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

September 12, 2022

NASAA Corporation Finance Section
Andrea Seidt, Section Chair
Mark Heuerman, Project Group Chair

c/o North American Securities Administrators Association, Inc.
750 First Street, N.E., Suite 1140
Washington, D.C. 20002

Re: Proposed Revisions to the NASAA Statement of Policy Regarding Real Estate Investment Trusts (the "Proposal")

Dear Section Members, Commissioner Seidt and Mr. Heuerman:

The Asset Management Group of the Securities Industry and Financial Markets Association ("SIFMA AMG") welcomes the opportunity to comment on the Proposal.[1]

The Proposal, if adopted by the states, would dramatically expand state regulation of non-listed REITs and would serve as a template for guidance about other products.[2] SIFMA AMG and other associations asked NASAA to extend the comment period, and we appreciate NASAA's willingness to do so for another 30 days. SIFMA AMG stands ready to meet with NASAA to discuss our concerns before a decision is made about the Proposal.

Summary of our Comments

SIFMA AMG strongly opposes the Proposal for several reasons:

- *State Adoption of the Proposal May be Subject to Legal Challenge.* States would be expressly preempted from adopting the Proposal by ERISA, the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Advisers Act of 1940. Moreover, routine incorporation of the Proposal into state rules would violate the laws of many jurisdictions that require state regulators to follow administrative rulemaking procedures.

[1] SIFMA AMG brings the asset management community together to provide views on policy matters and to create industry best practices. SIFMA AMG's members represent U.S. and multinational asset management firms whose combined global assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. For more information, visit http://www.sifma.org/amg.

[2] *See* 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

- *The Proposal Does Not Reflect Developments with the Product.* The Proposal does not reflect developments between the offering of legacy lifecycle REITs and REITs that continuously offer and regularly redeem at net asset value ("NAV REITs") -- virtually the only non-listed REITs offered today.[3] NAV REITs differ from legacy lifecycle REITs that are the focus of the Proposal. NAV REITs offer better liquidity through repurchase programs and pay lower fees to sponsors and broker-dealers. They are heavily regulated by the Securities and Exchange Commission and the Financial Industry Regulatory Authority, as are the broker-dealers and investment advisers that recommend them.[4] The Proposal does not take into account the differences between the two products.

- *The Proposal – Particularly the Concentration Limits -- Would Limit Investor Choice.* Many institutional investors allocate part of their investment portfolio to real estate in order to achieve diversification, reduce their portfolio risk, and obtain inflation protection and a source of income. The Proposal would limit the ability of even sophisticated, wealthy investors to follow similar investment strategies. SIFMA AMG supports the ability of retail investors to obtain the same opportunities for portfolio diversification, inflation protection, and income as institutional investors.

  Moreover, the concentration limits would apply to affiliates of the NAV REIT, which potentially could include index funds or other registered investment companies managed by its sponsor. These registered investment companies do not implicate the concerns identified in the proposal[5], and imposing the concentration limits on these funds would be unnecessary and counterproductive. Registered investment companies are comprehensively regulated under the Investment Company Act of 1940. They typically have separate boards of directors, charged with overseeing conflicts and daily liquidity, among other issues. The proposed concentration limits could force investors to choose whether to limit their investment in the NAV REIT (limiting their diversification opportunities) or in these types of affiliated investment companies (limiting their investment choice).

  At a minimum, SIFMA AMG recommends that NASAA provide an accredited investor carve-out to the concentration limits and that they not apply to the NAV REIT's affiliates, particularly registered investment companies with a separate board of directors.

[3] In 2020, a total of approximately $10.9 billion was raised for non-listed REITs, about 98.9% of which was raised for NAV REITs. In 2021, capital raising for non-listed REITs increased to approximately $36.5 billion, about 99.97% of which was raised for NAV REITs. In 2022 through June capital raising for non-listed REITs has been approximately $21.3 billion, about 99.93% of which was raised for NAV REITs. *See* The Stanger Market Pulse, December 2021 and June 2022. Only one lifecycle REIT is offered today; most are now closed to new investment and are in an operational phase only.

[4] Non-listed REITs are heavily regulated.

