Via Electronic Mail: (**nasaacomments@nasaa.org**)
(**faith.anderson@dfi.wa.gov**)
(**bill.beatty@dfi.wa.gov**)
(**ehouston@sos.nv.gov**)

May 28, 2025

North American Securities Administrators Association, Inc.
Faith Anderson, Esq. - Chair, NASAA Direct Participation Programs Project Group
Bill Beatty, Esq. - Co-Chair, NASAA Corporate Finance Section
Erin Houston, Esq. - Co-Chair, NASAA Corporate Finance Section

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

Ladies and Gentlemen:

Please allow this to serve as comments of Cetera Financial Group, Inc. ("Cetera") with respect to a proposal by the NASAA Corporation Finance Section (the "Section") and Direct Participation Programs Project Group (the "Project Group") with respect to the NASAA Statement of Policy Regarding Real Estate Investment Trusts (the "REIT Guidelines"). The proposed revisions would make substantive changes to standards governing offering, management, and recommendations to purchase interests in publicly-registered non-traded Real Estate Investment Trusts ("non-traded REITs"). We will refer to the proposed revisions to the REIT Guidelines collectively as the "Proposal".

Cetera is the corporate parent of five broker-dealers and two investment advisers. Through our nearly 14,000 financial professionals, we provide securities brokerage and investment advisory services to more than 1 million retail investors in all 50 states. Our customers are primarily individuals, families, and small businesses saving and investing for retirement, education funding, and creating financial legacies. Non-traded REITs represent a very small percentage of our overall product offering and revenue, but they are an important component of the investment portfolios of many of our customers. They are designed to provide income and potential capital appreciation and can serve as a non-correlated asset class, providing diversification benefits that may not be available in portfolios of investments that are all publicly listed. We have number of concerns about the Proposal, set forth in more detail below.

Relevant History of Non-traded REITs

At the outset, we believe it is important to consider the issues that the Proposal purports to address in light of the ways in which the structure of non-traded REIT offerings has changed

655 W Broadway, 12th Floor
San Diego, CA 92101

over the past decade. Prior to 2015, most non-traded REIT offerings were structured as "lifecycle" investment products. They raised funds, invested them in real estate or real estate-related instruments, and either liquidated by selling the assets in the portfolio or through a listing on a public securities exchange that allowed investors to sell their interests efficiently. This process often took 5 – 10 years, and as has been noted by the Project Group, it created issues for both sponsors and investors. In particular, lifecycle REITs often lacked transparency in valuation methods and provided limited opportunities for owners to sell or transfer their interests prior to sale of the assets owned by the REIT or a public listing.

Largely in response to these valuation and liquidity issues, the vast majority of the funds raised in non-traded REIT offerings in the past 5 years have been in a different structure, often referred to as "Net Asset Value" or "NAV" REITs. These offerings generally have a perpetual life, a standardized method to produce independent valuations, and offer a greater degree of liquidity for investors who seek to sell their interests. FINRA has also adopted rule changes designed to add more transparency to the valuation process.[1] These structural and regulatory changes have largely mitigated the prior concerns about valuation and lack of liquidity of non-traded REIT investments, but the Proposal seems to have ignored these changes. Based largely on limited data and conclusory statements about a lack of liquidity and the risks that it creates for investors, the Proposal would establish limits on the quantity of a non-traded REIT that an investor could purchase. In taking that approach, the Section and the Project Group appear to be fighting the previous war. The issues that the Proposal seeks to correct have already been addressed. Adoption would create collateral problems that far exceed the benefit of any incremental protection for investors.

<u>Considerations in Adoption of NASAA Model Rules</u>

As the Section and the Project Group consider the Proposal and comments received from interested parties, they would do well to bear in mind the following:

- A comprehensive regime applicable to the provision of investment advice to retail customers already exists.

    - SEC Regulation Best Interest[2] ("Reg. BI") establishes obligations for broker-dealers with respect to both the type and quantity of any security or class of securities recommended to retail customers. Reg. BI requires that financial advisers act in the best interest of the customer and not place their interest above that of the customer. FINRA rules have explicitly incorporated these concepts, as have many states. Indeed, NASAA recently adopted a model rule that would incorporate the obligations of Reg. BI in state regulations. Note, however, that neither Reg. BI, FINRA rules, nor the NASAA Model Rule singles out any investment product or class by applying limits on the quantity that an investor can purchase. This concept, referred to as a

[1] See FINRA Rule 2340.
[2] 17 CFR 240.15l-1

"concentration limit" is a centerpiece of the Proposal, but is not justified by much more than conclusory statements about non-traded REITs being overly risky.

