

VIA ELECTRONIC MAIL

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:

On January 31, 2014, the Financial Industry Regulatory Authority (FINRA) filed a proposed rule change to amend the provisions addressing per share estimated valuations for unlisted direct participation program (DPP) and real estate investment trust (REIT) securities (Proposed Rule)¹. The Proposed Rule would modify the requirements relating to the inclusion of a per share estimated value for unlisted DPP and REIT securities on a customer account statement under NASD Rule 2340 (Customer Account Statements) and modify the requirements applicable to members' participation in a public offering of DPP or REIT securities under NASD Rule 2310 (Direct Participation Programs).

The Financial Services Institute² (FSI) appreciates the opportunity to comment on this important proposal. FSI and its members support efforts by regulators to improve transparency and enhance investor protection. In this vein, FSI has strongly supported efforts to provide effective disclosures to clients about the features and risks of financial services and products. FSI and its members believe that investors are best served when receiving financial advice by an independent financial advisor. Financial advisors facilitate investor understanding of the features and risks involved in investment products. They are also skilled in aligning an investor's portfolio with his or her specific goals. The Proposed Rule makes progress in providing investors with additional and reliable transparency with respect to these products; however, we fear that some aspects of the Proposed Rule will be detrimental to investors by introducing various complex, confusing, and unreliable estimated valuation methodologies that may not be appropriate for unlisted REIT and DPP securities. We expand on these concerns and others in our comments below.

¹ Notice of Filing of Proposed Rule Change Relating to per Share Estimated Valuations for Unlisted DPP and REIT Securities, 79 Fed. Reg. 9535 (Feb. 19, 2014).

² The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has 100 Broker-Dealer member firms that have more than 138,000 affiliated registered representatives serving more than 14 million American households. FSI also has more than 35,000 Financial Advisor members.

Background on FSI Members

The independent broker-dealer (IBD) community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisers are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 201,000 independent financial advisers – or approximately 64 percent of all practicing registered representatives – operate in the IBD channel.³ These financial advisers are self-employed independent contractors, rather than employees of the IBD firms. These financial advisers provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisers are typically “main street America” – it is, in fact, almost part of the “charter” of the independent channel. The core market of advisers affiliated with IBDs is comprised of clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisers are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.⁴ Independent financial advisers get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisers have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisers. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisers play in helping Americans plan for and achieve their financial goals. FSI's primary goal is to ensure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

Comments

FSI appreciates the opportunity to provide comments on the Proposed Rule. We support efforts to increase transparency and investor awareness with respect to financial services and products. Investors should have effective disclosures that allow them to make fully informed decisions with respect to their investments. The Proposed Rule would alter the per share estimated values that appear on customer account statements for

³ Cerulli Associates at <http://www.cerulli.com/>.

⁴ These “centers of influence” may include lawyers, accountants, human resources managers, or other trusted advisers.

unlisted REIT and DPP securities in several ways, some which FSI supports and believes will enhance transparency and investor understanding. However, there are some aspects of the proposal which introduce complex and unreliable methodologies to arrive at an estimated price which will have the unintended consequence of confusing customers. Financial advisors who advise clients with respect to these products may also experience challenges when explaining how these estimated valuations are calculated and what they mean to the investor. This may occur in instances where the securities are not priced or where the estimated valuation provides an anomalous value due to several factors unique to these products, such as the stage in the offering period or the particular structure of the investment. We expand on these comments below.