- The Securities and Exchange Commission registers the public offerings of REITs under the Securities Act of 1933. Like other public companies, REITs must disclose the terms of their offerings and material information about the issuer in their registration statements and prospectuses, file them with the SEC (along with sales material that will be used in the offering) and deliver the prospectuses to investors. These prospectuses must be amended, filed and delivered to investors as material developments occur. Non-listed REITs are also subject to state regulatory oversight in all 50 states.
- REITs must file quarterly public reports and reports on material developments under the Securities Exchange Act of 1934. Like other public companies, REITs must file annual audited financial statements on Form 10-K, quarterly financial statements on Form 10-Q, and material development disclosures on Form 8-K.
- REITs are sold through broker-dealers that are regulated by FINRA and the SEC, and investments advisers that are regulated by the SEC and the states.

[5] *See* Proposal at 7:

> This structure was chosen based on the observation that liquidity is restricted in all programs; high fees and expenses, conflicts, and lack of historical operations also predominate these offerings.

- *The Proposal Would Sow Confusion in Compliance Programs and Create Operational Difficulties.* The Proposal would impose a myriad of requirements on federally-regulated investment advisers and broker-dealers, and would do so indirectly through the registration of NAV REIT securities. It would confuse the compliance programs of investment advisers and broker-dealers and could impose unworkable expectations on sponsors. It also would introduce a host of interpretive questions that will complicate compliance and present operational difficulties.

1. Any State Adopting the Proposal Might Face Legal Challenge.

The Proposal could face legal challenge for several reasons.

A. State Adoption Would Violate Federal Law.

The federal securities laws and ERISA would preempt the proposal. For example, because the Proposal would apply to federally-registered investment advisers, the Investment Advisers Act of 1940 would preempt it.[6] The Proposal would retain the requirement that sponsors or each person "selling shares on behalf of the sponsor or REIT" maintain records of the information used to determine that an investment is suitable and appropriate.[7] This requirement violates the Securities Exchange Act.[8] Moreover, the Proposal would impose an aggregate concentration limit to include not only investment in non-listed REITs but other securities offered by the sponsor and its affiliates, some of which potentially could include registered investment companies.[9] The Securities Act of 1933 would preempt this provision.[10] ERISA also would preempt the Proposal, since it would apply to investment advisers and broker-dealers who recommend REIT shares to employee benefit plans[11] and would require that the sponsor make every reasonable effort to determine that the purchase complies with ERISA.[12]

B. State Incorporation Could Violate State Law.

Routine incorporation of the Proposal into state rules would violate the laws of some states, which require compliance with administrative rulemaking procedures. Moreover, operation of the Proposal could violate state registration-by-coordination provisions. NAV REITs are registered by coordination in most states. Registration by coordination occurs "at the moment" of SEC registration.[13] The purpose of this procedure is to ensure that state

[6] Proposal, I.B.8. ("conduct standards" includes federal fiduciary duties). Section 203A of the Investment Advisers Act preempts the states from exercising jurisdiction over federally-registered investment advisers, other than by investigating individual cases of fraud and deceit.

[7] Proposal, III.C.4.

[8] Section 15(i) of the Securities Exchange Act states, "No law, rule, regulation, or order, or other administrative action of any State or political subdivision thereof shall establish . . . making and keeping records . . . requirements for brokers [or] dealers . . . that differ from, or are in addition to, the requirements in those areas established under this title."

[9] Proposal, III.D.

[10] Section 18 of the Securities Act of 1933 preempts states from *even indirectly* registering or qualifying investment company securities. Investment companies need only provide a notice filing to states in which they intend to offer their shares.

[11] Proposal, III.C.1 (recommendation or advice to "a shareholder").

[12] Proposal, III.C.5; I.B.8. ("conduct standards" includes ERISA). ERISA section 514(a) provides that, except as otherwise provided in section 514(b), title I and title IV "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan."

