U.S. Chamber of Commerce

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NASAA Corporation Finance Section
Andrea Seidt, Section Chair
Mark Heuerman, Project Group Chair
North American Securities Administrators Association, Inc. (NASAA)
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Via electronic submission to NASAAComments@nasaa.org, Andrea.Seidt@com.ohio.gov, and Mark.Heuerman@com.ohio.gov

Re: Request for Public Comment, The North American Securities Administrators Association; Proposed Revisions to NASAA Statement of Policy Regarding Real Estate Investment Trusts (July 12, 2022)

Dear Commissioner Seidt and Mr. Heuerman:

The U.S. Chamber of Commerce's Center for Capital Markets Competitiveness ("Chamber") submits these comments in response to the North American Securities Administrators Association's ("NASAA") proposed revisions to NASAA policies regarding real estate investment trusts ("REITs") ("Proposal"). The Proposal would fundamentally change how state securities administrators approach the regulation of REITs and could influence future regulation of other products.

The Chamber has serious concerns with the Proposal, which would severely restrict the ability of retail investors to diversify their savings and invest in highly regulated and transparent vehicles. Further, the Proposal represents a fundamental conflict with the Securities and Exchange Commission's ("SEC") Regulation Best Interest ("Reg BI"), federal conduct standards that include substantial investor protections. The Proposal appears to be yet another effort by state regulators to create their own complex regulatory patchwork at the expense of investors and small firms who will bear the costs of the new rules under consideration by NASAA and its members.

The Chamber offers the following views on the Proposal:

I. **The Proposal takes a merit-based approach to regulation and would interfere with the ability of financial professionals to make recommendations that are in the best interest of investors;**

II. **The Proposal directly conflicts with and undermines critical investor protections adopted under Reg BI;**

III. **The Proposal would inhibit the ability of investors to diversify their portfolios and invest in assets that can enhance investment returns; and**

IV. **NASAA has provided scant evidence of investor harm that would support the restrictions included in the Proposal.**

These views and concerns are discussed in further detail below.

<u>The Proposal takes a merit-based approach to regulation and would interfere with the ability of financial professionals to make recommendations that are in the best interest of investors.</u>

The Proposal would impose new standards on financial professionals when recommending investments in non-listed REITs to retail investors. However, NASAA also indicates that the Proposal could be used to "influence" future standards for other products, including business development companies (BDCs).[1]

If individual states were to adopt the proposed guidelines, financial professionals would become subject to a maze of rules when recommending non-listed REITs. These rules include Federal standards such as Reg BI and conduct standards under the Employee Retirement Income Security Act (ERISA), and state law requirements for "suitability," "appropriateness," and "best interest," all in addition to the new product restrictions that could be imposed by the Proposal. Each of those conduct standards would be subject to different interpretations and oversight by various Federal and state regulators, making it extremely difficult for financial professionals to know what constitutes full compliance with non-listed REIT recommendations. Such a patchwork would also result in investor confusion.

The Proposal provides no explanation for how these standards would work in tandem, which standard takes precedence, or why multiple standards applying to a single recommendation are necessary. State regulators would have carte blanche to pick and choose whatever standard they wish to enforce. The Chamber has long opposed this type of subjective enforcement that is not based upon clear rules and guidelines.

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[1] Proposal, I. at 2.

Many financial professionals will be disincentivized from making recommendations in non-listed REITs altogether (along with other vehicles if further guidelines are adopted), even if those recommendations are in the best interest of a particular investor, and that investor fully understands the risks and opportunities involved in a particular product. The Proposal effectively makes a merit-based decision that non-listed REITs are "bad" investments for all investors in all cases. This type of merit-based regulation for certain products is entirely contrary to Federal SEC and ERISA regulations and will allow regulators to second-guess every recommendation made by a financial professional.

The Proposal directly conflicts with and undermines critical investor protections adopted under Reg BI.

The Chamber understands that NASAA has long been opposed to Reg BI and that, since Reg BI's adoption, NASAA has sought to portray Reg BI as insufficient in terms of investor protection. The Chamber strongly disagrees with this characterization, and we point to a recent report that uncovered serious flaws with NASAA's 2021 Reg BI "survey."[2]

A critical aspect of Reg BI is that it is product-agnostic. In developing and implementing Reg BI over multiple years, the SEC never sought to impose different standards for different products. Instead, it adopted a uniform standard that applies the same rules to any recommendation made by a financial professional to a retail investor. This ensures that the SEC or other regulators are not in the position of determining appropriate products for every investor.