- o The Investment Advisers Act of 1940 creates fiduciary obligations for investment advisers providing investment advice and recommendations to advisory clients, including recommendations to purchase non-traded REITs. The fiduciary standard includes duties of care and loyalty that render concentration limits superfluous and counterproductive.

- The primary goal of all NASAA Model Rules should be to create standards that are uniform, both among states and with other regulatory regimes such as the federal securities laws and the Employee Retirement Income Security Act ("ERISA").[3] The Proposal contains numerous provisions that would encourage states or securities administrators to create standards applicable only in their states, and which would also conflict with federal law. Capital formation, investing, and the provision of investment advice are inherently national and global in nature. Erecting barriers at state borders that arbitrarily restrict access to investment products inhibits the efficient formation of capital and can negatively impact investment returns. It should be avoided except in truly compelling instances, which do not exist here.

- Investors are not all the same. The Proposal establishes concentration limits and standards with respect to the income and net worth of all prospective investors in non-traded REITs, without regard to their financial circumstances, level of knowledge and sophistication, risk tolerance, investment time horizon, or other holdings in their investment portfolios. Financial advisers who recommend purchases of non-traded REITs to retail customers are subject to Reg. BI and other standards that require them to consider the entire investment profile of the customer to whom they are making the recommendation. The Proposal places arbitrary and unjustifiable limitations on the ability of investment professionals to exercise their best judgment, substituting a one-size-fits-all standard for professional advice and investor choice.

- Just as all investors are not the same, neither are all investment risks. The logical foundation for much of the Proposal is that non-traded REITs present extraordinary risks, primarily by reference to a single criterion: Lack of liquidity in that they are not traded on a national securities exchange. Liquidity is clearly an important consideration in any investment recommendation, but elevating it above all others is simplistic at best. Investors, in consultation with their financial advisers, should be allowed to decide the type and degree of risks they are willing to accept in light of the potential for investment returns. Modern investing theory involves construction of portfolios of investments, each with different risk and return profiles, time horizons, and degrees of liquidity. To isolate

[3] 29 U.S.C. Section 1001, et. seq.

any class of investments and subject it to arbitrary limits devalues both the notion of portfolio construction and advice from professional advisors.

- All regulations should set forth clear and unambiguous standards that can be interpreted and operationalized by broker-dealers and others recommending purchases or sales of securities. A number of provisions in the Proposal are vague, ambiguous, and do not provide broker-dealers, investment advisers, or other financial professionals with reasonable notice regarding how terms are defined or rules will be applied.

- In adopting any kind of regulation, administrative agencies should make genuine attempts to measure not only the potential benefits to investors or other groups they seek to protect, but also to thoroughly consider the negative impacts that they will have on all affected parties, the economy, and capital formation. Proposed regulations should estimate the costs of compliance imposed upon investment sponsors and regulated entities, as well as the potential for negative impacts on investors through reduced access to investment products, and should make their best effort to balance the benefits and burdens. The federal government and virtually all states have laws that require regulatory agencies to perform this analysis prior to adopting regulations. We recognize that NASAA is not a government agency is not subject to such requirements, but the Proposal makes no effort to even consider the importance of the balancing exercise. This does a disservice to states considering adoption of their own regulations, investors, financial advisers, and sponsors of investment products.

We believe that the Section and the Project Group have published the Proposal in a well-meaning attempt to enhance investor protection, but it misses the mark in many important respects and in its present form would do more harm than good. We offer the following comments and suggest ways in which it could be improved.

<u>The Proposed Concentration Limits Have Numerous Flaws</u>

Section III. D. 3 of the Proposal gives a state administrator the right to establish a concentration limit for investors purchasing interests in not just a single non-traded REIT, but also in the aggregate with other investment products. Specifically, unless the administrator determines that the risks or other factors associated with the REIT require lower or higher standards, an investor's aggregate investment in the REIT, other non-traded REITs, and certain other categories of investments may not exceed 10% of the investor's liquid net worth.

This raises a number of concerns, including the following:

A. Giving a state administrator discretion to determine a concentration limit for any investment product directly undercuts the purpose of NASAA Model rules and uniform standards. The Proposal literally invites each state to review each non-traded REIT offering according to ill-defined standards to determine if it should be subject to a concentration limit. This is virtually guaranteed to result in a patchwork of determinations with little uniformity among states. It will also place a significant burden on well-intentioned administrators in determining which offerings should be subject to restrictions. We do not believe that many states have the expertise necessary to make what are essentially investment decisions when reviewing non-traded REIT offerings for purposes of determining their relative risk. Even if they do, it will create a significant burden that will likely result in delay in the process of reviewing offerings.