[13] *See, e.g.,* Maryland Section 11-503(c); Ohio Revised Code Section 1707.091(C); Uniform Securities Act Section 303 (2002), https://www.uniformlaws.org; Uniform Securities Act Section 303 (1956), https://www.nasaa.org/wp-content/uploads/2021/10/1956-Uniform-Securities-Act-with-NASAA-Updates-and-Commentary.pdf.

registration is coordinated with the primary regulator of these offerings, the SEC.[14] According to the official commentary to the Uniform Securities Act (1956), registration by coordination "is designed to achieve simultaneous effectiveness at the federal and state levels"[15] and "limits the Administrator to requiring only such information as is filed with the SEC."[16]

The Proposal would require state administrators to apply conditions on the registration of any NAV REIT offering that the SEC does not impose, such as disclosure requirements, concentration limits, and restrictions on the use of gross offering proceeds.[17] It would be impossible for NAV REIT offerings to be registered simultaneous with SEC registration as state registration-by-coordination requires. The Proposal thus would violate state registration-by-coordination provisions.

The Proposal similarly could violate *state notice filing provisions*. The concentration limits would apply to investment in NAV REITs and other securities offered by the sponsor and its affiliates, potentially including registered investment companies.[18] The latter securities are covered securities that are exempt from state registration. They are only required to submit notice filing in the states with respect to the offer and sale of the securities in a state. The Proposal effectively would impose a condition on the offering of investment company shares in a state – that no investor exceed the state's aggregate concentration limits – in contravention of the notice filing provisions.

2. The Proposal Does Not Reflect Developments in Non-Listed REITs.

Lifecycle REIT are no longer the predominant form of non-listed REIT distributed today. In fact, NAV REITs, not lifecycle REITs, are virtually the only type of REIT currently in distribution.

They are very different products. Unliked lifecycle REITs, NAV REITs are managed by some of the largest institutional asset management companies. They are distributed primarily by wire houses and other "well-established financial institutions."[19] The majority of NAV REIT shares are sold without any commission on a fee-based platform, presumably through fiduciary investment advisory accounts rather than commission brokerage accounts.[20]

[14] By contrast, registration by qualification is an extensive process that requires a set of findings. As the SEC has said, registration by qualification "requires a full review of the transaction by the state." Report on the Uniformity of State Regulatory Requirements for Offerings of Securities That Are Not "Covered Securities" (October 11, 1997), https://www.sec.gov/news/studies/uniformy.htm.

[15] Uniform Securities Law (1956), Section 303(c).

[16] See Sec. 303(b)—Filing same as with SEC. https://www.nasaa.org/wp-content/uploads/2021/10/1956-Uniform-Securities-Act-with-NASAA-Updates-and-Commentary.pdf.

[17] Even today, the REIT Guidelines violate state registration-by-coordination requirements by requiring merit review of securities that are simultaneously registered under state law "at the moment" of SEC registration.

[18] Proposal, III.D.

[19] Testimony of Melanie Senter Lubin before the United States Senate Committee on Banking, Housing and Urban Affairs 7 (July 28, 2022) ("Lubin Testimony").

[20] As of June 30, 2022, only .03% of non-listed REIT shares sold in their continuous offering had a full load commission, while 35.66% of sales were in low load share classes and 64.31% of sales were in no load share classes purchased on a fee-based platform Generally, "low load" share classes had an upfront 1.5%-3.5% combined sales commission and dealer manager fee, with a 0.25% to 0.85% annual shareholder servicing fee capped over the life of the REIT. "No load" shares typically were sold on fee-based platforms, often of a dually-registered broker-dealer/investment adviser. *See* The Source Stanger Market Pulse (June 2022).

Lifecycle REITs and NAV REITs operate differently. NAV REITs continuously offer their shares at net asset value over an indeterminate life and generally do not seek a liquidity event. By contrast, lifecycle REITs have a "lifecycle" that is intended to terminate with a liquidity event such as a share listing or an acquisition or liquidation.

NAV REIT fees are lower than those of the lifecycle REITs. It was not uncommon for legacy lifecycle REITs to include acquisition fees, financing fees, and development and disposition fees as part of their fee structure. NAV REITs have eliminated these fees.

NAV REITs also provide better liquidity for investors. They typically offer redemptions up to 2% of NAV per month and 5% of NAV per quarter – a *four-fold* increase from the amount of liquidity offered by lifecycle REITs. Unlike earlier lifecycle REITs, most NAV REITs allow shareholders to redeem at NAV after the first year. These redemption programs proved reliable during the pandemic. [21]

3. The Proposal Would Limit Investor Choice.

The concentration limits and the increase in the income and net worth requirements would restrict investment choice. Many investors need portfolio diversification, protection from inflation, and a source of income. Investors have found that NAV REITs are part of the solution. The Proposal would discourage investment in a diversifying asset when macroeconomic events make diversification, consistent with the basic tenets of modern portfolio theory, so important.