Further, the Proposal takes the extraordinary step of placing responsibility on the *sponsors* of products to determine that each investment is a "suitable and appropriate investment for each shareholder and/or is in compliance with applicable conduct standards."[3] This requirement presumes that sponsors have the ability to determine whether each investment is made in accordance with every applicable Federal and state standard. However, sponsors do not have the expertise and are not in an appropriate position to make this determination.

The Proposal would inhibit the ability of investors to diversify their portfolios and invest in assets that can enhance investment returns.

Regrettably, the Proposal embraces the view that investors should only be invested in the public equity and debt markets, and that non-listed vehicles or private placements are too "risky" for retail investors. This view entirely ignores the benefits of diversification that such

[2] https://greenwaldresearch.com/wp-content/uploads/2022/02/Analysis-of-NASAA-Surveys-on-Reg-BI-Greenwald-Research-2.22.pdf

[3] Proposal, III. C.5.

products can add to an overall portfolio, particularly when there is a sustained downturn in the public markets.[4] Products such as non-listed REITs or non-listed BDCs can offer valuable protection against inflation and be a reliable source of income for portfolios.

Financial professionals are in the best position to make determinations about what is in the best interest of a particular investor, and what percentage of a portfolio should be allocated to non-listed or similar products. Being entirely exposed to the fluctuations of the public equity and fixed income markets is often not the best approach for an investor.

<u>NASAA has provided scant evidence of investor harm that would support the product-specific restrictions included in the Proposal.</u>

It is notable that NASAA has provided little empirical or other evidence that would support the onerous restrictions contained in the Proposal. The only “evidence” NASAA offers appears to be one article and NASAA’s own Reg BI “survey” which was defined by a biased methodology and questions designed to make Reg BI look ineffective in practice.

The Proposal also lacks economic analysis to support the application of a 10% concentration limit on a purchaser’s aggregate investment in an issuer, its affiliates, and other non-traded participation programs. The Chamber questions the need for an arbitrary concentration limit when such decisions should be made between an investor and his or her investment professional. Furthermore, as we mentioned in our 2016 letter to NASAA, limitations on investing in non-traded REITs directly impact capital formation, particularly with respect to commercial real estate investment across the country.[5]

Prior to taking any further initiative with the Proposal, NASAA should at a minimum follow regulatory best practices and conduct a holistic economic analysis of the Proposal’s impact on investor returns, capital formation (particularly regarding small and middle market businesses that raise capital through these types of vehicles), job creation, and macroeconomic growth. Such an analysis would allow commenters to further assess NASAA’s underlying assumptions with the Proposal and provide further comment on this initiative.

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[4] See e.g. statement of former SEC Commissioner Mike Piwowar at May 18, 2016 meeting of the SEC Advisory Committee on Small and Emerging Companies: “…The second economic concept is modern portfolio theory. By holding a diversified portfolio of assets, investors reap the benefits of diversification; that is, the risk of the portfolio as a whole is lower than the risk of any individual asset. I do not have the time today to give a full lecture on the mathematics and statistics of portfolio diversification, so I will just assure you the correlation of returns is key. When adding higher-risk, higher-return securities to an existing portfolio, as long as the returns from the new securities are not perfectly positively correlated with (move in exactly the same direction as) the existing portfolio, investors can reap higher portfolio returns with little or no change in overall portfolio risk. In fact, if the correlations are low enough, the overall portfolio risk could actually decrease. These…concepts show how even a well-intentioned investor protection policy can ultimately harm the very investors the policy is intended to protect.”

[5] https://www.nasaa.org/wp-content/uploads/2016/10/CCMC-Comment-Letter.pdf

Conclusion

The Chamber urges NASAA to withdraw this Proposal in its entirety. Regulation should not impose different standards on non-listed REITs or other products. Financial professionals are in the best position to make determinations about what is in the best interest of a particular investor. Multiple and conflicting state and Federal regulations will make it extremely difficult for financial professionals to do their job and act in the best interest of the clients. We welcome the opportunity to discuss these issues further with NASAA staff or board members.

Sincerely,

K. