposal is silent on any potential conflicts in the application of each regulation (e.g. inapplicable, overlapping and/or conflicting rules from a state fiduciary rule to Reg BI, or from a state fiduciary rule to ERISA, or from one state fiduciary rule to another state fiduciary rule). Given too many conflicts in rule text,[15] preemption of state authority, and further confusion regarding applicable rules, would be a likely outcome. Additionally, although it may not have been the intent of the Proposal, the broad language provides a jurisdiction with the unfettered authority to apply any of these overlapping, potentially conflicting, standards to any REIT or DPP sale.

We note that NASAA's decision to single out a specified product is not consistent (or uniform) with the SEC's purpose in Reg BI, a product agnostic regulatory framework.[16] For example, rather

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[10] Press Release, *SEC Charges Firm and Five Brokers with Violations of Reg. BI*, SEC, June 16, 2022, *available at* https://www.sec.gov/news/press-release/2022-110.

[11] Staff Bulletin, *Standards of Conduct for Broker Dealers and Investment Advisers Conflicts of Interest*, SEC, Aug. 3, 2022, *available at* https://www.sec.gov/tm/iabd-staff-bulletin-conflicts-interest#_ftn2.

[12] *See* Employee Benefits Security Administration, *New Fiduciary Advice Exemption: PTE 2020-02 Improving Investment Advice for Workers & Retirees Frequently Asked Questions*, Department of Labor, *available at* https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/faqs/new-fiduciary-advice-exemption, Q.5.

[13] *See* Employee Benefits Security Administration, *Spring Reg. Flex Agenda, Proposed Rule regarding the Definition of the Term "Fiduciary,"* Department of Labor, anticipated publish date December 2022, *available at* https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202204&RIN=1210-AC02.

[14] *See* Reg. Notice 15-02, *SEC Approves Amendments to FINRA Rule 2310 and NASD Rule 2340 to Address Values of Direct Participation Program and Unlisted Real Estate Investment Trust Securities*, April 2016, *available at* https://www.finra.org/rules-guidance/notices/15-02.

[15] *Compare, e.g.,* SEC Regulation Best Interest (requiring brokers to act in the best interest of their clients without placing their financial or other interest ahead of the interest of the retail customer). *versus* the Massachusetts Fiduciary Conduct Standard for Broker-Dealers and Agents (requiring brokers to act as fiduciaries and creating a standard of utmost care and loyalty). The discrepancy between standards has been the subject of litigation. *See Robinhood Financial LLC v. William F. Gavin, Secretary of the Commonwealth, in his official capacity, and the Massachusetts Securities Division of the Office of the Secretary of the Commonwealth*, Suffolk County Civil Court Action No. 2184CV00884 (declaring the Massachusetts rule invalid and the implementing fiduciary rule changes unlawful).

[16] *See*, e.g., Prefatory Note to the Uniform Securities Act of 2002, at 7 (seeking "the objectives of uniformity, cooperation among relevant state and federal governments and self-regulatory organizations, investor

than having the federal regulations apply to accounts or investments as a whole, NASAA proposes to apply the terms of Reg BI to a single product.[17] The Proposal appears to broadly apply ERISA to a single product as well, though of course ERISA applies only to the transactions of retirement investors.[18] The lack of product neutrality here becomes particularly acute in light of the scale of NTR offerings.

FSI believes that a product offered to investors nationwide ("national product") should have a national standard (i.e., Reg BI as interpreted by the SEC) in order to avoid regulation that has a disparate impact on similarly situated investors in different jurisdictions. NTRs are federally regulated, national products with a wide investor base not limited to a single state or region.[19] Instituting the Statement of Policy as written creates the significant potential for state regulators and courts to interpret and apply federal statutes and SRO rules. We are concerned that, as a result of state interpretations, the uniform standard in Reg BI could devolve into multiple variations and disparate applications. This could be exacerbated by political and/or legislative differences across states enacting variations on the Proposal as drafted. In short, we hold a significant concern that state application of the rules would create a patchwork of rulings and requirements that make NTR sales impracticable in many states.

