March 12, 2014

Elizabeth M. Murphy
Secretary
Securities Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. SR-FINRA-2014-006, Proposed Rule Change Relating to Per Share Estimated Valuations for Unlisted DPP and REITS

Dear Ms. Murphy:

Since 1985, the Investment Program Association (IPA) has provided the direct investment industry with effective national leadership, serving as the leading advocate for the inclusion of unlisted direct participation programs ("DPPs") and unlisted REITs in a diversified investment portfolio. Over 1.5 million investors have purchased unlisted DPPs and REITs in recent years. IPA members include investment product sponsors, FINRA member broker-dealer firms, and investment service providers that together represent over $100 billion in equity under management. The vast majority of this capital comes from "main street America" where capital is pooled from investors professionally represented by tens of thousands of practicing registered representatives and investment advisors around the country. In 2013, IPA member sponsored programs raised over $24.2 billion in capital.

On January 31, 2014, the Financial Industry Regulatory Authority (FINRA) filed, and on February 19, 2014 the Securities and Exchange Commission (SEC) subsequently published in the Federal Register, proposed rule changes to amend the provisions addressing per share estimated valuations for publicly registered unlisted DPP and REIT securities. The proposal would modify the requirements relating to the inclusion of per share estimated values for publicly registered unlisted DPP and REIT securities on customer account statements under NASD Rule 2340 - Customer Account Statements and modify the requirements applicable to FINRA members' participation in public offerings of DPP or REIT securities under NASD Rule 2310 - Direct Participation Programs (together, the "Proposed Amendments").

The IPA appreciates the opportunity to provide information and views regarding the Proposed Amendments, particularly since these changes will substantially alter the regulatory and business environment for unlisted DPP and REIT securities and impact the benefits provided by these investments to investors and the U.S. economy. The IPA strongly believes that this continuing constructive dialogue will result in a final rule that is a collective best approach to promoting transparency and increasing investor protections while preserving the contributions of this industry to the nation's economic growth and to the financial well-being of investors.

The goals of the IPA complement perfectly the goals and mission of FINRA and the SEC. We seek to foster an environment where knowledgeable investors guided by educated financial advisors make fully informed investment decisions. We seek to foster the creation of investment products which provide the financial benefits needed by the investing public and which provide the highest quality investor reporting and transparency. We embrace whole heartedly the objectives FINRA and SEC are pursuing with the release of the Proposed Amendments. As further noted below, we support efforts to reflect the impact of securities distribution costs in a manner more consistent with account statement reporting for other retail investment products and to provide investors with estimates of share value based on determinations of net asset value significantly sooner than under the current NASD Rule 2340, thereby addressing in a more timely fashion the potential for value changes during an extended offering period. We also welcome changes that ultimately improve the information provided to investors concerning the sources of cash distributions received during the offering period as the issuer raises capital and aggregates assets.

Specifically, the IPA believes the following changes to the provisions of NASD Rules 2340 and 2310 proposed by FINRA benefit investors, and therefore we support such changes (subject to our detailed observations herein regarding the appropriate application of these rules to daily NAV REITs and unlisted Business Development Company DPPs):

- the prohibition of member participation in a public offering of a DPP or REIT security unless:
    - a per share estimated value is calculated on a periodic basis in accordance with a methodology disclosed in the prospectus; or
    - the general partner or sponsor of the program or REIT has agreed to:
        - disclose a per share estimated value;
        - such per share estimated value be conducted at least every two years[1] by or with the material assistance of a third-party expert;
        - such estimated value be determined in accordance with a methodology which conforms to standard industry practice[2];
        - such estimated value be accompanied by a written opinion from a third-party expert to the general partner or sponsor that explains the scope of the review, the methodology used to develop the valuation and the basis for the per share estimated value; and
        - the issuer has agreed to disclose such estimated value no later than in the first periodic report filed after the second anniversary of breaking escrow and in each annual report thereafter. (See Section 5 below for IPA's comment regarding FINRA's proposed timing of the initiation of such disclosure.)

[1] IPA Practice Guideline 13-01 Valuations of Publicly Registered Non-Listed REITs ("IPA REIT Valuation Guideline") recommends that independent valuations be conducted at least every two years and that there be material involvement and confirmation of valuations by third-party experts in the interim years. (See Section 7 below for related IPA comments.)

[2] The IPA REIT Valuation Guideline recommends the use of net asset value as a basis of valuation along with other specific standards.

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- the reporting of share values on customer account statements during the initial offering period, where a per share estimated value has not been disclosed, based on "Net Investment" where Net Investment is defined as gross offering proceeds reduced by: (i) commissions; and (ii) dealer manager fees. (See Section 1 below for the IPA's comments regarding FINRA's proposed treatment of issuer offering and organizational costs.)

The IPA respectfully submits, however, that certain aspects of the Proposed Amendments will not achieve our shared goals and, in fact, may potentially create unintended negative consequences for the investing public. Among these potential unintended consequences are: investor confusion caused by complex and arcane accounting adjustments to account statement values; increased risk of achieving the financial objectives of the investment program; a retreat from transparency in the form of possible removal of otherwise reliable estimates of value from investor account statements; potential degradation of the benefits of distribution re-investment programs and share redemption programs; and investor misperceptions regarding account statement changes in net worth.

In addition, as currently contemplated by FINRA, the Proposed Amendments will pose other significant challenges to both the industry and regulators, particularly with respect to maintaining consistency with existing recognized valuation and reporting standards, creating standardization across the many industries and asset classes to which unlisted DPPs and REITs provide capital, and the ultimate method of implementation by FINRA and the industry. Perhaps more importantly, these aspects of the Proposed Amendments also raise issues related to regulatory maintenance of a "level playing field" for alternative investments and the achievement of higher levels of transparency in the financial services industry.

Notwithstanding these challenges, the IPA believes that the Proposed Amendments, with appropriate modifications, can be successfully fashioned to provide significant benefits to the investing public. To that end, the IPA will present herein suggested alternative approaches which it believes will achieve regulatory objectives while overcoming such challenges.

Specifically, the IPA respectfully requests that the Commission consider revision of the following aspects of the Proposed Amendments, which revisions are described in greater detail in the indicated sections of this letter:

- the immediate deduction from gross offering proceeds in the definition of "Net Investment" of an amount of issuer organizational and offerings costs based solely upon estimates in the Prospectus rather than the amortization of actual amounts as incurred. (See Section 1.)

- the attempt to improve the transparency of cash distribution sources using a "one size fits all" methodology that does not conform to recognized standards of valuation to adjust account statement values rather than using enhanced disclosure. (As explained herein, the IPA strongly supports enhanced disclosure of the sources of cash distributions during the offering period prior to the issuance of per share estimated values consistent with the disclosure requirements currently applied to investment companies under Section 270.19(a)-1 of the Investment Company Act of 1940.) (See Section 2.)

- FINRA's proposal to eliminate the requirement to disclose unlisted DPP and REIT valuations on account statements even in situations where such valuations meet FINRA's requirement that the value be developed in a manner reasonably designed to ensure that it is reliable and the member has no reason to believe it is unreliable (i.e. where the methodology is one of the two methodologies "presumed reliable" by FINRA – "Net Investment" and "independent valuation"). (See Sections 3 and 4.)

- an implementation period of as few as six months between the approval and issuance of the final amendments and their effective date. (As written, the proposal leaves open the possibility of a six-month implementation period.) The IPA respectfully submits that an implementation period of 18 months is essential to avoid adverse consequences not only for industry participants and the industries which rely upon unlisted DPPs and REITs for capital, but more importantly for investors. A longer implementation period is necessary to mitigate negative consequences for investors in programs currently conducting offerings and to allow for a significant redesign of product structures going forward, including attempting to develop structures (or obtain necessary private letter rulings from the IRS to accommodate such structures) to preserve the ability of investors to purchase interests at a discount via distribution reinvestment plans and to preserve the limited liquidity provided by share redemption plans. In addition, member firms will be challenged during too brief an implementation period to make the necessary adaptations to internal procedures, investor communications, compliance protocols, programming of customer account statements, and, importantly, training of financial advisors to provide timely and accurate information to their clients regarding the new rules, account statement reporting, and the advisability of new product structures and alternatives. (See Section 8 for details of these implementation issues.)