A. The Proposal Would Disadvantage Retail Investors.

State public employee pension plans and other institutions invest in real estate to achieve diversification and reduce their portfolio risk. The Ohio Public Employees Retirement System Defined Benefit Fund, for example, targets over 23% of its assets to alternative investments, 10% to real estate.[22] The nation's largest pension fund, the California Public Employees' Retirement System, reportedly experienced a 24.1% return on real estate for the 12 months ending March 31, 2022. In contrast, smaller pension plans that were concentrated in the stock and bond market suffered their worst year since 2009. [23] The Proposal would impede retail investors form achieving the same portfolio diversification and other benefits by investing in a well-regulated vehicle, the NAV REIT.

Three elements of the proposed concentration limits are particularly ill-considered. First, the Proposal would rely on the concept of liquid net worth rather than total investment portfolio overall wealth. An investor might have a $500 million business or inherited real estate portfolio, but not $1 of that business or portfolio could be considered for purposes of the concentration limits. State administrators should not be encouraged to substitute their judgment about the needs of *all* retail investors, for the determination of a federally-regulated broker-dealer or investment adviser about the best interest of its individual customer. The concentration limits could simply drive retail investors to the less regulated private securities market.

Second, the concentration limits would provide no carve-out for accredited investors. It would impede even wealthy investors, advised by their federally-regulated broker or investment adviser, from following portfolio

[21] According to the Proposal, the stockholders of only four NAV REITs -- *constituting less than 3% of all capital raised by the NAV REIT industry since January 1, 2017* -- experienced any impediment to full redemption of their shares during the pandemic. These NAV REITs invested in assets that were particularly susceptible to valuation difficulties during the pandemic: mortgages, office properties, and retail properties. Put differently, during one of the most turbulent times in the history of modern financial markets, NAV REITs representing over 97% of all raised funds satisfied all of their stockholders' redemption requests – no pro rata redemption, no suspension. Proposal at p. 7, n. 18.

[22] OPERS 2022 Annual Investment Plan at 6 https://www.opers.org/pubs-archive/investments/inv-plan/2022-Annual-Investment-Plan.pdf.

[23] "State and City Pension Funds Suffer Worst Year Since 2009," *The Wall Street Journal* (August 10, 2022).

diversification strategies like those employed by big institutions. For example, a dually-registered broker-dealer/investment adviser might recommend that a client with enough cash to meet reasonably foreseeable needs diversify her portfolio by investing more than 10% of her liquid net worth in an NAV REIT. The REIT might be one in which she has a long history of successful investing. The Proposal would forestall the financial professional's recommendation.

Third, the concentration limits would apply to affiliates of the NAV REIT, which potentially could include index funds or other registered investment companies managed by its sponsor. These registered investment companies do not implicate the concerns identified in the proposal[24], and imposing the concentration limits on these funds would be unnecessary and counterproductive. Registered investment companies are comprehensively regulated under the Investment Company Act of 1940. They typically have separate boards of directors, charged with overseeing conflicts and daily liquidity, among other issues. The proposed concentration limits could force investors to choose whether to limit their investment in the NAV REIT (limiting their diversification opportunities) or in these types of affiliated investment companies (limiting their investment choice).

At a minimum, SIFMA AMG recommends that NASAA provide an accredited investor carve-out to the concentration limits and that they not apply to direct participation plans and NAV REIT's affiliates, particularly registered investment companies with a separate board of directors. Without these changes, the Proposal could redirect investors to less regulated products – products for which (in the words of NASAA's President) "state securities regulators dedicate significant resources to respond to fraud and other violations."[25]

B. The Concentration Limits Are Unjustified.

The Proposal provides no justification or economic analysis for a 10% limit and does not explain why the standard should be liquid net worth rather than the size of the investment portfolio. The Proposal does not demonstrate that NAV REIT investment concentration has presented any liquidity problems for investors.

