



NASAA

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August 22, 2014

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

RE: Comments in Response to Proposed Rule Change SR-FINRA-2014-006

Dear Ms. Murphy:

Thank you for the opportunity to comment on proposed rule change SR-FINRA-2014-006 affecting NASD Rule 2340 (Customer Account Statements) and FINRA Rule 2310 (Direct Participation Programs). NASAA¹ previously commented in support of two prior iterations of this proposal, FINRA Regulatory Notice 11-44 and FINRA Regulatory Notice 12-14. While the specific proposals have changed somewhat in the current version, our two previous letters still reflect the views of NASAA on the issue of reporting DPP security values on customer account statements. NASAA remains supportive of FINRA's efforts to improve the accuracy and transparency of DPP price reporting, and we support rule proposal SR-FINRA-2014-006 as filed January 31, 2014. However, NASAA has substantial concerns with FINRA's Partial Amendment No. 1.

DPP securities are typically expensive, illiquid, and involve a greater degree of risk than other publicly offered investments. Accordingly, investors deserve to know what these securities are worth on a current basis, and deserve to see the effects of the high fees and expenses reflected on their account statements. NASAA offers the following comments and suggestions to further enhance the accuracy and transparency of customer account statement reporting. These comments are in response to FINRA's Partial Amendment No. 1, filed with the Commission on July 16, 2014.

1. NASAA supports the proposed revision to NASD Rule 2340(c) to eliminate the "not priced" option and require securities to be valued on either a "net investment" or "appraised value" basis. Requiring a security to be valued on the customer account statement enhances transparency to the customer, while the "net investment" valuation

¹ NASAA is the association of the 67 state, provincial, and territorial securities regulatory agencies of the United States, Canada, and Mexico. NASAA serves as the forum for these regulators to work with each other in an effort to protect investors at the grassroots level and to promote fair and open capital markets

method would impose no meaningful burden on program sponsors or FINRA member firms.

2. NASAA strongly opposes the elimination of the “over distribution” deduction from the per share estimated value under the “net investment” methodology as originally proposed in NASD Rule 2340(c)(1)(A)(ii). DPP sponsors that choose to return a customer’s money through distributions of offering proceeds make an immediate and definite cash-based reduction of that customer’s investment. If the purpose of this rule proposal is to accurately reflect security values on customer account statements, it is inconsistent to eliminate the requirement that “over distributions” be accounted for on customer account statements. Instead, proposed NASD Rule 2340(c)(2)(A) would require only boilerplate disclosure that “over distributions” are not reflected in the per share estimated value, which seems to defeat the purpose of this rule proposal altogether.²

The proposed disclosure does not result in increased transparency of security prices on the customer account statement, and simply serves to communicate to customers that the new, purportedly more accurate prices listed on their account statements are, in fact, not accurate. On page 12 of FINRA’s initial filing of this rule proposal on January 31, 2014, FINRA stated the “inclusion of a value on customer account statements for unlisted DPPs and REITs is beneficial to investors only if the valuation is reliable.” However, the proposed disclosure at NASD Rule 2340(c)(2)(A) indicates that such valuations are not in fact reliable.

NASAA agrees with FINRA’s original reasoning on this issue as stated in its initial filing of January 31, 2014. On page 8 of that filing, FINRA stated, “The per share estimated value also must deduct the portion, if any, of cumulative distributions per share that exceeded GAAP net income per share for the corresponding period, after adding back depreciation and amortization or depletion expenses. This provision recognizes that depreciation, amortization and depletion expenses reduce net income per share, but are not expenditures and do not impact the issuer’s cash reserves.” Additionally, at footnote 20 of its January 31 proposal, FINRA noted that it “believes that investors will be better served by understanding immediately the effect of a return of capital as a distribution (rather than the use of the capital to generate a return on investment) on the value of their investment.” In its January 31 proposal, FINRA recognized the difference between a direct cash outlay, as in distributions of offering proceeds, versus intangible expenses, such as depreciation and amortization, and further recognized the benefit to investors of seeing the effect of distributions of offering proceeds on their investments. NASAA questions why FINRA would now depart from this well-reasoned approach.

²The proposed disclosure reads as follows: “IMPORTANT – Part of your distribution includes a return of capital. Any distribution that represents a return of capital reduces the estimated per share value shown on your account statement.”