- **FSI supports “Net Investment” Reporting as Proposed in Regulatory Notice 12-14:** FSI supports the deduction of sales commissions to calculate Net Investment and displaying this price in customer account statements. This approach provides an easily calculable price that financial advisors can clearly explain and investors should easily understand. However, the deduction of offering and organizational (O&O) costs is more challenging, as these estimates are difficult to ascertain at the time of the offering. While sales charges are deducted upfront, ongoing O&O costs occur continuously. These costs, which include ongoing legal, due diligence, and other issuer expenses, are difficult to estimate and may increase or decrease based upon the size of the capital raised by the offering. This threatens to confuse investors. FSI suggests that FINRA adopt Net Investment reporting to facilitate investor understanding.⁵
- **FSI Has Concerns with FINRA’s Proposed “Over Distribution” Adjustments:** FSI is concerned with the approach advanced by FINRA for adjusting account statement values by deducting distributions of GAAP net income plus depreciation and amortization and depletion. While this approach may be appropriate for other securities, applying this practice to unlisted REIT and DPP securities will create significant confusion for investors. This methodology introduces a complex accounting method that has not been demonstrated to be reliable with respect to these types of securities and would not conform to recognized real property or real estate securities valuation standards utilized in the industry. FSI is also concerned that the methodology chosen by FINRA will confuse investors by increasing these securities’ price volatility on customers’ account statements as the securities move through various stages of the investment cycle. While the underlying value of the investments may have not changed, the price movements included in the customer account statements will become more volatile over time, increasing investor confusion while not reliably increasing the transparency of these investments. FSI suggests that FINRA eliminate this approach, and replace it with enhanced customer disclosures requirements with respect to “over distributions.” FSI believes an appropriate replacement would include a written notice or communication be provided to investors that explains and quantifies the source of distributions rather than altering customer account statements.
- **FSI Believes FINRA’s Proposed “Not Priced” Option Would Be Detrimental to Investors:** FSI has concerns with FINRA allowing unlisted DPP or REIT securities to be shown as “not priced” on

⁵ Regulatory Notice 12-14, FINRA Requests Comment on Proposed Amendments to NASD Rule 2340 to Address Values of Unlisted Direct Participation Programs and Real Estate Investment Trusts (March 7, 2012); available at <http://www.finra.org/Industry/Regulation/Notices/2012/P125772>.

customer account statements. While FSI supports certain changes to customer account statements that provide reliable and useful increases in transparency, the result of this particular approach would be to reduce transparency with respect to these securities and to immediately write-down the amount invested in certain programs that have not yet produced estimated per share valuations. This threatens to increase the confusion of investors and impair financial advisors' ability to assist clients in achieving effective asset allocation and tax planning. Therefore, FSI recommends that FINRA continue to expand the transparency of these products by requiring that estimated values be disclosed on customer accounts for unlisted DPP and REIT securities.

- **FSI Supports More Frequent Appraised Values and Additional Customer Disclosure:** FSI supports requiring more frequent independent appraisals after the offering period as this increases transparency and is therefore beneficial to investors. In addition to the more frequent appraisals, FSI supports additional disclosures relating to the illiquidity and other features unique to unlisted REIT and DPP securities. These efforts will enhance the ability of investors to make informed decisions with respect to these investments. They will also increase the ability of investors to identify any questions they may have for their financial advisors with respect to these securities.
- **FSI Supports an Extended Implementation Period for the Proposed Rule:** FSI believes that an effective date no earlier than 18 months following SEC approval will provide firms, advisors, and investors with an adequate period to avoid disruptions and significant confusion. Clients may hold several different issuances of unlisted DPP and REIT from different product sponsors, each of which may behave differently after the rule becomes effective and the estimated valuation methodologies are applied to the customer account statements. Firms will require additional time to adequately prepare staff and create training for financial advisors regarding these changes and to assess which products will be most affected. Firms and advisors offer a variety of unlisted REIT and DPP securities to clients, each with different structures and features. Due to this variety, an extended and adequate compliance period will be necessary to address the unique challenges associated with each product type. Advisors will also need adequate time to prepare their clients and their staffs for the impact of these changes due to the variety of structures and features of unlisted DPP and REIT securities.

Conclusion

We remain committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with FINRA and the SEC on this and other important regulatory efforts.

Thank you for your consideration of our comments. Should you have any questions, please contact me at 202 803-6061.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "D. T. Bellaire". The signature is fluid and cursive, with a large initial "D" and "T" followed by "Bellaire".

David T. Bellaire, Esq.
Executive Vice President & General Counsel