The Proposal asserts that the concentration provision will "limit investor risk."[26] According to NASAA's most recent statistics, non-listed REITs are not a significant source of complaint related to senior investor fraud. In NASAA's 2021 Enforcement Report, the "Top Investment Products/Sales Tactics in Senior-Related Enforcement Actions" are unregistered securities, traditional securities, commodities/precious metals, variable annuities and equity indexed annuities – not NAV REITs. SEC and FINRA rules already require that broker-dealers and investment advisers consider the portfolio concentration and liquidity needs of each investor, and the SEC and FINRA have emphasized the responsibilities of their regulated firms to supervise recommendations to senior investors. [27]

[24] *See* Proposal at 7:

> This structure was chosen based on the observation that liquidity is restricted in all programs; high fees and expenses, conflicts, and lack of historical operations also predominate these offerings.

[25] Lubin Testimony at 8.

[26] Proposal at p. 3.

[27] FINRA recently barred a registered representative for making unsuitable recommendations to senior customers concerning non-listed REITs. *Department of Enforcement v. Mercer Hicks III* (May 19, 2021), https://www.finra.org/sites/default/files/2021-07/oho-hicks-2017052867301-051921.pdf. This case and the other seven listed in footnote 11 of the Proposal all concerned sales practice violations related to the distribution of lifecycle REITs, not to the structure or operation of a NAV REIT. The very existence of these cases demonstrates that the Proposal is unnecessary; securities regulators can address any sale practice concern under existing law.

To justify its requirements the Proposal refers to FINRA arbitration claims.[28] This reference appears to reflect a misunderstanding about the nature of arbitration claims. One cannot assume, for example, that each claim resulted in an award, or that each claim constituted a sales practice violation rather than another type of claim such as one for breach of contract. Multiple products are often the subject of a single claim and typically concern the distribution of a product, not its design or operation.[29]

4. The Proposal Could Undermine Compliance.

Federally-regulated broker-dealers and investment advisers must adopt comprehensive systems to supervise their associated persons. They must adopt written supervisory procedures reasonably designed to ensure that these associated persons comply with federal and state law. Broker-dealers must supervise their registered representatives in a manner reasonably designed to ensure that they comply with Reg BI, including the requirement that their securities recommendations are in the best interest of their retail customers. Registered investment advisers must supervise their advisory representatives in a manner reasonably designed to ensure that they comply with their fiduciary duty under the Investment Advisers Act.

The Proposal would upset these carefully designed supervisory systems. It could undermine compliance and create an operational nightmare the effect of which might be the migration of the non-listed real estate business sales to tender offer and interval funds – covered securities beyond the registration authority of state administrators.

A. The Proposal Would Indirectly Regulate Intermediaries Through Securities Registration.

The Proposal would attempt to regulate how broker-dealers and investment advisers distribute NAV REITs by imposing a panoply of requirements on the registration of NAV REIT securities. Paradoxically, the Proposal would improve neither the public offering of NAV REIT securities nor their distribution by financial intermediaries. It will lengthen prospectuses and complicate compliance by broker-dealers and investment advisers.

This circuitous method of regulation would present many practical problems. Broker-dealers and investment advisers would have no avenue to obtain interpretation of the requirements from the various states, since the requirements would apply to the NAV REIT sponsors, not to them. As we discuss below, the Proposal presents a host of questions that require interpretation.

The Proposal could be read to interject the sponsor into the compliance system of broker-dealers and investments advisers. For example, the Proposal would require sponsors or each person "selling shares on behalf of the sponsor or REIT" to maintain records of the information used to determine that an investment is suitable and appropriate.[30] The Proposal also would require sponsors to disclose in the final prospectus:

> the responsibility of the sponsor and/or each person selling shares or providing a recommendation on behalf of the sponsor or REIT to 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 in

---

[28] Proposal, note 13.

[29] The Proposal cites the work of litigation consultants who "found that [from June 1990 to December 2019] investors in non-traded REITs underperformed investors in traded REITs by approximately $75 billion." Proposal, note 8 (citing Mallett and McCann, *Further on the Returns to Non-Traded REITs,* The Journal of Wealth Management (Winter 2021)). The study was fundamentally erroneous. For example, its time period was conveniently fitted to end immediately before the pandemic, when NAV REITs outperformed the study's benchmark, publicly-listed REITs. It arbitrarily discounted the valuations of NAV REITs in order to make the performance of publicly-listed REITs appear superiors. *See* Selman, *Non-Traded REIT Performance: A Response to Mallett and McCann,* The Journal of Wealth Management (Fall 2022).