The large majority of states do not currently impose concentration limits, and the Proposal does not provide justification or economic analysis sufficient to support adopting them. The 10% limit and the process by which states would administer it is also highly arbitrary. Portfolio composition should be determined by investors and their advisors, not dictated by a one-size-fits-all standard. This approach will unduly limit access to investments that many investors find valuable.

B. Neither Reg. BI, the Investment Advisers Act, nor FINRA rules single out any specific security or asset class for a concentration limit. In adopting Reg. BI, the SEC specifically rejected that concept in favor a principles-based regime, primarily in recognition of the fact that all investors are different. Applying the same limitations to a 70-year-old retiree with $500,000 million of net worth and a 40-year-old physician with $1 million of annual income and $20 million of net worth in real estate and the value of her medical practice defies logic. Reg. BI lists a number of factors that make up the investment profile for every customer, and explicitly requires financial advisers to take all of them into account in formulating any investment recommendation. The notion of a concentration limit conflicts directly with the comprehensive standards in Reg. BI, creating confusion and operational difficulties for broker-dealers without adding any incremental protection for investors.

C. The 10% concentration limit would apply not only to recommendations to purchase interests in a single non-traded REIT, but would be aggregated with other holdings of non-traded REITs and other securities. This formulation is flawed in multiple respects.

1. It fails to recognize the differences between non-traded REIT offerings. Some such offerings involve equity ownership of real estate, while others invest primarily in debt instruments or other financing vehicles that extend credit to real estate projects. Some offerings utilize significant leverage in the form of borrowed money and others do not. Lumping all of these offerings together when their only common characteristic is that they are not publicly traded is not justified.

2. The Proposal would aggregate all investor holdings of non-traded REITS, non-traded Business Development Companies ("BDCs"), and Direct Participation Programs ("DPPs") when applying the 10% concentration limit. This suffers

from the same infirmity as aggregating holdings of REITs that have different underlying investments, but goes a giant step further. It would require aggregation with investor holdings of limited partnerships and other investment types that have very few common attributes. For example, BDCs are essentially fixed income investments that generate returns through interest payments received from borrowers. Some utilize leverage to seek higher investment returns, but to create a blanket equivalency between non-traded REITs and BDCs is also unjustified.

DPPs, limited partnerships, and other investments that would be included in the aggregated concentration limit also have little in common with non-traded REITs. FINRA Rule 2310 defines DPPs as follows:

> "… *program(s) which provide for flow-through tax consequences regardless of the structure of the legal entity or vehicle for distribution including, but not limited to, oil and gas programs, real estate programs, agricultural programs, cattle programs, condominium securities, Subchapter S corporate offerings and all other programs of a similar nature, regardless of the industry represented by the program, or any combination thereof."*

We note that REITs, non-traded or otherwise, are not included in the definition of DPPs.

FINRA Rule 2310 was adopted in an era in which there were a large number of limited partnership offerings whose primary investment benefit was tax deductions that could be utilized to offset other income earned by the investor. The number of DPP offerings dropped dramatically after adoption of the Tax Reform Act of 1986, and FINRA Rule 2310 now primarily affects only a very limited set of investment offerings that consist mostly of oil and gas drilling programs and other investment products that offer flow-through of tax credits to purchasers of specific types of property.

Offerings in which a significant portion of the potential return to investors is represented by tax benefits presents a unique set of considerations, complications, and risks that need to be identified and managed. However, the risk and return profiles of oil and gas drilling programs and tax credit ventures investments bear almost no similarity to those of non-traded REITs. For example:

- Non-listed REITs are subject to specific requirements under the Internal Revenue Code, including the obligation to distribute at least 90% of taxable income annually. They primarily invest in real estate assets with distinct income and risk characteristics. Flow-through of tax benefits is not generally considered a significant part of their prospective investment return.

- Non-listed BDCs are subject to the provisions of the Investment Company Act of 1940, which imposes protections related to conflicts of interest, asset coverage, and leverage. BDCs invest primarily in private credit and other securities issued by emerging companies.

The group of investments that would be aggregated in determining the concentration limit share a single common attribute: A relative lack of liquidity. As noted above, this singular risk factor is not sufficient to justify lumping this incredibly diverse group of investments together. If the Section and the Project Group determine that it is necessary to include any concentration limit, it should apply only to investments in a single non-traded REIT.