In addition, the IPA respectfully submits that a number of issues and specific provisions of the Proposed Amendments require clarification prior to the approval of final rules. These issues and provisions are addressed in our more detailed comments which follow the Background section and are organized herein as follows:

Section 1: Reporting of Share Values Based on Net Investment
Section 2: Addressing Potential "Over-Distributions" During the Offering Period Prior
To Disclosure of Per Share Estimated Value
Section 3: The "Not Priced Option"
Section 4: Reliability of Account Statement Values
Section 5: Timing of Initiation of Valuations
Section 6: Additional Disclosure Requirements
Section 7: Frequency of Per Share Estimated Valuations
Section 8: Implementation Period
Section 9: No Disclosure of Supporting Analysis Regarding Economic Impact
Section 10: Business Development Company DPPs

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Section 11: Daily NAV REITs
Section 12: Additional Requested Clarifications to Text of Proposed Amendments

BACKGROUND

- Role of Unlisted DPPs and REITs in the U.S. Economy **--** Unlisted DPPs and REITs have historically played an important role in providing equity capital for growth to a broad cross section of American industries. While the types of assets and businesses financed at any time by unlisted DPPs and REITs ebb and flow with market conditions and perceived investment opportunities, the historical range of business activities which have obtained capital from unlisted DPPs and REITs is extraordinarily large and includes all types of real estate properties (e.g. multi-family residential, office, R&D, industrial/warehouse, retail, hospitality, hospitals, medical office buildings, senior living facilities, nursing homes, medical research and pharmaceutical facilities, self-storage, and other specialty property types), oil and gas drilling, income, and royalty investments, equipment leasing, agri-business, R&D, biotechnology, and many others.

Publicly registered unlisted DPP and REIT investments are similar to start-up businesses in that they are typically formed to raise and invest capital in a diversified portfolio of assets and/or business ventures. By way of example, this year the capital raised by these products will promote the recovery of the U.S. economy and contribute to business growth in the following sectors:

- Construction and Building Trades – By acquiring newly developed commercial properties, unlisted Equity REITs enable builders (and their lenders) to monetize their construction projects and recycle capital to initiate new development projects which in turn make purchases of materials and expand employment of labor. Unlisted Mortgage REITs also provide debt financing to the real estate industry.

- Consumer Retail Employment and Activity – Through their acquisition or financing of new retail properties, unlisted REITs contribute to the expansion of franchise and unique retail businesses, thereby creating employment opportunities and promoting consumer activity.

- Data Services, Internet & Communications – The expansion of communications and data processing infrastructure is being facilitated by equipment leasing DPPs and unlisted REITs that acquire uniquely configured data storage and processing properties and equipment, thereby liberating capital in this industry for other growth and research opportunities.

- Energy Independence – Oil and gas drilling DPPs provide equity capital to finance new exploration and development of energy sources.

- Healthcare – Through their acquisition of hospitals, medical office and research facilities, skilled nursing and assisted living projects, and retirement communities, unlisted REITs are helping address the growing demand for such facilities as the baby boomer generation reaches the years of high medical care consumption.

- <u>Emerging and Middle Market Businesses</u> – In an environment where the flow of investment and debt capital to emerging and middle market businesses is constrained, unlisted Business Development Company DPPs are providing capital and expertise to assist small and middle market businesses to succeed and grow.

- <u>General Corporate Investment & Growth</u> – Corporations preserve or obtain new capital for growth through "sale/leaseback" transactions of corporate real estate with unlisted REITs and the leasing of equipment essential to their businesses (e.g. aircraft, telecommunications, shipping and rail equipment, manufacturing and heavy equipment, and office equipment) purchased and owned by DPPs.

- <u>Other Emerging Areas</u> – New areas which are likely to become the focus of increasing capital deployment by unlisted DPPs and REITs include alternative energy, infrastructure, and impact lending.

The sector of the unlisted DPP and REIT industry which has been most active in recent years is real estate (unlisted REITs). These investment products have raised and deployed over $105 billion of equity capital since 2000. Public unlisted REITs have become a major factor in the securitization of real estate and are the primary incubator of new, publicly traded REITs, having raised over three times as much equity capital as traded REIT IPOs during the same period, according to data published by NAREIT and Robert A. Stanger & Company.

The IPA respectfully observes that given the contributions of unlisted DPPs and REITs to the nation's economic activity, any proposed rule changes and, in particular, the method and timing of implementation of any proposed rule changes, which have the potential to adversely impact or interrupt capital formation through these investment vehicles, should be subjected to a sufficient comment period and a complete evaluation of their intended and unintended consequences. The IPA notes that a thorough study of the economic impact of the rule change, and in particular the economic impacts of the method and timing of its implementation, is imperative.

In this regard, the IPA believes that the perceived pendency of the changes proposed by FINRA has had a chilling effect on unlisted DPP and REIT new offerings. For example, as of January 1, 2014 there were approximately $65.6 billion of unlisted REIT securities in registration. Of this amount, only $3.4 billion was placed into registration in the fourth quarter of 2013, approximately 38% below the "replacement rate" of new offerings required to preserve the amount of potential equity fundraising of the unlisted REIT industry. The IPA believes the uncertainty regarding the precise requirements of a revised rule accounts for much of this chilling effect. This apparent reduction in the pace of new investment product introductions suggests scrutiny of the economic impact of implementation is advisable.

- Recent Regulatory and Product Trends – No analysis of the Proposed Amendments can be complete without an appreciation of the chain of events that brought the Customer Account Statement Rule to this point and the intervening changes in standards and practices in the unlisted DPP and REIT industry which have occurred in response to market and regulatory forces. On February 4, 2009 FINRA published *Regulatory Notice 09-09: Customer Account Statements*. Among other things, this notice affirmed that during the offering period of an unlisted DPP or REIT it may be reasonable to determine that the estimated value of an issued share is the value at which other shares are being offered to the public (typically $10 per share). The notice went on to observe that 18 months after the conclusion of an offering, a value based on the offering price would be deemed "aged data" and should not be the basis for the valuation provided on a customer's account statement. This policy of valuation disclosure on customer account statements for unlisted DPP and REIT products has been in place for well over a decade, and reflects the historical understanding that unlisted DPPs and REITs are formation stage enterprises similar to any start-up venture. As such, they experience extraordinary start-up expenses and initial levels of earnings which are not indicative of stabilized earnings or intrinsic value of the business which is manifested once the capital has been deployed and a fully assembled portfolio of assets and mature operating phase has been reached. The challenge of accurately reflecting the intrinsic value of a formation stage enterprise during an extended offering period motivated the IPA in 2010 to begin an intensive internal process focused on valuation best practices.

On September 29, 2011 FINRA published *Regulatory Notice 11-44 - Customer Account Statements* ("NTM 11-44"). NTM 11-44 proposed to require FINRA's member firms to, among other things: (1) show on account statements during the offering period a per share "Net Offering Price" derived by deducting from gross offering proceeds all organization and offering expenses (including commissions, dealer manager fees and issuer offering and organizational costs) – a value deemed to approximate more closely the intrinsic value of the security; (2) limit the time period during which this Net Offering Price could be shown on customer account statements to the initial offering period (up to three years under Rule 415(a)(6) of the Securities Act of 1933 plus any additional carryover period); and (3) remove or amend a per share estimated value from any source if the member firm "*knows or has reason to know that the value is unreliable,*"[3] based upon public or non-public information that has come to the member firm's attention.