[30] Proposal, III.C.4.

compliance with applicable conduct standards based on information provided by the shareholder regarding the shareholder's financial situation and investment objectives.[31]

These provisions are ambiguous, and perhaps NASAA did not intend that issuers police the conduct of financial intermediaries over whom they lack supervisory authority. As a practical matter no sponsor is able to determine whether a recommendation complied with the conduct standards of a broker-dealer, investment adviser or its representatives.[32] The sponsor cannot be presumed to have expertise about Reg BI, ERISA or the investment adviser fiduciary duty.

For broker-dealers and investment advisers, the Proposal would engender this confusion and complication *only* for NAV REITs. Broker-dealers and investments advisers would have to create a separate set of written supervisory procedures and a distinct compliance program for these state NAV REIT requirements. The Proposal could increase the cost to customers of investing in NAV REITs, without providing any additional protection.

Much of this confusion would be sown through prospectus disclosure, but the Proposal would add information that is of little use to investors. The disclosure would constitute boilerplate because every sponsor would have to make it. The Proposal illustrates why NAV REIT prospectuses are so long, a condition about which state administrators have complained.[33]

B . The Proposal Would Perpetuate a Multitude of Standards.

NAV REITs are nationally offered and distributed investments. In 2021, NAV REITs raised over $36 billion and in the first half of 2022 the pace has quickened as NAV REITs raised over $21 billion.[34] NAV REITs are sponsored and managed by some of the largest and most successful asset management companies in the country, and they are distributed through nationally situated wire houses, independent broker-dealers, and registered investment advisers.

The Proposal would subject this national product to a panoply of state requirements that would make implementation virtually impossible.

1. Example One: The Conduct Standards

For example, under the Proposal each person selling, recommending or providing investment advice with regard to a REIT would have to:

make every reasonable effort to determine that such sale, recommendation or investment advice is in compliance with applicable conduct standards and is a suitable and appropriate investment for each

[31] Proposal, III.C.5.

[32] The concentration limits imposed through securities registration similarly would be requirements that neither the REIT nor the sponsor could implement. Concentration limits would have to be managed by the broker-dealers and investment advisers who recommend the product as part of their best-interest or fiduciary obligation.

[33] The length of the prospectus is influenced by the disclosure rules and regulations applicable to the registration statements of non-listed REITs, including the SEC's Form S-11 and the NASAA REIT Guidelines, and are a result of additional disclosure requests by the SEC, FINRA and state regulators. Each Prospectus contains a "Prospectus Summary" or similar section, thereby providing a helpful summary of the Prospectus.

[34] The Stanger Market Pulse (December 2021 and June 2022).

shareholder.[35]

The Proposal would define "conduct standards" to include Reg BI, ERISA, applicable fiduciary duties, and, apparently, *state standards not yet enacted*. Moreover, under the Proposal broker-dealers and their associated persons would have to:

> act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer or associated person making the recommendation ahead of the interest of the retail customer.[36]

This best interest standard resembles the Care Obligation under Reg BI but it is set forth separately in the Proposal.

The Proposal thus would impose four categories of conduct standard:

- conduct standards that federal or state law imposes on the person selling, recommending, or providing investment advice (Reg BI, ERISA, fiduciary duty);
- a state law requirement that the investment be "suitable;"
- a state law requirement that the investment be "appropriate;" and
- a state law requirement that the investment be in the retail investor's "best interest."[37]

The Proposal does not explain how these various conduct standards would interact with one another or about the contours of the state law requirements. The Proposal would offer state administrators the chance to impose the conduct standards however the administrator pleases, under whatever facts the administrator chooses, without any expectation of consistency with the SEC, FINRA, or other state administrators. The determination of any state administrator would be subject to state judicial review as well.

This myriad of requirements for the same conduct would sow chaos in the compliance departments of regulated firms. They would undercut, not advance investor protection.