Requiring the deduction of “over distributions” from estimated value per share would not add any meaningful burden on program sponsors because they must already account for it anyway. The Internal Revenue Code requires issuers to report to shareholders on an annual basis any income received from distributions, including any reduction in cost-basis resulting from a return of capital. In fact, some DPP sponsors have even used samples of IRS Form 1099-DIV in their advertising in order to portray the basis reduction from over distributions as a positive feature. Additionally, most (if not all) DPP issuers report a breakdown of distributions by source in the financial statements included in their Form 10-K and 10-Q filings. Accordingly, issuers account for distribution payments in much the same way that they account for other expense payments. It is unclear, then, why customer account statements should reflect deductions for organization and offering expenses, which reduce the amount of the customer’s investment available for deployment by the issuer, but should not reflect a deduction for return-of-capital distributions, which also reduce the amount of the customer’s investment available for deployment by the issuer.

For these reasons, NASAA respectfully urges the Commission to return to FINRA’s original proposal requiring the deduction of “over distributions” from the per share estimated value of DPP securities on customer account statements.

3. Under the “net investment” methodology in the proposed revision to proposed NASD Rule 2340(c)(2)(A), an issuer disclosing a range of front-end fees and expenses, rather than a definitive percentage, may use the lesser end of the range of fees and expenses in calculating the customer’s “net investment.” NASAA is concerned that this unnecessarily opens the “net investment” methodology to gamesmanship by members or program sponsors. The more conservative approach, and the method providing a more realistic depiction of the extent and impact of front-end fees and expenses would be to require the calculation of the price reflected on the customer account statement to be based on the fees and expenses at the maximum end of the disclosed range.
4. The proposed revision to proposed FINRA Rule 2310(b)(5)(B) eliminates the requirement to identify the service used to obtain a valuation under the “appraised value” methodology. NASAA appreciates FINRA’s desire to streamline disclosures on the customer account statement, but also appreciates the materiality of the identity of the service providing valuation services. To accommodate both concerns, NASAA suggests that FINRA add the identity of the service conducting the appraisal to the list of information required to be included in the annual written report required at proposed FINRA Rule 2310(b)(5)(D)(iii).
5. Proposed NASD Rule 2340(c)(1)(B) requires that a member using the “appraised value” methodology obtain an appraisal of the assets and liabilities of the DPP or REIT performed by “a third-party valuation expert or service.” While NASAA believes that FINRA’s intent in drafting this requirement was to require the use of an *independent*

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third-party valuation expert or service, NASAA respectfully requests that FINRA clarify the ambiguity by specifically requiring the appraiser's independence from the program being appraised and its affiliates.

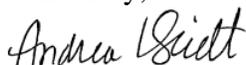
Additionally, Proposed NASD Rule 2340(c)(1)(B)(ii) requires the "appraised value" methodology used by the member or program sponsor be "derived from a methodology that conforms to standard industry practice." NASAA appreciates the difficulties in drafting a rule applicable to the wide range of DPP programs; however, the term "standard industry practice" is inherently vague. NASAA would support clarifying the meaning of "standard industry practice" with a reference to U.S. GAAP, the standards of the Appraisal Institute, or another appropriate standard of equivalent rigor.

6. FINRA's original rule proposal of January 31, 2014 included an effective date of the proposed rule change six months following Commission approval. FINRA's Partial Amendment No. 1 proposed to extend the effective date of the rule change to no earlier than eighteen months following Commission approval, citing a need to give "industry participants time to make adjustment to product structures and any necessary operational changes." NASAA does not support this delay in implementation of the rule change. Industry has been on notice that changes were coming to price reporting on customer account statements since FINRA published Regulatory Notice 11-44 in September of 2011. Now, nearly three years later, industry should not need an additional year-and-a-half to make the necessary changes. Once effective, the proposed rule changes will immediately benefit investors, and they should not be forced to wait another year for more transparent price reporting. Accordingly, NASAA respectfully urges the Commission to reinstate the initially-proposed effective date of six months post approval.

NASAA continues to support FINRA's efforts to enhance the accuracy and integrity of investment valuations reported on customer account statements, and believes that the proposed changes to NASD Rule 2340 and FINRA Rule 2310 represent meaningful improvements over current industry practices. However, NASAA is deeply concerned with FINRA's recent reversal on the requirement to deduct "over distributions" from the per share estimated value of securities, and strongly urges FINRA to reconsider its change of position on this issue.

NASAA appreciates the opportunity to comment on this proposal. Please do not hesitate to contact me or NASAA's General Counsel, Joseph Brady, should you have any questions regarding this letter.

Sincerely,



Andrea Seidt
NASAA President
Commissioner, Ohio Division of Securities