On March 7, 2012 FINRA published *Regulatory Notice 12-14 – Customer Account Statements* ("RN 12-14") as an amendment to its proposal under NTM 11-44. Several critical changes and new concepts were introduced:

(1) With respect to the NTM 11-44 proposal to deduct all organization and offering expenses from the estimated value per share of an unlisted DPP or REIT, FINRA acknowledged "*practical limitations of calculating a net offering price*."[4] Accordingly, FINRA proposed to redefine "net offering price" for purposes of the rule as the gross offering price less any front-end underwriting compensation expenses (as defined in FINRA Rule

[3] FINRA Regulatory Notice 11-44 - Customer Account Statements, page 4.
[4] FINRA Regulatory Notice 12-14 - Customer Account Statements, page 3.

2310(b)(4)(c)(ii)) reimbursed or paid for with offering proceeds. In determining this modified net offering price for account statement reporting, firms would not be required to subtract from gross offering proceeds issuer expenses, due diligence expenses, or trail fees. This revision: (i) eliminated the original proposal's incentive to reduce expenditures on due diligence; (ii) created equitable treatment with other securities in that the deductions would reflect "point of sale" costs only; and (iii) mitigated other complications in implementation related to issuer dividend reinvestment and redemption plans, as highlighted in the IPA's comment letter dated April 11, 2012. FINRA stated in RN 12-14 that "*simplifying the methodology to arrive at a net offering price should ease the burdens on firms electing to use that figure. Moreover, since the net offering price would reflect only the amount of front-end underwriting compensation expenses (used typically to pay the wholesaler and dealers), that value will be easily identified by firms participating in the offering and the estimated value would not have any undesired implications on the operation and pricing of an issuer's dividend reinvestment or share repurchase plans.*"[5]

(2) FINRA proposed elimination of the requirement that a FINRA member firm disclose on the account statement a per share estimated value for an unlisted DPP or REIT that appears in an issuer's annual report.

(3) With respect to the limit on the time period during which a "net offering price" may be used in customer account statements, FINRA extended its prior proposal to include the initial offering period of an offering plus an additional period up to the second quarterly public filing by an issuer following the initial offering period. FINRA noted that *"an appraised value during most of the initial offering period would not be as useful to investors because most of the assets in the program will typically consist of cash and short-term, liquid securities.*"[6] This two-quarter filing grace period was designed to ensure that issuers would have sufficient time to conduct an appraisal and include an appraised value after the initial offering period. Moreover, because a quarterly public filing deadline might occur immediately after the initial offering period, the proposal would allow firms to present the net offering price until the issuer has filed a second period report, unless the issuer includes an appraised value in its periodic or current reports before that time.

(4) During the initial offering period in which the issuer has not provided an appraised value, FINRA permitted a member firm to list the securities on a customer account statement as "not priced."

(5) Finally, FINRA withdrew its proposed requirement that a member firm remove or amend a per share estimated value from any source if the member firm "*knows or has reason to know that the value is unreliable*," based upon public or non-public information that has come to such member firm's attention.

[5] FINRA Regulatory Notice 12-14 – Customer Account Statements, page 5.
[6] FINRA Regulatory Notice 12-14 – Customer Account Statements, page 4.

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On April 25, 2013, after exhaustive review by the industry, the IPA Board of Directors unanimously adopted its own comprehensive set of REIT Valuation Guidelines.[7] These guidelines represented an industry-produced response to the same concerns raised by FINRA originally in NTM 11-44, and were developed by a committee of IPA Members representing asset management organizations that accounted for in excess of 95% of all investment funds raised by unlisted REITs since the year 2000. Moreover, the development of this industry practice guideline reflected the collective effort of due diligence service providers serving over two hundred broker-dealer organizations involved in the sale and monitoring of unlisted REIT investments, members of the IPA's Legal and Regulatory Committee that includes many of the most active, nationally recognized legal practitioners in the securities industry, and broker-dealer organizations engaged in the sale and monitoring of unlisted REIT investment securities that account for over 90% of all funds raised for unlisted REIT investments. The guideline provided significant benefits for investors and financial advisors, including a standardized valuation process and metric consistent with real estate industry practices, an acceleration of the date of initial valuation, the involvement of independent third-party experts, and elaboration of recommended disclosure relating to the valuation.

Despite this private sector progress toward more frequent, consistent and reliable valuations and their improved disclosure, on January 31, 2014, FINRA published *SR-FINRA-2014-006 - Proposed Rule Change Relating to Per Share Estimated Valuations for Unlisted DPP and REITS* ("SR-FINRA-2014-06"). As with RN 12-14, this notice posed new issues and again introduced significant changes and new concepts to FINRA Rule 2340 (Customer Account Statements) and FINRA Rule 2310 (Direct Participation Programs). These issues and changes are discussed at length below, with a particular emphasis on the many constructive features of the new FINRA proposal which the IPA believes are beneficial to the investing public and therefore supports. As a key stakeholder in the direct investment industry and as a guardian of industry best practices, the IPA appreciates the opportunity to continue to contribute to the FINRA rule development process.[8]

IPA'S DETAILED COMMENTS ON THE PROPOSED AMENDMENTS

1. <u>Reporting of Share Values Based on "Net Investment"</u>

The IPA supports the reporting of share values on customer account statements (prior to the filing of a per share estimated value in the issuer's periodic report two years after breaking of escrow and where no per share estimated value has been developed) based on "Net Investment" where Net Investment is defined as gross offering proceeds reduced by (i) commissions, and (ii) dealer manager fees (based on percentages, as shown in the Estimated Use of Proceeds section of the offering prospectus). This is an easily identifiable and simple approach to calculating a Net Investment amount for statement purposes, and conforms to the "point of sale" cost deduction

[7] IPA Practice Guideline 13-01: Valuations of Publicly Registered Non-Listed REITs, April 29, 2013.

[8] "Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking" September 2013 – Section III(a) FINRA Core Principles.

approach taken for other securities, thereby providing equitable treatment. The IPA also appreciated FINRA's choice of the term "Net Investment" in lieu of "Net Offering Price."

However, since issuer offering and organizational costs are indeterminate at the time of commencement of an offering, the IPA questions the advisability of deducting estimates of these costs from reported account statement values prior to the incorporation of the actual costs incurred in the per share estimated value contemplated by the Proposed Amendments two years after the breaking of escrow. The indeterminate nature of these costs is compounded by uncertainty as to the ultimate amount of capital raised in the offering. FINRA's proposed methodology (basing a percentage deduction on estimated issuer offering and organizational costs as a percentage of gross offering proceeds) does not address the uncertainty and variability of the ultimate level of fundraising and actual costs incurred. FINRA's proposal would almost certainly result in an erroneous deduction of offering and organizational costs relative to actual costs incurred and, depending on the level of fundraising assumed, could result in a deduction at a level significantly higher than actual costs incurred, thereby resulting in an understatement of value perpetuated during the offering period. Importantly, as FINRA has previously conceded, no pricing construct should be set up as an incentive to reduce expenditures on offering due diligence processes. Yet, a regimen that inherently penalizes account statement values for all issuer offering and organizational costs encourages reduced expenditures for due diligence. Finally, the IPA respectfully submits that there is no methodology that can be developed in a manner reasonably designed to ensure that it is reliable with respect to issuer offering and organizational costs prior to the actual expenditure of these costs.

The IPA recommends that FINRA return to the position it endorsed in RN 12-14 for all the reasons cited by FINRA therein, and that Net Investment be determined based only on the deduction of sales commissions and dealer manager fees, thereby conforming to the "point of sale" cost deduction approach taken for other securities and providing equitable treatment for unlisted DPPs and REITs.

The IPA notes an important unintended consequence of use of Net Investment in that it may have significant negative consequences for investors' ability to obtain shares at discounted prices through distribution reinvestment plans ("DRPs") or potentially obtain limited liquidity through share redemption plans ("SRPs"), as explained in Section 8 herein. Although this problem exists even without a deduction for offering and organizational costs, such deduction increases the difficulty of finding a solution to the potential loss of such investor opportunities. The ramifications of this problem for the structuring of new offerings will present a significant challenge to the industry and argues for a sufficient implementation period.