2. Example Two: The Concentration Limits

The Proposal says,

> In light of . . . a proliferation of non-uniform concentration limit standards within the membership, NASAA is renewing advancement of a uniform concentration limit to the NASAA REIT Guidelines.[38]

The Proposal would not, however, establish a uniform concentration limit. It would require the sponsor to propose a concentration limit *particular to its own REIT*, and each state administrator could accept or adjust the limit based upon a list of 14 wide-ranging factors. These factors would include "the REIT's use of leverage,"

[35] Proposal, III.C.1.

[36] Proposal, III.C.1.

[37] The Proposal also would impose "suitability" and "appropriateness" standards on broker-dealers who recommend non-listed REITs to non-retail customers. Proposal, III.C.1.

[38] Proposal at p. 7.

"balloon payment financing," "potential variances in cash distributions," "prior performance," and "any other relevant factors."[39]

The state administrator could adopt the sponsor's proposed limit or demand that the sponsor accept a higher or lower limit. The sponsor might not be afforded notice of the factors considered or the process followed in reaching a determination. The state administrator also could establish a limit that applies to all NAV REITs that apply for registration in the state. The 10% concentration limit would apply only if the state does not establish its own concentration limit.

Any state would be free to choose a different concentration limit. Any limit, whether 10% or another, would be a subjective condition that fails to consider the needs of an individual investor, and would interfere with the judgment of their financial professional on factors including age, risk tolerance, financial objectives and other life circumstances.

Experience demonstrates that uniformity is impossible. Even today, up to 20 states have established concentration limits, including such variations as 10% of liquid net worth in a REIT and its affiliates, liquid net worth of $300,000, liquid net worth of $350,000, and total non-listed REIT investment of 10% of total net worth. Some states provide an exception for accredited investors; others do not. NASAA cannot force these states to adopt a single percentage and the Proposal does not even attempt to do so. There is no reason to presume that states would dramatically change their concentration limits to 10% of liquidity or that they would apply them precisely to those securities covered by the Proposal.

C. The Proposal Would Raise a Panoply of Interpretive Questions

The Proposal is ambiguous in many respects. It would present a myriad of interpretive questions for sponsors, broker-dealers and investment advisers. Because the Proposal would apply to the sponsor and not the intermediary, it provides no avenue for a broker-dealer or investment adviser to obtain clarification.

1. Example One: Application of the Concentration Limits to Other Securities.

The new concentration limits would apply not only to retail investment in non-listed REITs but to securities of an "affiliate" and "other non-traded direct participation programs."[40] The definition of "affiliate" presents numerous ambiguities. For example, it includes any person "directly or indirectly controlling, controlled by, [or] under common control with" another person.[41] The meaning of "control" and "indirect" control are unclear, for example. Nor does the Proposal define "direct participation program." We are unaware of any other state or NASAA definition of that term and FINRA's definition excludes REITs.[42]

The concentration limits would apply to securities issued or managed by an affiliate of the NAV REIT sponsor. It appears that if an investor held one share of a non-listed REIT, she would be unable to purchase any security issued or managed by an affiliate of the REIT in excess of 10% of her liquid net worth.

---

[39] Proposal, III.D.

[40] Proposal, III.D.3.

[41] Proposal, I.B.5.

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

Moreover, the concentration limits apparently would apply even to covered securities, the shares of registered investment companies managed by the NAV REIT sponsor. It is unclear why investment in these securities should be subject to the same limits.

Indeed, the Proposal does not explain why the mere fact that securities are issued or managed by an affiliate warrants their subjugation to the concentration limits. By limiting investment in the securities of affiliates, the Proposal would discourage the entry of the types of sponsors who will provide high-quality, transparent investments: large asset management companies with an established record and a platform of wide investment choices, including index funds and other investment companies that are not alternative investments, including index funds and other registered investment companies that are not alternative investments.
.

2. Example Two: Unspecific Application of the Concentration Limits.

The Proposal would provide no specificity in time for evaluating the concentration limits, for example, “at the time of recommendation” or “at the time of the transaction.” Perhaps NASAA does not expect investment advisers and broker-dealers to monitor continued compliance with the concentration limits, but if it does, this feature would be unworkable.

For example, an investor might not exceed the concentration limits at the time of the initial subscription for primary shares, but over time, due to the investor’s participation in the REIT’s distribution reinvestment program, the investor could trip the concentration limits. Another investor might find that the listed stocks in her portfolio declined in value and she has exceeded the concentration limits without having purchased another REIT share.