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protection and, to the extent practicable, capital formation."). Indeed NASAA has historically recognized the value of coordinating with the federal securities regulators as evidenced by its continued participation in the Annual Conference on Uniformity of Securities Laws under Section 19(d) of the Securities Act of 1933, and its work on seniors issues in issuing the Senior Safe Act. Press Release, *NASAA, SEC & FINRA Issue Senior Safe Act Fact Sheet to Help Promote Greater Reporting of Suspected Senior Financial Exploitation*, May 23, 2019, *available at* https://www.nasaa.org/47991/nasaa-sec-finra-issue-senior-safe-act-fact-sheet-to-help-promote-greater-reporting-of-suspected-senior-financial-exploitation/. Coordination and uniformity are key to NASAA realizing its mission to "[r]epresent and serve members through education, cooperation, coordination, communication, subject matter expertise and advocacy."

[17] *See*, e.g., SEC Rel. No. 34-86031, June 5, 2019, *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, at 242 ("Rather, Regulation Best Interest as adopted provides broker-dealers with flexibility to provide disclosures that are consistent with the various ways in which broker-dealers may already provide disclosure to their customers. … While we are not setting forth a prescriptive approach regarding exactly when disclosures should be made as suggested by some commenters, we believe that a broker-dealer may determine that certain disclosures are most effective if they are made at multiple points of the relationship, or alternatively, certain material facts may be conveyed in a more general manner in an initial written disclosure accompanied or followed by more specific information.").

[18] *See* Employee Benefits Security Administration, *Prohibited Transaction Exemption 2020-02, Improving Investment Advice for Workers & Retirees*, 85 Fed. Reg. 82798, December 18, 2020, *available at* https://www.govinfo.gov/content/pkg/FR-2020-12-18/pdf/2020-27825.pdf. A Retirement Investor is defined as:

(1) A participant or beneficiary of a Plan with authority to direct the investment of assets in his or her account or to take a distribution;

(2) The beneficial owner of an IRA acting on behalf of the IRA; or

(3) A fiduciary of a Plan or an IRA.

[19] We note that the Proposal as drafted would impose additional recordkeeping requirements on broker-dealers and investment advisers offering and selling non-traded REITs. Pursuant to the National Securities Markets Improvement Act of 1996 ("NSMIA"), states or political subdivisions thereof cannot impose rules or regulations that require recordkeeping that is different from or in addition to the requirements established at the federal level. The Proposal should be revised to comply with NSMIA requirements and/or specifically state that no new books or records will be required or maintained as a result of this rule.

C. Issuers Should Not Be Required to Provide Oversight of Financial Intermediaries.

In its current draft, the Proposal could be read to extend the oversight of Investment Adviser and Broker Dealer sales practices to REIT issuers beyond what can be reasonably assured through contractual means. Issuers should not be put in the position of providing oversight over intermediaries. For investment advisers and broker dealers, this could create an additional supervisory aspect and compliance requirement for each NTR or DPP sponsor where the intermediary offers or sells their products. Complying with regulatory oversight and individual sponsor oversight will create significant, duplicative cost and reporting requirements for these intermediary firms.[20] It also places the burden on private entities to police the actions of upstream or downstream counterparts, and could apply liability for bad actors completely outside of the control of the issuer, broker-dealer, or investment adviser. Faced with such oversight, it is likely broker-dealers and investment advisers would choose to limit the products they offer to alleviate compliance costs or simply choose not to offer these products, to the detriment of investors.

We are also concerned that the drafted language creates a requirement that each person selling, recommending, or providing investment advice must make every reasonable effort to determine "that the purchase of shares, recommendation or advice is a suitable and appropriate investment for each shareholder and/or complies in compliance with applicable CONDUCT STANDARDS."[21] While perhaps not the intention, we are concerned that the draft language would impose a layer of regulation on intermediaries at least somewhat performed by the issuer *and* vice versa. Generally, for issuers, this creates a burden to review third-party books, records, and practices by an entity that may not have the resources and in-house skill level to accomplish this task. More importantly, issuers have not been required to perform this function under any previous federal or state law. For the intermediaries, it creates an additional reporting and disclosure cost with little potential gain for investor protection. FSI feels that it is inappropriate to impose regulatory oversight requirements in general on private entities to ensure that third-party participants comply with federal and state regulations.