The IPA also respectfully recommends that the following clarifications be provided with respect to the Net Investment amount:

- for the purpose of clarity, explicitly cite in the definition of "Net Investment" at Section (c)(1)(A)(i) of Rule 2340 the elements which are to be deducted from gross offering proceeds (i.e. sales commissions and dealer manager fees);

- clarify whether or not Rule 2310 includes (as a precondition for a member firm to participate in an unlisted DPP or REIT offering) a requirement that the issuer disclose in its periodic reports the Net Investment amount unless the issuer is also reporting an estimated per share valuation.

2. <u>Addressing Potential "Over-Distributions" During the Offering Period Prior To Disclosure of Per Share Estimated Value</u>

FINRA has proposed that account statement values be further adjusted prior to the issuance of an per share estimated value by an amount deemed to constitute cumulative cash distributions in excess of cumulative GAAP net income before deduction of depreciation and amortization or depletion expenses. The IPA believes an approach that addresses this issue through adjustments to account statement values is inadvisable due to:

- the unprecedented nature of such a regulatory approach compared with all other public securities offerings;
- the nature of unlisted DPPs and REITs and the operational anomalies associated therewith;
- the severe implementation challenges for FINRA and the SEC to incorporate in a single rule accounting standards and practices unique to a variety of asset classes and industries in which unlisted DPPs and REITs conduct operations and to define appropriate "earnings" metrics, potentially leading to a multitude of inquiries and interpretive releases;
- potential confusion created among investors by valuation changes dictated by a single accounting metric while ignoring other factors which impact value; and
- the fact that the issue of over-distributions has already been substantially addressed by the industry via:
    - enhanced member firm due diligence relating to distribution sources, coverage and sustainability;
    - improved disclosure required by the SEC in periodic filings relating to sources of distributions;
    - the current requirement of several states and expanding to others, that SEC disclosure be supplemented by separate written communications to investors detailing the sources of distributions when such distributions are not provided entirely by earnings/cash flows;
    - the emergence of new product structures which subordinate operational phase fees and/or reimbursements to the achievement of full earnings coverage of distributions, or which provide for sponsor supplementation of general and administrative expenses incurred above certain levels – changes which have been motivated by free market forces;
    - the acceleration of initial valuations, as contemplated in the Proposed Amendments, which will capture the cumulative impact of any over-distribution on share values; and

- the promulgation in 2013 of the IPA Valuation Guideline and the expanding requirement in broker-dealer selling agreements that valuations be performed approximately two years after breaking of escrow.

The IPA notes that the adjustment recommended by FINRA accommodates only reductions of the Net Investment amount and does not provide for situations where the cumulative earnings metric exceeds cumulative distributions (i.e. "earnings", as defined, are retained, thereby increasing shareholder value). The IPA believes that if FINRA intends to preserve an adjustment mechanism, it is appropriate to have it address both over and under distribution.

More importantly, the IPA respectfully submits that the adjustment mechanism proposed by FINRA to determine the amount that constitutes "over-distribution," while well intended, is ill-advised for the following reasons:

- The mechanism (deducting distributions in excess of GAAP net income plus depreciation and amortization and depletion) appears to address only one of a number of accounting anomalies that must be addressed to achieve an accurate determination in the many industries funded by unlisted DPPs and REITs.

- As proposed to be applied to unlisted REITs, the proposed methodology does not conform with recognized real property or real estate securities valuation standards and practices utilized by securities analysts, institutional real estate investors, real estate appraisal texts, or such professional organizations as the National Council of Real Estate Investment Fiduciaries, the Pension Real Estate Association, the Chartered Financial Analyst (CFA) Institute, the Real Estate Information Standards Council or International Valuation Standards.

- FINRA has not demonstrated the reliability of the specific adjustment mechanism proposed when applied to the operational results of numerous other industries in which DPPs now or may potentially invest, including oil and gas drilling, equipment leasing, and tax credit-oriented investment vehicles, to name only a few. For example, does it make sense to add back depreciation to equipment leasing DPPs where the assets, unlike real estate, are virtually certain to be depreciating and depreciation therefore reflects a loss of asset value?

- The methodology is potentially flawed and creates unintended biases and inconsistencies among issuers (and thereby among FINRA member firms that are responsible for the amounts shown on customer account statements) due to the nature and variety of accounting variables that are incorporated into GAAP net income with and among the various industries financed by unlisted DPPs and REITs, including among others:

    - straight line rent adjustments;
    - amortization of lease intangibles;
    - transient "mark-to-market" adjustments;
    - capitalization versus expensing of interest during construction periods;

- treatment of minority interests in joint ventures;
- the implicit assumption that acquisition-related costs which are expensed in GAAP accounting do not create enterprise value (e.g. that the implicit value of an unlisted REIT declines as acquisitions are made to aggregate a diversified portfolio of properties);
- financing/capital lease versus operating lease categorization;
- use of alternative depreciation methods or lives;
- accounting for investor tax credits; and
- alternative methods of accounting for depletion.

In addition, FINRA's proposal to address the visibility of "over-distributions" via adjustments to account statement values has numerous potential unintended consequences which work to the detriment of the best interests of investors, in that it may potentially:

- be so cumbersome and accounting explanations so extensive that investors have a lesser rather than greater understanding of the sources of their distributions;

- increase the volatility of account statement values without commensurate changes in the true underlying value of the enterprise;

- create potential confusion given the non-contemporaneous relationship between the issuance of customer account statements for a particular quarter and the filing of an issuer's report for the same quarter;

- magnify the "time penalty" for non-immediate deployment of capital to asset purchases, thereby increasing the risk of expedited asset purchase negotiations, increased acquisition price concessions and accelerated acquisition due diligence;

- have the unintended consequence of adversely affecting the potential capital and liquidity structure of unlisted DPPs and REITs -- structures which have proven over the years to be beneficial to investors and enhance their investment returns. The IPA believes that the a regulatory effort to enhance transparency should pursue paths which <u>do</u> <u>not</u>: (i) penalize the use of lines of credit in anticipation of equity raises to accelerate portfolio aggregation and therefore earnings; (ii) artificially suggest a declining investment value when such decline is not accurate; (iii) create obstacles to the effective use of distribution re-investment programs that, in addition to the loss of an enhanced investment opportunity, may lead to less portfolio diversification, lower price (and quality) asset acquisitions, higher leverage levels, fewer liquidity alternatives (e.g. listing on a national securities exchange) due to lower potential market capitalization; and (iv) impair the availability of funding for share redemption programs which provide limited liquidity to investors with a financial need to exit the investment and which is a vital investor benefit.

Given these considerations and the associated need for extensive regulatory interpretations and guidance which will delay or complicate full adoption of the intended improvements, the IPA recommends an approach that avoids the numerous difficulties associated with attempting to adjust account statement valuations for over-distributions – a recommended approach that will enhance investor understanding of the composition of distributions received, is entirely consistent with existing regulations of the SEC and, importantly, will provide a level regulatory playing field across various securities types.

The IPA recommends a significantly enhanced disclosure regimen that parallels the principals which exist in current regulations regarding "over-distributions" by companies subject to the Investment Company Act of 1940 ("1940 Act Companies"). Section 270.19a-1 of the Investment Company Act requires (simplifying the concept) that the payment of any dividend from a source other than current or preceding fiscal year net income or accumulated undistributed net income, or both (not including in either case profits or losses from the sale of securities or other properties) is prohibited unless such payment is accompanied by a written statement (a "Section 19(a) Notice") that discloses the source(s) of the distribution. The SEC has stated that "*the purpose of this Section….is to afford security holders adequate disclosure of the sources from which dividend payments are made*."[9] The parallel between this requirement for 1940 Act Companies and the stated objectives of FINRA with respect to unlisted DPPs and REITs is striking and suggests that this alternative is the appropriate and proven path for addressing the issue of "over-distribution" and is a path that provides more clear and complete information to investors regarding the sources of distribution received and a level regulatory playing field for unlisted DPPs and REITs and 1940 Act Companies.