D. The Proposal defines “liquid net worth” as that portion of net worth consisting of cash, cash equivalents, and readily marketable securities. This creates a new standard which is not consistent with the provisions of in Reg. BI and FINRA rules. As noted in our example above, liquid net worth reduces a complex set of investor attributes to a single number. It conflicts directly with the principle that all investors and their circumstances are different.

E. The term "minimum concentration limit" is unclear. As drafted, it suggests that the concentration limit could vary by investor, REIT type, or risk profile, but the guidelines do not define how these variations should be determined or applied. This ambiguity could result in inconsistent application and confusion for both investors and those responsible for compliance. Additionally, it is unusual and problematic for the sponsor to be tasked with proposing a concentration limit, as sponsors do not typically have access to all of the relevant information regarding prospective investors. Financial professionals making investment recommendations to retail customers already have comprehensive obligations to know all relevant information regarding the customer and any recommendation. This provision would create a significant burden on sponsors of non-traded REITs without any corresponding benefits for investors.

<u>There Should be an Accredited Investor Carveout That is Applied Uniformly</u>

The Proposal provides that a state administrator may elect to exclude from the concentration limit any person that is an “Accredited Investor” under the provisions of Rule 501(a) of SEC Regulation D. The discretion granted to the administrator is not limited.

A carveout from the concentration limits for Accredited Investors is the correct approach. They typically have greater financial resources and/or higher levels of investment expertise and sophistication, and this carveout represents an appropriate attempt to balance investor choice and access to investment products with investor protection. Unfortunately, the Proposal would encourage each state to adopt the accredited investor exception, ignore it, or change the applicable standard arbitrarily. It suggests that a state administrator could grant or deny the accredited investor exception on a case-by-case basis for each individual offering. Neither sponsors nor investors could reliably predict whether the exception would apply to a particular offering. This can only result in a fragmented, subjective system that is likely to produce inconsistent treatment across jurisdictions.

Large broker-dealers and investment advisers have millions of customers in all 50 states. Developing effective processes to perform oversight and supervision of sales practices is difficult under the best of circumstances. When jurisdictions have different or conflicting standards it becomes nearly impossible. The critical objective of investor protection is better served through uniformity.

A uniform carveout is also consistent with federal regulation. Accredited investors are presumed to have the financial sophistication, resources, and access to advice necessary to evaluate investment risks independently. Under federal law, accredited investors are permitted to participate in private placements, where disclosure may be far more limited, without any investment concentration restrictions. It would be illogical and inconsistent for states to impose stricter limitations on those same investors when purchasing publicly registered securities subject to comprehensive SEC oversight and disclosure requirements. The Proposal should be amended to provide that Accredited Investors are excluded from all concentration limits.

The Proposal Increases the Likelihood that Non-Traded REIT Offerings Will Avoid State Merit <u>Review</u>

State regulation applicable to review of securities offering is limited by the operation of federal law. States do not review unregistered offerings such as private placements or those by entities registered under the Investment Company Act of 1940. Large investment firms are the sponsors of the offerings that are currently raising the vast majority of the funds in the non-traded REIT space. These sponsors can easily utilize different structures for their offerings, such as Rule 506 under Regulation D or registration under the Investment Company Act. There are already a number of offerings structured as such, and adopting restrictions such as concertation limits for registered offerings will have the effect of forcing more investment sponsors to consider that choice. It would be ironic indeed if NASAA adopts the Proposal with the intent of heightening investor protection only to find that issuers and sponsors can easily avoid it. We submit that they can and will do exactly that.

<u>The Proposal Would Create Unconventional Conduct Standards</u>

The Proposal seeks to incorporate the conduct standards in Reg. BI applicable to broker-dealers recommending non-traded REIT interests to retail customers, but it goes further and creates standards applicable to recommendation to “non-retail” customers. This creates multiple complications:

- The term “non-retail” customer is not specifically defined; and

- It requires the broker-dealer to have a reasonable basis to believe that a purchase of interests of a non-traded REIT is ***suitable and appropriate*** for such non-retail customer. Federal law and FINRA rules apply a suitability standard to all recommendations to purchase or sell securities to non-retail investors, and that standard is well understood. Adding the term “appropriate” implies a higher standard than under existing law, but does not specify what it is. At a minimum, this is ambiguous and likely to create confusion for both investors and sponsors of non-traded REITs.

****

We appreciate the opportunity to provide comments on this important NASAA initiative and look forward to engaging with the staff of the Section and the Project Group as they conduct their review. If we may offer any additional information, please let me know.

Sincerely,

Mark Quinn
Director of Regulatory Affairs
Cetera Financial Group