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Comments on the National Association of Realtors Application for Exemption

Independent Financial Group LLC is a full service broker dealer with over 230 registered representatives in sales offices located primarily in the Western United States. We have been offering securitized tenant-in-common investments since early 2004. TIC sales account for approximately 25% of our overall business. We have transacted roughly 1000 TIC exchanges totaling approximately \$350 million since 2004. Our typical TIC investors are accredited with net worth in the \$2 Million to \$3 Million range, are 65 or older, and are retired or preparing for retirement; these investors are generally looking to shift their investment portfolios to income generating investments. Our financial advisors involved in TIC transactions, as well as the principals of this firm, have many years of broad experience.

The *National Association of Realtors* application for exemption is a flawed attempt to circumvent various securities laws designed to protect the investing public. In its current form, it not only threatens the public by removing the investor protections associated with broker-dealer registration but places broker-dealers like us at a competitive disadvantage.

The exemption would allow real estate brokerage firms and 'qualified' commercial real estate agents to be exempt from registration and licensing requirements and still receive a portion of the commission from TIC Securities. Although real estate brokers are permitted to share in the broker-dealer's compensation, they will not share in the liability for the suitability analysis, which is left to the broker-dealer. Further, the exemption allows investors to waive the broker-dealer's suitability analysis and proceed with the transaction, leaving a broker-dealer in a questionable regulatory position.

I believe the biggest flaw in the proposal lies in the fact that the "Commercial Real Estate Professional" (CREP) can solicit orders for a securities offering prior to any broker-dealer involvement. This is the equivalent of "selling away" under securities laws, a practice prohibited because it allows an associated person to engage in unsupervised sales activities thereby reducing investor protection. Further, this will allow the CREP to "shop" for the cheapest broker to process the transaction once the sale is pending, further reducing the supervision of the transaction by independent broker-dealers. Given this latitude, many investors will be pre-sold by their CREP prior to any suitability review, including income and liquidity needs, overall diversification, and risk tolerance. When investors are shown properties that are unsuitable for them, but are made to appear attractive by a real estate broker motivated to receive a commission, it is likely they will be willing to sign a suitability waiver presented by any broker-dealer willing to process the transaction. This predictable scenario will remove all investor protections afforded by registered broker-dealers. This scenario ignores the important investor services a registered representative should add to the process prior to solicitation for orders. To properly facilitate investor protection, real estate broker solicitation activities need to be limited to those under the supervision of a



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registered broker-dealer, and real estate broker must not be able to select the participating broker-dealer.

It is highly likely that every CREP will take their business to the broker-dealer most amenable to processing a sale to any investor (i.e. the managing broker-dealer or the sponsor's affiliated broker-dealer) to the significant detriment of the investing public. Such action would deprive investors of an independent due diligence review from an unbiased broker-dealer when determining which TIC offerings to approve for distribution. Further, suitability review would be performed and determined by the compliance personnel of the managing broker-dealer or the sponsor's captive broker-dealer, which are more experienced in Reg. D requirements than in evaluating investor risk tolerance, liquidity and diversification needs. My firm and other independent broker-dealers like us specialize in providing investors with investment options specific to their needs, which enhances investor protection and satisfaction.

Another troubling side effect of the severely delayed participation of broker-dealers under the exemption is that it places truly independent broker-dealers and their registered representatives at a competitive disadvantage. Independent broker-dealers will lose significant market share in the TIC Securities industry if the exemption is adopted, which would hurt investors.

In general, we believe that registration is not overly burdensome for CREPs. CREPs should register if they want to receive securities commissions. We believe that a dual registration scheme is the most desirable solution to this problem. We do have the following concerns, not necessarily in the order of importance.

1. If CREPs are permitted to engage in solicitation activities prior to broker-dealer involvement, investor protections will be compromised.
2. The ability of real estate brokers to contract with clients in exclusive buyer's agent agreements is unprecedented in the securities industry, is not fair competition, and should be specifically prohibited under the exemption.
3. The qualification that CREPs must be "*predominately engaged in the real estate business*" is overly vague.
4. The definition of CREP is vague and overly broad. The definition should ensure that only persons with significant relevant experience that can add value to a transaction will be permitted to share in the commission.
5. In order to prevent real estate brokers from "commission shopping" among the securities broker-dealer community, the amount of commission sharing should be fixed.

6. The exemption needs to address whether anyone will be responsible for monitoring and controlling the sales practices of CREPs and how any limitations will be enforced.
7. The exemption should be modified to remove the incentive for CREPs to use broker-dealers with conflicts of interest (i.e. managing or sponsor controlled) in order to prevent CREPs from circumventing due diligence and other investor protections provided by independent broker-dealers.
8. Weakening of public protections required by securities laws; knowing your customer, due diligence, selling away.
9. The value of the CREP is overstated. In practice, CREPs are primarily sales people who are experts in specific markets and types of real estate. TIC Securities are geographically diverse and include many property types. Unless a CREP with specific experience is matched to a complementary TIC Security, it is unlikely they will be able to add value to the transaction.

If some form of the exemption is granted, it is my opinion that the best and simplest solution would be to exempt Real Estate brokerage firms from being registered as broker-dealers enabling them to share compensation with their agents and to require the agents who are participating in the securitized TIC market place to become licensed and registered with a broker-dealer. By requiring the real estate agents to become licensed and registered, investor protections (e.g. broker-dealer supervision, training and due diligence) would be maintained while subjecting only real estate agents to the burden of becoming licensed and registered. This solution appears to strike the best balance for maintaining investor protections without being overly burdensome.

I believe granting an exemption from registration for both CREPs and real estate brokerage firms presents serious investor protection issues. However, in the event an exemption is granted in this manner, I would recommend the following:

1. Restrict the ability of CREPs to use managing or sponsor-controlled broker-dealers. This would ensure the performance of independent due diligence and an unbiased suitability analysis in order to more thoroughly protect the investor.
2. Require the CREP to work exclusively with one broker-dealer and their approved TIC Securities. The CREP must be committed to this relationship prior to soliciting any business. This requirement would protect the investing public by ensuring the standard of due diligence required by FINRA be in place prior to any solicitation, while maintaining the industry standard against selling away.
3. Limit the amount of the commission which could be shared with the CREP to 3.5% or 50% of the gross dealer concession in order to prevent commission shopping and provide broker-dealers with sufficient compensation to ensure that the broker-dealer



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and its registered representative provide the investor with objective, full scope financial advice regarding how the specific TIC investment would fit into its overall portfolio and meet its financial needs and risk tolerance. Additionally, this will compensate the broker-dealer for assuming the liability associated with the suitability analysis. It is critical to both the investing public and the TIC industry that these services be performed as thoroughly and professionally as they are today. The sponsoring and managing broker-dealers would have a tremendous incentive to undercut the rest of the industry because of other profit centers and little additional risk due to the capacities.

4. Hone the CREP qualification and the “predominately engaged” standards under the exemption in order to ease monitoring and compliance; limiting the availability of the exemption.
5. Clarify which parties are responsible for monitoring compliance with the exemption, which parties will be penalized for non-compliance, and the potential penalties for non-compliance. This is particularly important considering the limitations on advertising imposed by Regulation D.

I believe this proposal significantly reduces investor protections under securities laws and removes many of the benefits investors gain from working with a registered representative. The only parties that stand to significantly profit from the exemption are real estate sales agents. Currently, if investors need the expertise of a real estate agent in connection with TIC Securities, they can hire one on a fee basis. It is unlikely that CREP would abandon the offering of traditional real estate as a 1031 solution merely because the investor is also considering a securitized TIC investment. Thus investors will not be deprived of the expertise or the options provided by real estate agents without the exemption. In short, the proposed exemption gives up too much protection in exchange for very little gain, if any.

Joe Miller
Managing Director