Therefore, the IPA strongly urges that in lieu of account statement adjustments Rule 2310 be amended to require that to participate in the offering of unlisted DPP or REIT securities, the general partner, sponsor or issuer must agree to provide during the offering period prior to the initial determination of a per share estimated value, a notice to investors that quantifies the source(s) of distributions when such distributions come from a source other than "earnings." The IPA further submits that the definition of appropriate alternative performance metrics for the purpose of determining "over-distributions" is essential for accurate adjustments rather than arbitrary "one size fits all" adjustments. To that end the IPA recommends that the quantification of such sources be based upon any ordinary cash distributions in excess of a performance metric allowed by the SEC in periodic filings (including GAAP Cash Flow from Operating Activities, NAREIT FFO, or any other such metric allowed by the SEC), as deemed appropriate by the issuer based on the facts and circumstances of the business and accompanied by an explanation by the issuer for the choice of such metric.

3. <u>The "Not Priced Option"</u>

Under the Proposed Amendments, a FINRA member firm would not be required to include in a customer account statement a per share estimated value for an unlisted DPP or REIT security, but any member (not only a general securities member) may choose to do so if the value has been developed in a manner reasonably designed to ensure that it is reliable and the member has no reason to believe that it is unreliable. This portion of the proposal also re-introduces the general

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[9] Part 270 – Rules and Regulations, Investment Company Act of 1940, Section 270.19a-1-(g).

requirement on members to review per share estimated value reliability set forth in NTM 11-44 (and withdrawn in RN 12-14).

FINRA's statement that such "*optionality is necessary to ensure that the valuation is reliable*"[10] appears to contradict its presentation of two acceptable valuation methodologies for account statement reporting that it deems presumptively reliable. Since FINRA posits that Net Investment or a valuation "*calculated by or with material assistance of a third-party valuation expert*" has been "*developed in a manner designed to ensure that it is reliable*," then why would FINRA not continue to require the disclosure of such value to investors on account statements and thereby obtain the benefits of such disclosure as explicitly cited by FINRA -- that providing a reliable valuation provides "*a level of transparency concerning the value of those securities and the effect of brokerage commissions and other expenses.*"[11]

FINRA states that "*if we require presentation of a valuation, then in some circumstances a member might have to weigh two conflicting obligations, to present a valuation or to exclude one that, in the member's judgment might be unreliable*."

FINRA goes on to state: "*If presentation of a valuation were optional, then the rule would not deter the member from following up on red flags and excluding a valuation that it has reason to believe is unreliable. A requirement to present a valuation would place the member in a conundrum: Should it exclude a suspicious valuation based upon the limited facts at its disposal, or must it present the valuation because the rule requires it? A requirement that might discourage members from being vigilant would not be consistent with the objective of investor protection.*" [12]

Notwithstanding whether or not such a determination is an appropriate requirement on behalf of investors, this position by FINRA appears to ignore the ability of the member under the existing rules to refrain from presenting a valuation deemed inaccurate or based on data more than 18 months old[13] - a provision that could easily be retained in any amended Rule.

The IPA further notes that FINRA acknowledges that "*customers react very negatively to seeing their positions shown without a value*."[14] FINRA indicates that it intends to monitor changes to business practices and if it observes a "significant shift" in instances where a valuation is not presented it will reconsider the optional nature of the proposal. The IPA respectfully submits that delaying the requirement for presentation of a reliable valuation when no such delay is necessary

[10] SR-FINRA-2014-006 - Proposed Rule Change Relating to Per Share Estimated Valuations for Unlisted DPP and REITS – page 13.
[11] SR-FINRA-2014-006 - Proposed Rule Change Relating to Per Share Estimated Valuations for Unlisted DPP and REITS – page 12.
[12] SR-FINRA-2014-006 - Proposed Rule Change Relating to Per Share Estimated Valuations for Unlisted DPP and REITS – page 13.
[13] Rule 2340, Sections (c)(B)(2) and (4).
[14] SR-FINRA-2014-006 - Proposed Rule Change Relating to Per Share Estimated Valuations for Unlisted DPP and REITS – page 14.

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deprives investors of valuable information during this period of review, and conditions the required provision of reliable valuation estimates on the occurrence of a “significant shift”.

The IPA respectfully submits that retaining an option to not price these securities, while intended to improve reporting, could be interpreted by other regulatory authorities, legislators, the media and the investing public as a retreat from the very transparency that FINRA, the SEC and other securities regulatory bodies seek to enhance. Allowing an unlisted DPP or REIT security to be shown as “not priced” on customer account statements or placing the security “below the line” when a presumptively reliable method has been used would deprive investors of useful information, would not make distribution costs more visible to investors and would not provide a more dynamic pricing protocol during the offering period (i.e. the security would remain un-priced).

Most importantly, the “not priced” option returns the industry to a situation, previously and appropriately rejected by regulators, where investors are kept in the dark indefinitely concerning the value of their investment. For example, an investor purchasing $30,000 of an issuer’s securities in January 2007 and holding them through the typical life cycle of a non-listed DPP or REIT (six or seven years) would have received no indication of value changes or performance of the investment during the dramatic market changes of the period.

The IPA has identified a number of other significant issues relating to the implementation of the “not-priced” or “below the line” options, including the following:

- Both options would result in an immediate “write-down” (or more accurately, elimination) from customer net worth of the amount invested in all currently offered and closed investment programs that have not yet commenced producing estimated per share valuations. The estimated aggregate magnitude of this customer net worth write-down on account statements exceeds $3 billion, potentially triggering a precipitous number of customer questions and complaints to FINRA and FINRA-member broker-dealers, and potentially triggering frivolous legal action against issuers, sponsors, and broker-dealers.

- From the perspective of individual investors, purchasing a DPP or non-listed REIT security would result in an immediate reduction in account statement net worth by the entire amount invested, raising confusion and concern and creating a reluctance to make future investments. (Correspondingly, upon valuation of the security, account statement net worth would suddenly rise, potentially creating a misleading impression of the performance of the investment account.)

- The resulting invisibility of actual net worth impairs the ability of the investor and his advisors to conduct prudent financial and tax planning as well as asset allocation decisions. Such invisibility can also impact the investor’s credit profile, qualification for mortgages, financing, and brokerage fee discounts relating to the amount of investor net worth under management.

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- The resulting potentially biased perception of these investments would result in a significant decrease in capital formation unrelated to the merit and efficacy of the individual investment programs. Given the Congressional desire to facilitate capital formation for American businesses, as evidenced in the provisions of the JOBS Act of 2012 and the SEC's mandate to implement such capital formation provisions, the IPA prefers a solution which would not negatively impact capital formation. (See "Background – Role of Unlisted DPPs and REITs in the U.S. Economy" above.)

- An estimated 40% of the capital invested in unlisted DPPs and REITs comes from ERISA accounts. The "not priced" and "below the line" options would complicate broker-dealer and custodian compliance with the requirement to provide pricing for such accounts and could compromise accurate RMD calculations and Form 5498 reporting.

The IPA recommends that a "not priced" alternative only be provided where, despite the issuer commitments required by Rule 2310, the issuer does not provide a per share estimated value or does not provide such value in a timely manner, or where the member firm can demonstrate that the estimated value is no longer accurate as a result of disclosure in the issuer's periodic reports of a material change in the value of the underlying assets of the program or trust.