We also note that, as drafted, the requirement places a disclosure burden on issuers to include concentration limits and Reg BI disclosures in the offering materials. This seems to be an incongruous outcome, as Reg BI targets the fiduciary duties of investment advisers and broker dealers, and was not designed to apply to a particular product or particular set of issuers. By including this requirement the Proposal would increase the length of the prospectus by having issuers disclose limits and requirements for each jurisdiction, dictating oversight responsibilities for national products, and generally regulating issuer companies typically covered under the Investment Company Act of 1940. FSI takes the position that Reg BI disclosures and concentration limits are not appropriate in a NTR prospectus, and including these statements blurs the lines between issuer and intermediary. Such blurred lines result in potential misunderstandings and confusion for investors.

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[20] Certain client information may be privileged or confidential, and PII could require additional disclosures or consents from the client to the financial intermediary. Any additional oversight requirements must account for these rules and accompanying additional compliance costs/concerns.

[21] Proposal Statement of Policy at 13, Section III.C.5. We note, as discussed above, that this would refer to the multiple conduct standards listed in the Proposal and any other rules or regulations that the regulator may deem appropriate.

D. References to Federal Statutes and SRO Requirements Should Be Removed from the Proposal or Rewritten to Avoid Confusion.

For the foregoing reasons, FSI believes that the multiple, competing standards of care should be removed from the Proposal. Barring a complete removal, FSI believes the following language would be more appropriate for entities covered by the Proposal, and would dissuade states from creating multiple interpretations of federal statutes on a state by state, or court-by-court, basis:

> CONDUCT STANDARDS: Any Investment Adviser Representative or Broker Dealer Agent selling, recommending, or providing investment advice relating to the SHARES of the REIT to the SHAREHOLDER or prospective SHAREHOLDER will abide by applicable federal and state law or standards set by self-regulatory organizations.

II. FSI Is Concerned That a 10% Limit is Too Restrictive Given the Nature of Non-Traded REITS, Movement of the Market, and Lack of an Accredited Investor Carve Out.

A. Introduction

The Proposal would amend NASAA's REIT Guidelines to create a "standardized concentration limit" for non-traded REITs, and forge a path for future regulations and guidelines on similar terms. NASAA's apparent intent is to limit an investor's participation in what were traditionally illiquid, risky investments to 10% of the investor's liquid net worth, or some other amount determined by the state's securities administrator. This limit includes NTRs and any other direct participation program by the sponsor or its affiliates.[22] While FSI generally supports the investor protection intent of a measured concentration limit, we believe this draft fails to consider the application of federal standards and regulations, as noted above, and significant developments in the REIT industry including a shift to Net Asset Value ("NAV") REIT offerings. FSI is concerned that the unintended consequences of this change would include, but not be limited to, removing an investor's choice and autonomy to invest in federally regulated products and driving investors looking to diversify their portfolio into other, potentially more risky holdings. We are also concerned that this proposal, which is "six years in the making following the release of the first iteration back in 2016,"[23] addresses historical issues with NTRs and would cause significant damage to the market that has evolved in the interim. For the reasons stated below, we oppose the proposed 10% concentration limit.

B. The Proposed 10% Concentration Limit Would Create Significant Investor and Intermediary Compliance Concerns.

[22] Affiliate is defined broadly, and would encompass many financial arrangements between issuers, intermediaries, and financial institutions that have contractual or sales relationships. This term would also limit large financial institutions, with a track record of success and the ability to grow an investor's investment, from creating certain offerings. We encourage the Committee and NASAA to consider the legal issues, implications, and challenges from this definition.

