

March 12, 2014

VIA ELECTRONIC MAIL ([rule-comments@sec.gov](mailto:rule-comments@sec.gov))

Elizabeth M. Murphy  
Secretary  
Securities and 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:

We appreciate the opportunity to respond to the request by the U.S. Securities and Exchange Commission (“SEC” or “Commission”) for comments regarding the above-referenced release (the “Proposing Release”) filed by the Financial Industry Regulatory Authority, Inc. (“FINRA”). The Proposing Release proposes amendments to provisions addressing per share estimated valuations for public unlisted direct participation program (“DPP”) and real estate investment trust (“REIT”) securities. The proposed amendments would amend (1) NASD Rule 2340 (Customer Account Statements) to modify the requirements relating to the inclusion of a per share estimated value for unlisted DPP and REIT securities on a customer account statement, and (2) FINRA Rule 2310 (Direct Participation Programs) to modify the requirements applicable to FINRA members’ participation in a public offering of DPP or REIT securities (together, the “Proposed Amendments”).

Dechert LLP is an international law firm with a wide-ranging financial services practice that serves clients in the United States and abroad. In the United States, we represent a substantial number of U.S. fund complexes (including business development companies (“BDCs”)), fund boards, fund independent directors, fund advisers, and service providers to funds. Our clients include several of the largest fund complexes and/or their sponsors. In developing these comments, we have drawn on our extensive experience in the financial services industry generally and with fund regulation specifically. Although we have discussed certain matters addressed in the Proposing Release with some of our clients, the comments that follow reflect

only the views of a group of attorneys in our corporate and securities and investment management practices, and do not necessarily reflect the views of our clients, other members of our groups or the firm generally.

We applaud the Commission for the obvious care and thoughtfulness that went into the preparation of the comprehensive Proposing Release and strongly support the Commission's goal of improving and strengthening the sufficiency of information provided on customer accounts statements for DPPs and REITS. The concerns expressed by FINRA with respect to the reliability of the information included on a customer account statement are equally relevant in the BDC industry. We believe, however, that the extensive valuation and reporting requirements under the Investment Company Act of 1940, as amended (the "1940 Act"), and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), to which non-traded BDCs are already subject, together with interpretive guidance from the SEC staff, provide a responsible framework to address the concerns underlying the Proposed Amendments. In light of the existing valuation obligations of BDCs under the 1940 Act and Exchange Act, we believe that the Proposed Amendments would serve only to cause confusion and inconsistency with respect to existing valuation and reporting standards applicable to BDCs. We would propose instead that any amendments to NASD Rule 2340 and FINRA Rule 2310 expressly direct that the net asset value ("NAV") reported by BDCs in their most recent quarterly or annual report be included on periodic account statements to customers and that such valuation be deemed to be conclusively reliable for purposes of such rules.

**A. Proposed Amendments**

As discussed in the Proposed Release, FINRA proposed to amend NASD Rule 2340 (Customer Account Statements) and FINRA Rule 2310 (Direct Participation Programs). NASD Rule 2340 generally requires FINRA members to provide periodic account statements to customers, on at least a quarterly basis, containing a description of any securities positions, money balances or account activity since the last statement. In such statements, NASD Rule 2340 requires, subject to certain conditions therein, the inclusion of per share estimated values for unlisted DPP or REIT securities included on customer account statements. When an unlisted DPP or REIT security's annual report includes a per share estimated value, the FINRA member would be required to include the estimated value from the annual report in the customer account statement or an estimated value from an independent valuation service or any other source, in the first customer account statement issued thereafter. In addition, FINRA Rule 2310(b)(5) provides that no FINRA member is permitted to participate in a public offering of DPP or REIT securities unless the general partner or sponsor will disclose in each annual report distributed to investors: (1) a per share estimated value of the securities; (2) the method by which such estimated value was developed; and (3) the date of the data used to develop the estimated value.

A DPP, as defined in NASD Rule 2810(a)(4), is “a program that provides for flow-through tax consequences regardless of the structure of the legal entity or vehicle for distribution, including, but not limited to, oil and gas programs, cattle programs, condominium securities, Subchapter S corporate offerings and all other programs of a similar nature, regardless of the industry represented by the program, or any combination thereof.” The most common DPPs are non-traded REITs, equipment leasing corporations, and energy exploration and development limited partnerships. Non-traded BDCs are also considered DPPs for purposes of the FINRA rules and therefore are subject to any rules and regulations applicable to DPPs, including NASD Rule 2340 and FINRA Rule 2310(b)(5).

The Proposed Amendments would amend NASD Rule 2340 to generally require that the per share estimated value included in a customer account statement by an unlisted DPP or REIT be calculated using either (1) the “net investment” methodology, or (2) the “independent valuation” methodology. The “net investment” methodology, which may only be used for up to two years following satisfaction of any minimum offering requirement, would reflect the “net investment” disclosed in the issuer’s most recent periodic report and must be based on the “amount available for investment” percentage included in the offering prospectus (i.e., the offering price per share after deduction of selling commissions and organizational and offering expenses). The per share estimated value must also deduct the portion, if any, of cumulative distributions per share that exceed GAAP net income per share for the corresponding period, after adding back depreciation and amortization or depletion expense. The “independent valuation” methodology, which may be used at any time, requires that a third-party valuation expert or experts determine, or provide material assistance in determining, the valuation.