4. Reliability of Account Statement Values

The Proposed Amendment allows the member firm to report a per share estimated value on customer account statements if such value has been determined in accordance with the proposed amended requirements of Rule 2340 and 2310, and the member has "*no reason to believe that the per share estimated value is unreliable*."[15] The IPA believes that this new "no reason to believe" standard is ambiguous and does not clearly define the responsibilities of the member firm. The IPA also believes that the Proposed Amendment potentially places member firms in an untenable position of jeopardy from ex post facto claims that "they should have known" a value was unreliable. The IPA believes that the processes dictated by the Proposed Amendments to Rule 2340 and 2310 which are designed to ensure the reliability of the valuation at the time of issuance and which according to the Proposed Amendments result in a presumptively reliable valuation make unnecessary the imposition on member firms of a burden of proof of reliability. A similar view was expressed by FINRA in its commentary on Reliability of Estimated Values in RN 12-14 when it stated: *"Under the revised proposal, we anticipate that per share estimated values will be almost exclusively derived from values based on appraisals obtained by issuers and included either in the issuer's periodic or current reports or a daily NAV calculation. As such, firms typically will have no reason to question their reliability, and the proposed requirement should not be necessary."*[16]

The IPA respectfully submits that, in addition to the removal of a "not priced option" as described in Section 3, Rule 2340 indicate that: (i) Net Investment is a presumptively reliable amount for

[15] Proposed Amendment to Rule 2340, Section (c).
[16] FINRA Regulatory Notice 12-14, March 2012, page 6.

member firms to disclose on customer account statements prior to the disclosure by the issuer in a periodic filing of a per share estimated value as required as a condition of participation in Rule 2310; and (ii) that a per share estimated value be included on customer account statements if it has been developed in accordance with the requirements in Rule 2310 (b)(5)(B) or such other manner reasonably designed to insure that it is reliable, unless the member can demonstrate that the estimated value is no longer accurate as a result of disclosure in the issuer's periodic reports of a material change in the value of the underlying assets of the program or trust.

5. Timing of Initiation of Valuations

The IPA supports FINRA's proposed requirement that member firms may only participate in an offering if the general partner, sponsor, or issuer agrees to disclose an estimated per share value in its periodic report filed with the SEC after the second anniversary of the breaking of escrow and in each annual report thereafter. However, the IPA notes that the timing of initial disclosure of a per share estimated value as proposed by FINRA in RN 12-14 was the *"second quarterly filing after the initial offering period*" as opposed to the first filing in the currently Proposed Amendments.

In finalizing the timing provisions of the Proposed Amendment the IPA recommends that FINRA adopt the timing provision in the IPA REIT Valuation Guideline which calls for disclosure no more than 150 days after the second anniversary of escrow break. This period is designed to address the difficulties that can arise when the second anniversary of breaking of escrow occurs in close proximity to the deadline for filing the periodic report and to recognize the calendar non-uniformity of SEC periodic filing deadlines.

6. Additional Disclosure Requirements

The IPA supports FINRA's proposal regarding required additional disclosure in customer account statements relating to the nature and illiquidity of unlisted DPP and REIT securities, including the retention of existing disclosure requirements of Rule 2340 that: (1) briefly describe the per share estimated value, its source and explain the method by which such per share estimated value was developed; and (2) disclose that the unlisted DPP or REIT securities are not listed on a national securities exchange, are generally illiquid and that, even if a customer is able to sell the securities, the price received may be less than the per share estimated value provided in the statement. The IPA also supports the proposed amendments to Rule 2310 which require as a condition of participation in the unlisted DPP or REIT offering the agreement of the issuer to disclosure in the periodic report containing the valuation: (a) the per share estimated value; (b) an explanation of the method by which the estimated value was developed; (c) the date of the valuation; and (d) the identity of the service (presumably the third-party valuation expert) providing material assistance or used to obtain the valuation. Given the potential difficulty (depending upon the procedures used to conduct the valuation) to "briefly describe" the method on a customer account statement, the IPA recommends that FINRA acknowledge that a cross reference on the account statement referring the user to the description of the methodology set forth in the prospectus or periodic report is allowed.

7. Frequency of Per Share Estimated Valuations

FINRA's proposed amendments to Rule 2310 require that participation of a member in the unlisted DPP or REIT offering be conditioned on the agreement of the general partner, sponsor or issuer to ensure that the valuation is: (a) conducted at least once every two years; (b) derived from a methodology that conforms to standard industry practice; and (c) accompanied by a written opinion to the general partner or sponsor of the program or REIT that explains the scope of the review, the methodology used to develop the valuation, and the basis for the per share estimated value.

The IPA supports the foregoing proposed provisions of Rule 2310, which are generally consistent with the IPA REIT Valuation Guideline. However, the IPA recommends FINRA require that once estimated valuations commence they be performed and disclosed by issuers no less frequently than annually. The IPA believes that annual valuations provide vital information to investors regarding the ongoing performance of the investment and the estimated value in the event of a sale or redemption of the security, and are helpful to ERISA trustees in complying with IRS requirements relating to ERISA account reporting. Further, the IPA also recommends FINRA indicate in the final rule or any subsequent guidance that a valuation methodology which is consistent with the provisions of the IPA REIT Valuation Guideline would be considered presumptively conforming to industry standard practice for unlisted Real Estate DPPs and REITs.

8. Implementation

FINRA has suggested that in order to give industry participants time to make changes to distribution agreements in response to the Proposed Amendments, the effective date of the proposed rule change be no earlier than 180 days following SEC approval. The IPA believes an 18-month period between issuance of the final rule amendments and their effective date is imperative to avoid significant market disruption, adverse consequences for investors and industry participants, and a potential significant reduction of capital provided by these investments to U.S. industries as the economy struggles to recover. After careful consideration, the IPA and most industry observers have concluded that immediately following the approval of the proposed amendments, the current product design and offering structure of unlisted DPPs and REITs will need to undergo significant changes to continue to raise the capital needed for successful formation and operation of these enterprises.

To determine the most advisable implementation period it is necessary to understand the typical timeline of new unlisted DPP and REIT product introductions. Unlike traded securities, these public investments must undergo not only the new offering regulatory regimens of the SEC and FINRA, but also reviews in each state where the securities will be offered (typically all 50 states) – a process that can take up to nine months or more. Further, since these offerings are not underwritten, once declared effective, the dealer manager must commence the formation of a best efforts selling group, and participating broker-dealers must conduct due diligence and then negotiate a selling agreement. This process is typically incremental, meaning that participating broker-dealers are gradually added to the selling group as the offering progresses. Once sales commence, formal investor admissions and the payment of distributions to investors cannot commence until sufficient funds have been raised to break escrow. The result is that the substantial majority of capital is typically raised after the eighteenth month following the initial filing of the registration statement for the offering.

Issuers will likely need to change their plans of distribution to address the new regulations. Implementing such changes requires filing the changes with regulators and, in many cases, clearing the changes with the SEC, FINRA and the states. In addition, the issuer (and therefore the existing investors of the issuer) would incur a significant additional expense of commencing an offering and then having to terminate it and commence a new offering to change the plan of distribution. Accordingly, it is appropriate and reasonable that the implementation period be long enough to allow for existing offerings to close or for distribution plan changes to be made, thereby avoiding costs, delays or a premature cessation of fundraising (and consequent lower capitalization of the enterprise), all of which would operate to the detriment of investors. The IPA also respectfully submits that in calculating the cost of the new rules, FINRA and the SEC should include the potential economic harm to these programs which will ensue if the implementation period is too short.

The IPA understands that FINRA and the SEC may have concerns regarding any potential adverse consequences (including attempts to "front-run" the amendments) of unwarranted delays in the effectiveness of the amended rules. However, in light of the typically long time lag between initial filing of a registration statement and the point at which the offering has raised meaningful amounts of capital in the marketplace as described above, a short implementation period is unnecessary. It is highly improbable that a material number of filings will occur once issuance of the final rule amendments has taken place irrespective of the implementation period. Even with an 18-month implementation period, any filings made in an attempt to front-run the amendments would need to be significantly restructured just as they were beginning to raise material amounts of capital. Upon approval of final amendments to the rules (and not until the details of the final amendments have been promulgated), the direct investment industry will need sufficient time to undertake numerous preparations, including but not limited to:

- the evaluation of alternative distribution networks and revision of plans of distribution;
- the evaluation of alternative offering structures and redesign of products (e.g. new fee structures, introduction and provision of alternative share/unit classes, consideration of expanding fee or reimbursement subordinations and analysis of alternative hurdles, capital provision or co-investments by the sponsor organization, methods of accelerating property acquisitions or portfolio seeding, consideration of the magnitude and timing of advisor compensation, etc.);
- the preparation of new offering and marketing materials;
- obtaining a private letter ruling from the IRS to address the use and structure of multiple classes of stock;
- sponsor training of marketing and sales personnel;
- sponsor identification of new compliance requirements and the associated tasks required;

- the potential adjustment of broker-dealer compensation arrangements with their financial advisors/reps;
- the identification and codification in procedure manuals of new compliance requirements for broker-dealers related to monitoring (and possible determination) of account statement valuations, particularly during the offering period;
- re-programming of customer account statements to conform to the disclosure requirements;
- re-programming of automated pricing systems and the creation of quality control procedures by account statement service providers and broker-dealers and clearing firms to enable timely analysis and recognition of securities whose valuations do not conform to the requirements of the amended rules (e.g. do not make the necessary disclosures or adjustments; do not provide estimated values in a timely fashion; do not follow the methodology and expert requirements, etc.); and, importantly,
- financial advisor education concerning new structures and the evaluation of alternatives for investors.