[23] NASAA Press Release, *NASAA Extends Comment Period on Proposed Revisions to Statement of Policy Regarding Real Estate Investment Trusts*, August 4, 2022, (comments of Andrea Seidt).

We begin this section by noting that, similar to our position in 2016,[24] FSI believes that the current regulatory framework adequately addresses the Committee and Project Group's objectives regarding investor protection. FINRA imposed significantly increased disclosure and transparency requirements on REIT offerings in 2015, and continues to regulate these offerings through Rules 2111 (Suitability), 2310 (Direct Participation Programs), and 2231 (Customer Account Statements). FSI believes that the Proposal would interfere with the current regulatory framework by effectively making a presumption that more than 10% concentration is inherently unsuitable rather than deferring to the expertise of broker-dealers and investment advisers operating under existing rules and industry practice. In contrast, NASAA's own Uniform Limited Offering Exemption[25] creates a presumption that concentrations of more than 10% in any one product are generally unsuitable for an investment account. Many brokers and investment advisers follow this general practice and diversify as a matter of sound business.

The concentration limit as outlined in the Proposal imposes a "one-size-fits-all" methodology to investors. An investor, regardless of their circumstances, sophistication, or net worth, is faced with a paternalistic bar to autonomous investment decisions imposed by the Proposal. While generally a diversified portfolio offers investor protection, certain instances or an investor's unique profile or situation may deviate from the standard. Instead of allowing the option to accept full disclosure from the investment adviser or broker-dealer (who often lives and works in the same community as the investor and is particularly familiar with the investor's goals, needs and circumstances) and make an informed investment decision, the Proposal introduces an obstacle. At best, the client is forced to make other investment decisions due to a state's position based on the Proposal's concentration limits structure. At worst, the client may seek to open additional accounts with other intermediaries to gain further exposure to the desired investment. A financial intermediary would be in compliance with the rule, based on the account with the intermediary and information provided by the client, but the potential harm NASAA is seeking to address would remain when considering all accounts held at various intermediaries. Rather than addressing the problem with a significant disclosure-based regime, the rule would proliferate the issue by adding more complexity for the investor in dealing with multiple intermediaries.

The Proposal also lacks clarity on when an intermediary would apply the concentration limit to the investor. REITs tend to have a longer investment horizon and involve dividends and other payouts to investors. They also tend to be held for significant periods of time. As a result, due to market fluctuations or changes to an investor's lifestyle or activities, an investor that initially qualified at the 10% concentration limit may fall below this threshold over the life of their investment. If an issuer or intermediary is tasked with calculating or verifying net worth on an annual basis, this creates a series of issues for minimum investment amounts, minimum redemption amounts, and the REIT's investment profile as a whole. Alternatively, NAV REITs, the most popular NTR product on the market today, are offered on a continuous basis with generous redemption provisions for investors. Among other investor-facing benefits, NAV REITs offer dividend reinvestment programs ("DRIP") which allow the investor to rollover any dividend offerings back into the REIT. Based on the Proposal's terms, an investor may be barred from participating in a DRIP program and would lose the ability to increase their long-term growth potential by reinvesting. At a minimum, NASAA should add a grandfather clause allowing existing investors to continue investments and participate in reinvestment opportunities. However, we believe the better

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[24] FSI 2016 Letter, *supra* note 2, at 2-3.
[25] NASAA, Uniform Limited Offering Exemption, as amended April 29, 1989, *available at* https://www.nasaa.org/wp-content/uploads/2011/07/UNIFORM-LIMITED-OFFERING-EXEMPTION.pdf.

approach would be to amend the proposed term to state that the concentration limit "shall not exceed [X]% of the PERSON's NET WORTH at the time of initial investment."

C. If a Concentration Limit Must Be Imposed, the Accredited Investor Carve Out Must Be Reintegrated into the Proposal.

The 2016 Proposal included a carve out for Accredited Investors as defined by the SEC. We believe that if the proposal is adopted by NASAA as drafted, an Accredited Investor carve out is essential. As NASAA is well aware, the Accredited Investor standard is utilized in private placements and areas of the market where disclosure and regulatory oversight may be less apparent compared to public offerings. The premise is that a higher net worth carries sophistication or allows the investor to obtain guidance from other parties regarding the risks and benefits of a proposed investment. As discussed in the Proposal, NASAA has repeatedly sought to have the Accredited Investor standard adjusted for inflation, and though the SEC has revisited the definition multiple times the Commission has elected not to adjust that standard.[26]

NTRs have significant registration and disclosure requirements with the SEC.[27] Arguably the Accredited Investor standard is less necessary for NTRs than other private offerings. We understand however, in this instance, that NASAA has taken issue with the SEC not electing to increase the Accredited Investor standard for inflation or other considerations.[28] As written, the Proposal would limit *any* investor, regardless of their sophistication or net worth, in their investment decisions to a maximum of 10% of the investor's net worth. While we appreciate the investor protection concerns expressed by NASAA, the issue between NASAA and the SEC regarding the Accredited Investor definition should not lead to a wholesale removal of the carve out from the Proposal. This concentration limit incentivizes Accredited Investors to enter into private equity and private offerings that are not regulated by the states and, in some instances, provide arguably less disclosure or information to the investors.

Particular attention needs to be given to NASAA's justification for removing the carve out from the Proposal stating that "many elderly citizens qualify as Accredited Investors based on accumulated retirement savings, a critical class of investors that NASAA has advocated should be protected."[29] While we generally agree that the elderly population should be protected, the Proposal eliminates the entire category of Accredited Investors that the SEC has deemed qualified and/or sophisticated from participating in NTRs above 10%. Barring ageism issues and paternalistically interfering with an investor's ability to make investment decisions, a more targeted rule or clause addressing senior investors and limiting that subgroup's investment concentration would be more appropriate for the Proposal. We would anticipate a significant number of comments from elder investor advocates regarding such a rule and a limitation on their ability to freely make investment decisions.

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[26] *See,* e.g., SEC Rel. No. 33-10824, December 8, 2020, *Amendments to the Accredited Investor Definition*, at 71. The Commission notes NASAA and other commenters' position that the Accredited Investor threshold should be adjusted for inflation. However, the commission elected to retain the current net worth requirements.
[27] We note in passing that, given the registration and disclosure requirements at the federal level, FSI does not think that the income and net worth requirements for participation need to be increased in the proposal. However, given that the threshold was included in the 2007 REIT guidelines, we understand the sentiment and decision to increase these values for inflation. We would ask that the final Statement of Policy include a clause that either the stated requirements or Accredited Investor standard apply, but not both.
[28] Proposal at 8, FN 19.
[29] Proposal at 8.

D. To Promote Uniformity the Proposal Should Remove Administrator Discretion to Change the Investment Concentration Limit.

FSI generally supports uniformity in state regulation (and across areas of state-federal regulation) as it allows our members to efficiently and effectively understand and comply with state regulatory requirements. The so-called "patchwork" of regulations on a state-by-state basis has the negative impact of increasing compliance, reducing investor returns, and burdening the relationships between regulators and their regulated entities. In this instance, if a concentration limit is imposed under the Proposal, we support the creation of uniformity that our members so often seek in state regulation. However, the Proposal's authorization for Administrators to set a specific standard at their discretion would essentially extinguish the benefits of true uniformity.

By structuring the Proposal where a sponsor sets a limit that is then subject to individual state determinations and changes, the concentration limit and the Proposal itself becomes a guideline as opposed to a uniform rule. Indeed, in the example provided in the Proposal, the concentration limits set by some 20 states included several applications of the proposed 10% of net worth standard, others included an Accredited Investor carve out, and still others made the concentration limit a recommendation without being a requirement. We therefore respectfully ask that the language in Section III.D.3 be removed from the Proposal and any subsequent rulemakings as it compromises uniformity.