The Proposed Amendments also propose to amend Rule 2310 to provide that a FINRA member may not participate in a public offering of a DPP or REIT security unless: (A) a per share estimated value is calculated on a periodic basis in accordance with a methodology disclosed in the prospectus; or (B) the general partner or sponsor has agreed to disclose in the first periodic report filed after the second anniversary of breaking escrow: (1) a per share estimated value calculated by, or with material assistance of, a third-party valuation expert; (2) an explanation of the method by which the per share estimated value was developed; (3) the date of the valuation; and (4) the identity of the third-party valuation expert used.

As indicated in the release relating to the Proposed Amendments, the proposal is intended to “protect the investing public by seeking to ensure that any per share estimated value for an unlisted DPP or REIT security included on a customer’s account statement is developed in a manner reasonably designed to ensure that it is reliable.” Further, FINRA has indicated that the proposed rule change is “necessary for the protection of investors in unlisted DPP and REIT securities who currently often receive unreliable per share estimates on their customer account statements.”

While we appreciate the desire to improve the reliability of information provided on customer accounts statements for certain DPPs and REITs, we believe that the language of the Proposed Amendments is confusing with respect to BDCs when considered against the backdrop of the existing valuation and reporting standards applicable to BDCs. Accordingly, we propose that any amendments to NASD Rule 2340 and FINRA Rule 2310 expressly direct that the NAV reported by BDCs in their most recent quarterly or annual report be included on periodic account statements to customers and that such valuation be deemed to be conclusively reliable for purposes of such rules.

## **B. Business Development Companies**

A BDC is a type of closed-end investment company that was created by Congress in 1980 through the enactment of the Small Business Investment Incentive Act of 1980 and the corresponding amendments to the 1940 Act. The legislation was enacted to facilitate and promote the flow of capital and assistance to small, developing or financially troubled companies.

Although a BDC is not technically registered under the 1940 Act, it is subject to many of the detailed regulations and requirements that are applicable to registered investment companies. To qualify as a BDC, a company is generally required to invest at least 70 percent of its total assets in securities of “eligible portfolio companies” as defined in Section 2(a)(46) of the 1940 Act, which generally means the debt or equity securities of private U.S. companies or public U.S. companies that have a public float of less than \$250 million.

In addition to registering its securities for sale under the Securities Act of 1933, as amended (the Securities Act), a BDC is required to have a class of equity securities registered under the Exchange Act in order to make its election to be treated as a BDC under the 1940 Act. As a result, BDCs are subject to a broad spectrum of regulation under the 1940 Act, the Securities Act and the Exchange Act and the rules and regulations promulgated thereunder. For example, BDCs must file periodic and current reports (i.e., Forms 10-Q, 10-K and 8-K) as well as proxy statements with the SEC pursuant to the Exchange Act that are similar to those filed by public operating companies.

As further described below, unlike other non-traded DPPs and REITs, BDCs are subject to extensive valuation requirements under the 1940 Act, as well as enhanced disclosure requirements under the Securities Act and Exchange Act. A BDC is required to mark its portfolio assets to “market” on at least a quarterly basis, with each security being valued separately, based on its market value if there is a trading market or on its “fair value” as determined in good faith using a consistently applied valuation process under the supervision of the BDC’s board of directors. In addition, each portfolio security must be separately valued and disclosed on the “Schedule of Investments” contained in the financial statements of the BDC that is included in

each quarterly and annual report filed with the SEC pursuant to the Exchange Act. While the Proposed Amendments may address legitimate concerns relating to certain non-traded DPPs and REITs, we submit that such requirements are unnecessary for BDCs given the detailed regulatory regime to which BDCs are subject under the 1940 Act, the Securities Act and the Exchange Act and the rules and regulations promulgated thereunder.

**C. Independence Requirements for BDCs**

The 1940 Act requires that at least a majority of a BDC's directors be persons who are independent (i.e., not "interested persons" as defined in Section 2(a)(19) of the 1940 Act). In addition, the 1940 Act requires that any investment adviser, principal underwriter and independent public accountant of a BDC be selected, and reapproved on an annual basis, by a majority of the members of the board of directors who are not "interested persons" of the BDC.

BDCs are also required to adopt and implement policies and procedures designed to prevent violations of the federal securities laws, review these policies and procedures annually for their accuracy and effectiveness, and appoint a chief compliance officer to administer the compliance policies and procedures. The board of directors is tasked with approving, generally on an annual basis, any investment advisory agreement, valuation policies, compliance policies, codes of ethics and other corporate governance procedures applicable to the BDC and its investment advisers. These requirements are designed to require independent directors to review and approve regularly the BDC's material policies and procedures, including the methodology and related policies and procedures for valuing its investment portfolio. The SEC conducts periodic exams of BDCs and their investment advisers to ensure compliance with these and other regulatory requirements as well as periodic review of disclosure documents in connection with registered offerings.