(The Appendix to this letter provides an illustrative listing of preliminary initial implementation tasks which was prepared and continues to be elaborated by a FINRA member firm active in the placement of unlisted DPPs and REITs.)

The IPA respectfully submits that given the scope and nature of the above tasks – not to mention the time required to execute the required regulatory filings and launch a best efforts offering – a six-month implementation period is grossly insufficient.

In addition, the Proposed Amendments could have significant negative consequences for current offering structures that offer shares through distribution reinvestment plans ("DRPs") and provide share redemption plans ("SRPs") that enable limited liquidity to investors who need to exit the investment prematurely. DRPs are priced at a "discount" to the gross offering price. The "Net Investment" approach may create a situation wherein either: (i) the price to be paid for the DRP share exceeds the statement price, thereby discouraging DRP investment; or (ii) the "discount" from gross offering price will be deemed by the IRS to exceed tax-free discount limits. For example, assume a share sold for $10 is carried at Net Investment amount of $9 on the account statement. If the DRP price is $9.50 per share, 5% below the issue price, then the customer would see on a quarterly account statement the security being priced at $9.00 and the simultaneous purchase of the same security at $9.50. If the DRP price is $9.00, the apparent discount for issue price is 10%, potentially triggering a tax liability for a discount in excess of 5% as permitted by IRS rules. In either case the result is not in the best interests of investors in that they would either suffer negative tax consequences or lose the limited liquidity provided by SRPs due to the fact that SRPs are funded by DRPs. The ramifications of this potential problem for the structuring of new offerings will present a significant challenge to the industry and will require sufficient time and thought to address.

Further, any implementation period needs to recognize the implications (as exemplified by the above discussion of DRPs and SRPs) for ongoing offerings which have been structured in good faith under the existing rules and in which various sponsor organizations and member firms have devoted considerable financial and organizational resources to launch. According to Robert A. Stanger & Co. approximately $68.9 billion of unlisted DPP and REIT offerings structured under the existing rules are currently in the market raising money and an additional $13.0 billion of similarly structured offerings are registered but have not yet been declared effective. Assuming a hypothetic effective date for the Proposed Amendments of January 1, 2015 and no new product registrations, an estimated $51 billion of unlisted DPP and REIT securities would still be in their offering period. If amendments to the rules are implemented in less than 18 months, then the IPA believes the ability of these offerings to achieve their fundraising objectives, build broadly diversified portfolios of high quality investments, and achieve their anticipated operational efficiency will be materially compromised -- results clearly detrimental to the best interests of investors who have previously acquired interests in these offerings. In addition, investors in these offerings will see a sudden and previously unanticipated and unexplained drop in their account statement net worth when the first Net Investment amount replaces the amount currently on their account statements. The IPA recognizes that the potential for such occurrences cannot be entirely eliminated. However, the IPA submits that an implementation period of 18 months will provide many of these offerings with additional time either to pursue their target capital raise and close the offerings prior to the effective date of implementation, or educate investors about the coming changes.

The implementation period also has implications beyond the direct investment industry and its participants. Too rapid an implementation schedule will result in the premature closing of existing offerings while "next generation" offerings (i.e. offerings designed and structured in light of the requirements of the amended rules) have not yet gone through the lengthy process of design, registration, regulatory reviews, broker-dealer due diligence, selling group formation, launch, and financial advisor education. As a result, the industry will experience a significant period of extremely low capital formation. Not only will this "donut hole" in capital formation adversely affect the income of member firms and their financial advisors, but it will also impact the industries that rely on the unlisted DPP and REIT industry for a reliable flow of capital.

Although the desire to implement expeditiously rule changes which are deemed beneficial is understandable, the IPA respectfully submits that the goals of the rule changes will be achieved despite a longer implementation period and that the proposed rule changes should be implemented in a thoughtful and deliberate way that will minimize market disruption for investors, issuers, and the industries that rely on unlisted DPPs and REITs as a reliable source of capital.

9. No Disclosure of Supporting Analysis Regarding Economic Impact

In SR-FINRA-2014-06, FINRA states that it "*does not believe that the proposal will cause a significant economic impact on members.*"[17] The absence of support demonstrated for FINRA's conclusion that the amendments will not have a significant economic impact on members is inconsistent with FINRA's public position that "*rule filings should provide insight into our evaluation of the economic impacts to help the public understand why FINRA reached its position*."[18] We also respectfully submit that FINRA has not met the burden of demonstrating that the Proposed Amendments only require a simple "limited statement of economic impact."[19]

We believe that if FINRA had conducted such an economic impact evaluation, it would have recognized the far reaching impacts and adjustments which are required to implement the changes in a manner which will cause minimal market disruption, allow for development of appropriate compliance, training and education, and prevent unintended adverse consequences for investors. The IPA submits that the remedies to address this deficiency are either to allow an 18 month implementation period or for FINRA to undertake a thorough economic impact assessment. Such an assessment should include an evaluation and, where appropriate, quantification of such considerations as: (i) the groups of industry participants and other parties who are impacted; (ii) the actions industry participants will be required to undertake to implement the proposed changes; (iii) the costs and benefits of the new compliance activities; (iv) how behaviors will change among all industry participants and the potential impact of those changes on investor risk and return; and (v) how different types of industry participants may be affected (e.g. sponsors versus broker-dealers, large versus small firms, etc.).

The IPA also notes that FINRA does not appear to have performed an analysis regarding the potential creation of barriers to entry into the unlisted DPP and REIT industry which might occur as a result of the redesign and restructuring of these products triggered by the methodologies proposed by FINRA to determine account statement valuations during the offering period. Such product changes hold significant implications for the amount of risk undertaken and capital necessary for new sponsors to enter the industry and successfully raise capital. Further, FINRA does not appear to have considered the potential of these amendments to create adverse economic impacts outside of the financial services industry to the extent capital availability to the industries funded by unlisted DPPs and REITs is materially diminished, whether on a short-term basis or long-term basis. The IPA notes a particular concern with adverse economic impacts resulting from an insufficient implementation period, as noted above.

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[17] SR-FINRA-2014-006 - Proposed Rule Change Relating to Per Share Estimated Valuations for Unlisted DPP and REITS – page 13.

[18] FINRA "Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking" (September 2013)

[19] Cite FINRA "Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking" (September 2013)

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As previously noted, the IPA believes that a thorough study of the economic impact of the rule change, and in particular the economic impacts of the method and timing of its implementation, is imperative.

10. <u>Business Development Company DPPs</u>

Business Development Companies (BDCs) are distinctive DPPs in that they are also a type of closed-end investment company that elects to be regulated under a specialized regime added to the Investment Company Act of 1940 (1940 Act) by the Small Business Investment Incentive Act of 1980. This framework is intended to promote the provision of capital to small and growing businesses that may otherwise have limited access to capital and to make this type of investment opportunity, previously available almost exclusively to institutional investors, available to retail investors.

As a result of requirements in the 1940 Act and the rules and regulations thereunder, BDCs have an existing regulatory framework for determining and publishing net asset value on a regular basis. The board of directors, a majority of which is independent, is required to value the BDC's portfolio securities on at least a quarterly basis and include the BDC's NAV per share in the periodic reports filed with the SEC. These valuations appear in each periodic report, including those issued during the initial offering period. The use of third-party valuation firms or pricing services is not required; however, because of the complexity of valuing securities of private and thinly-traded companies, most BDCs employ one or more third-party valuation firms and/or pricing services to provide valuation assistance. Net asset value is also a line item on a BDC's balance sheet, and as such is reviewed or audited by the BDC's independent auditors.

In addition, BDCs (and other 1940 Act Companies) are prohibited from making distribution payments from any source other than current or preceding fiscal year net income or accumulated undistributed net income, or both (not including in either case profits or losses from the sale of securities or other properties) without providing written notice to stockholders disclosing the source of the distribution. The IPA believes that this requirement effectively addresses FINRA's concerns relating to "over-distributions" and, as recommended in Section 2 hereof, provides a framework which can be adapted for other unlisted DPPs and REITs which would thereby provide a consistent regulatory regimen for all such investment products.

The IPA requests that FINRA acknowledge in the amended rules that this established framework under the 1940 Act for determining and publishing net asset value on a regular basis results in a presumptively reliable valuation of BDC DPPs for disclosure by FINRA member firms on customer account statements in lieu of a Public Offering Price or Net Investment amount during the offering period and thereafter. In addition, since BDCs already provide notices to stockholders relating to the source of distributions in the event of "over-distributions," the IPA requests that, to the extent that DPPs and non-traded REITs are required to provide similar notice to their stockholders as is requested in Section 2 hereof, FINRA acknowledge that BDCs are already subject to such requirements under the 1940 Act and that such disclosures by BDCs would satisfy any such requirements of Rule 2340.

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11. Daily NAV REITs

The IPA respectfully recommends that clarification be provided with respect to the proposed requirement in Rule 2310 Section (b)(5)(A) relative to Section (b)(5)(B) and to Rule 2340. In particular, the IPA believes the proposed rule should clarify what constitutes calculating a per share estimated value "on a periodic basis" – daily, monthly, quarterly, or annually. Also, the IPA requests that FINRA clarify in the amended rules: (i) that Section (b)(5)(A) of Rule 2310 applies to daily NAV products or any unlisted DPP or REIT providing an estimated per share value calculated "on a periodic basis" in accordance with a methodology disclosed in the prospectus and in connection with the offering of securities to the public; (ii) whether or not such a periodic valuation is required under Rule 2310 and/or Rule 2340 to involve the material assistance of a third-party valuation expert and, if so, that such valuation may be performed on a rolling basis wherein a portion of the unlisted DPP or REITs assets are valued with the material assistance of a third-party each period, provided all assets are so valued at least once each year; (iii) whether or not the per share estimated value calculated on a periodic basis for the purpose of compliance with Rule 2310 Section (a)(5)(A) or Rule 2340 should be derived from a methodology that conforms with standard industry practice in light of the Securities Act liability for an ongoing offering with periodic valuations; and (iv) that the website disclosure of the per share estimated value on a daily basis by daily NAV DPPs or REITs is approved by FINRA and the disclosure of such values in such issuer's periodic report per Rule 2310 is not required.

12. Additional Requested Clarifications to Text of Proposed Amendments

The IPA respectfully suggests the following additional clarifications to the proposed amendments and final rule should be considered by FINRA and the SEC:

- if FINRA does not decide to address the cash distribution issue through enhanced disclosure, then the following clarifications are suggested, in addition to necessary clarifications to address GAAP accounting anomalies for the various industries and asset types served by unlisted DPPs and REITs:

    - clarify that the intended frequency of adjustments to account statement valuations during the offering period is quarterly;
    - clarify the time allowed between the release of the issuer's periodic filing and the disclosure of an adjusted Net Investment amount on customer account statements. (The IPA recommends that the amended rules provide that the adjusted value appear on the next monthly or quarterly account statement issued to the security holder after the filing of the issuer's periodic report, but no sooner than 45 days after filing of the issuer's periodic report in recognition of the processing time required to gather and review the reported values and incorporate them into the broker-dealer's securities pricing file and generate account statements.)

- clarify in Section (c)(1)(A) that Net Investment may be included in customer account statements at any time before 45 days after the filing of the issuer's period report in which the per share estimated value is initially disclosed; and
- clarify that any unlisted DPP or REIT products that produce at least quarterly valuations and follow either the Business Development Company regimen or the daily NAV REIT regimen for valuing their assets be subject to the same customer account statement reporting rules as BDCs or daily NAV products.

Conclusion

The IPA appreciates your consideration of the foregoing views on the Proposed Amendments. The views expressed herein reflect the collective assessments of the IPA Legal and Regulatory, Due Diligence, Broker Dealer Advocacy, Non-listed REIT, Oil & Gas, Business Development Company, and Equipment Leasing Committees and the general membership of the IPA, which includes the leading sponsor, broker-dealer, due diligence and securities law and service organizations active in the industry. This broad constituency believes that the Proposed Amendments, when tempered by the foregoing comments and suggestions, will improve the transparency of the industry, provide useful and accurate information and protections to investors, and usher in a new and productive era of maturation and growth for this essential industry.

Unlisted DPPs and REITs are increasingly viewed by financial professionals as an essential component of an efficient and diversified portfolio – a component that can address the financial needs of countless Americans and provide a variety of desired investment benefits. The IPA looks forward to continuing to work collaboratively with the SEC and FINRA as proactive participants in enhancing the ability of direct investments to effectively address the needs of the investing public and continue to play a positive role in providing capital for the nation's economic growth.

Respectfully submitted,

Mark Goldberg

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Chairman
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APPENDIX

Illustrative Listing of Preliminary Initial Member Firm Implementation Tasks

Note: The tasks and potential impacts listed below are provided as a sample of internal broker-dealer processes for implementation of any proposed amendments and do not reflect other implementation requirements which must be undertaken by sponsors, dealer managers, issuers, and financial advisors. The list below is illustrative and is taken from a preliminary high level assessment by a FINRA member firm. A final listing of all tasks will require thorough assessment of the details of the final rule changes and determination of the cost associated with each impact. The rule change will not only impact current internal processes and systems requirements but will have a significant impact on our customer service demands, particularly during the implementation period.

- <u>Due Diligence of New Share Prices</u>
  - Determine process whereby broker-dealers will receive the necessary information regarding Net Investment and any adjustments thereto and determine that the information is reliable.
    - Accommodate Frequency – weekly, monthly or quarterly
    - Plan how product firms will provide information to BDs
    - Evaluate product firms' capability to provide relevant information and context required for BDs in a timely fashion - logistics
    - Establish an internal best practice or procedure for reliability if not defined in the final rule.
  - Build out architect for potential due diligence procedure
- <u>Communication on changes</u>
  - Internal – articles and FAQs will be created
  - Advisor – all platforms of communication will be assessed including articles on advisor site, email communications and conference calls
  - Client – Client letters and or Statement Stuffers with additional disclosures on other client agreements will be needed
- <u>Training</u>
  - Internal training (Customer Service Experts) – Online, Web Ex, or on demand may be utilized (depending on complexity of final rule)
    - Staffing may be required to handle new phone volumes
  - Advisor Training – Potential Conference Calls, Road Shows, Web Ex, etc.
- <u>Operations, Trade Executions & DRIP Pricing</u>
  - Perform systems revisions
  - Test revisions
- <u>Confirmations</u>
  - Assess the changes to confirms
  - System logic will need to be assessed for pricing to settle correctly

   - Confirmation disclosures and footnotes will need to be changed and reprogrammed
   - Project and round of testing will be required
- Statements
   - Assess necessary changes to statements
   - Legal and compliance reviews of proposed changes
   - Statement disclosures will need to be drafted
   - Systems re-programming
   - Update footnotes on statements regarding net investment methodology
   - Execute statement testing

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