III. FSI Has Significant Concerns with the Proposal and the Application of the Statement of Policy Going Forward.

A. Discussion

FSI has significant concerns that the proposal will create an unworkable, untenable set of rules that would restrict investment advisers, broker dealers, and investors. One simple example is the use of "liquid net worth" as opposed to an investor's net worth as described in the Accredited Investor standard for determining the concentration allowance. Many intermediaries already track their client's investments and net worth for compliance with the Accredited Investor standard. As written, the Proposal would require these firms to track the investor's net worth and liquid net worth for any NTR or DPP investments, increasing the cost of compliance and decreasing returns to investors.

Another issue is presented with the broad definition of "affiliates" already in the proposal. While this may not have presented a significant issue previously, the concentration limit and lack of a grandfather clause could put many accounts out of compliance as soon as the Statement of Policy goes into effect through state rulemaking. Prematurely unwinding these positions to comply with the Proposal, if adopted, could prove costly and significantly impact an investor's portfolio.

The Proposal is also unclear on what, exactly, the remedy would be if an investor's portfolio exceeds the concentration limit. For example, if an investment adviser realized that an error occurred six months after the investment had been purchased due to a clerical error, is the Proposal's intention that the issuer uninvolved in the sales process is required to rescind? While this may be less of an issue with NAV REITs and their redemption program features, it seems problematic to impose these rules on an issuer as much as on an intermediary.

FSI is also concerned, as noted above, that the concentration limit places a burden on issuers in addition to intermediaries to report concentration limits as a part of the offering documents. This would significantly add to the already lengthy prospectus. Furthermore, as written, concentration limits could negatively impact Accredited Investors who may elect to go further into private equities. This Proposal, unfortunately, would have the effect of limiting investor choice and inadvertently making other complex, costly, or risky products more attractive investment decisions for certain investors.

Finally, the elimination of issuers using gross offering proceeds to fund distributions is an unworkable facet of the Proposal. If accepted, these federally registered products would be hampered by state law and firms would be barred from participation in interstate commerce. Most NTRs are Maryland corporations, and the use of offering proceeds funding distributions is a permissible activity subject to board approval and fiduciary requirements. Additionally, the SEC has addressed, and not objected to, NTRs paying distributions in excess of cash flow from operations provided appropriate disclosures are provided.[30] With these disclosures, specifically for NAV REITs on an ongoing basis, investors and intermediaries are well apprised of this practice. The illogical result of this requirement for adopting jurisdictions would be an inability of REITs to make distributions if investors from certain jurisdictions join despite other jurisdictions where similar rules are not in place. Alternatively, issuers and intermediaries could elect to not offer NTRs to specific states (e.g., a website or offering menu that states "if you're an investor in Alabama, New Jersey, or Ohio, you cannot continue.") Investors in those jurisdictions would likely object to their inability to participate in these offerings.

IV. Conclusion

As always, FSI appreciates the opportunity to comment on NASAA proposals. We support NASAA's goal of protecting investors, and we are committed to constructive engagement in the regulatory process. To summarize the foregoing, FSI supports the inclusion of applicable federal and state standards as interpreted by the SEC, DOL, or a self-regulatory entity. We share NASAA's desire for uniformity and goal of avoiding 54 differing state and federal compliance regimes. If the Proposal moves forward we believe that at a minimum, as noted above, the references to federal statutes and SRO requirements should be removed to avoid confusion and that the Accredited Investor carve out should be reintroduced to this Statement of Policy. However, more work is needed on this Proposal before being considered for adoption, and we welcome the opportunity to work with NASAA on this and other important regulatory efforts.

Thank you for considering FSI's comments. Should you have any questions, please contact my colleague, Dan Barry at (202) 517-6464 or dan.barry@financialservices.org.

Respectfully submitted,

Robin M. Traxler
Senior Vice President, Policy & Deputy General Counsel

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[30] SEC Division of Corporation Finance, CF Disclosure Guidance: Topic No. 6, Staff Observations Regarding Disclosures of Non-Traded Real Estate Investment Trusts, July 16, 2013, *available at* https://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic6.htm.