**D. Valuation of Investments by BDCs**

Unlike other DPPs and REITs, which are not subject to the 1940 Act, a BDC is subject to valuation requirements under the 1940 Act and the Exchange Act that result in regularly disclosed NAV determinations. A BDC is required to value its portfolio assets at least each quarter based upon a determination of the current value of its portfolio securities. Securities that are publicly-traded are valued at the reported closing price on the valuation date. Securities that are not publicly-traded are valued at fair value as determined in good faith under the supervision of the BDC's board of directors, as required by the 1940 Act. In connection with that determination, a BDC's board of directors will review and consider portfolio company valuations based on relevant inputs, including, but not limited to, indicative dealer quotes, values of like securities, recent portfolio company financial statements and forecasts, and valuations prepared by third-party valuation services.

BDCs adopt valuation policies and procedures that are consistent with Accounting Standards Update No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (“ASC Topic 820”), issued by the Financial Accounting Standards Board (“FASB”) in May 2011. ASC Topic 820 represents the converged guidance of FASB and the International Accounting Standards Board on fair value measurement. ASC Topic 820 clarifies the definition of fair value and requires companies to expand their disclosure about the use of fair value to measure assets and liabilities in interim and annual periods subsequent to initial recognition. ASC Topic 820 defines fair value as the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

With respect to investments for which market quotations are not readily available, a BDC generally undertakes a rigorous multi-step valuation process each quarter that involves a determination of fair value by the board of directors of the BDC through cooperation with the BDC’s management and its investment advisers, and regularly involves participation of internal auditors and independent third party pricing and valuation firms.

Under the Exchange Act and Regulation S-X, a BDC is required to include a “Schedule of Investments” as part of its financial statements with each quarterly or annual report filed with the SEC, providing an increased level of portfolio transparency. The Schedule of Investments lists each investment the BDC holds at the end of the period and provides information related to the investment, including the fair value as determined by the BDC’s board of directors in accordance with such BDC’s valuation policies and procedures. Accordingly, the Schedule of Investments provides more detail about the individual investments in a BDC portfolio than is generally found in a prospectus or periodic report. In addition, Rule 6-04 under Regulation S-X requires that the financial statements of BDCs include the NAV per share of the BDC. Accordingly, the BDC’s independent auditors are closely involved in the determination of NAV and will either review (in the case of quarterly reports) or audit (in the case of annual reports) the Schedule of Investments and related NAV determination.

Further, BDCs are generally prohibited from selling shares at a price below NAV, after excluding selling commissions and discounts. Accordingly, non-traded BDCs are obligated to closely monitor their NAVs and adjust their offering price in any offering to ensure compliance with the 1940 Act. As a result, investors will generally know the NAV of a non-traded BDC when such investors purchase shares (and at any other time during the offering), unlike other DPPs or REITs.

**E. Application of Proposed Amendments to BDCs**

Based on the above discussion, we respectfully request that the Proposed Amendments be revised to expressly direct that the NAV reported by BDCs in their most recent quarterly or annual report be included on the customer account statements and that such NAV be deemed conclusively reliable under such rules.

We appreciate that the Proposed Amendments may promote greater accuracy and transparency with respect to the value of securities held by DPPs and REITs that are not otherwise subject to recognized valuation and reporting standards, and we are supportive of FINRA's efforts to improve disclosure. However, applying the Proposed Amendments indiscriminately to the direct participation industry (including BDCs), without exception or consideration for the existing regulatory framework applicable to certain participants in the industry, will cause considerable challenges in applying the rules uniformly and in a manner consistent with existing valuation and reporting obligations, and is likely to cause confusion and uncertainty in the industry and among investors. As described above, unlike many non-traded DPPs and REITs, BDCs are subject to existing valuation and reporting requirements under the 1940 Act, the Exchange Act and the rules and regulations promulgated thereunder. These requirements are already designed to ensure that the per share estimated values for the portfolio securities of BDCs included in public reports and customer's account statements are developed in a manner reasonably designed to ensure that it is reliable, thereby achieving the goal of the Proposed Amendments. Therefore, while the valuation requirements included in the Proposed Amendments may be necessary to enhance reporting accuracy and disclosure for other DPPs and the REITs, such requirements are unnecessary for BDCs. Accordingly, we respectfully request that any amendments to NASD Rule 2340 and FINRA Rule 2310 expressly direct that the NAV reported by BDCs in their most recent quarterly or annual report be included on periodic account statements to customers and that such valuation be deemed to be conclusively reliable for purposes of such rules.

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We appreciate the opportunity to comment on the Proposing Release. Please feel free to contact James A. Lebovitz at 215.992.2510 or Thomas J. Friedmann at 202.261.3313 with any questions about this submission.

Sincerely,

*Dechert LLP*

Dechert LLP

cc: Thomas J. Friedmann  
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