The Proposal has no grandfather provision. An investor who owns shares at the time that his state adopts a concentration limit might inadvertently violate them.

If the concentration limits are meant to apply continuously, it is unclear what sponsors, broker-dealers and investment advisers are required to do. They cannot force the investor to sell his shares.

3. Example Three: The Enigmatic Prohibitions of the Use of Gross Proceeds.

In three sentences the Proposal would prohibit the use of gross proceeds for stockholder distributions:

> The REIT may not have an investment objective or strategy to source regular distributions with gross offering proceeds from the sale of shares.[43]
>
> The REIT may not reserve the right that gross offering proceeds from the sale of shares will be reserved or used to source regular or declared distributions.[44]
>
> The REIT may not source regular or declared distributions from gross offering proceeds.[45]

These three statements are different and they will engender abundant interpretive questions as various states implement them. It is unclear how sponsors are expected to implement these prohibitions. For example,

[43] Proposal, V.E.1.

[44] Proposal, V.K.1.

[45] Proposal, VI.H.

would they apply to the "return of capital" that is a tax benefit to stockholders, representing the depreciation expense the NAV REIT has deducted from gross income for U.S. income tax purposes? Given that cash is fungible, how would a sponsor determine whether distributions are paid from gross offering proceeds? Would it be based upon funds from operations, adjusted funds from operations, or another operational metric?

How would these prohibitions square with SEC requirements and state corporate law? Under federal law, a REIT must make distributions to stockholders equal to at least 90% of its net taxable income each year (determined without regard to the dividends-paid deduction and excluding net capital gain). The Proposal could jeopardize a REIT's federal tax status.

The Proposal would prohibit a practice that other state laws permit and that is an essential determination of a REIT's board of directors. Most NAV REITs are Maryland corporations and Maryland law permits the use of proceeds for distribution if it is approved by the board of directors, which has a fiduciary obligation to both the REIT and its stockholders. The ability to make determinations on how to fund distributions, through offering proceeds or otherwise, is an essential function of the board. Maryland law has solvency tests that address concerns about the overpayment of distributions; the REIT's board must determine that the REIT will be able to pay its debts as they become due and that after any distribution the REIT's assets will exceed its liabilities.

The SEC does not prohibit the payment of distributions from offering proceeds, having explicitly addressed this question, provided that the REITs include appropriate disclosure in the prospectus.[46] Moreover, the SEC has published disclosure guidance that requires non-listed REITs to present, on a quarterly basis, the sources of distributions.[47] Because this disclosure is available each quarter, investors have adequate historical information regarding the sources used to fund distributions prior to making an investment decision, and after investing they can redeem their shares if they object to the manner in which fund distributions are paid. Broker-dealers and due diligence firms review the historical distribution coverage to determine if they should make an investment in the REIT available to their clients. They pay close attention to distribution coverage, and a failure to demonstrate full coverage or positive trends toward full future coverage could result in firms suspending or terminating selling agreements.

The NAV REITs raising capital today publish their net asset value on a daily or monthly basis. This practice is an improvement for investors, who receive regular disclosure regarding the value of their investment in the REIT and are no longer sent account statements for extended periods that show a "value" equal to the price they paid for the investment. Payment of distributions from offering proceeds reduces NAV (after inclusion of unrealized gains). The effect of this practice is thus apparent to investors and their financial advisors when they look at changes to the NAV.

* * *

[46] 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 ("SEC Disclosure Guidance: Topic No. 6").

[47] SEC Disclosure Guidance: Topic No. 6.

SIFMA AMG appreciates the opportunity to comment on the Proposal. We stand ready to work with NASAA members on ensuring that any guidance that they provide reflects the characteristics of NAV REITs, the needs of investors, and the obligations of financial professionals to act in their best interest. in the meantime, should any member of NASAA or its staff have any questions about our comments, please feel free to contact Lindsey Keljo at (202) 962-7312 or lkeljo@sifma.org or Tom Selman, Scopus Financial Group, at tomselman@scopusfinancial.com.

Sincerely,

Lindsey Weber Keljo, Esq.
Head - Asset Management Group
Securities Industry and Financial Markets Association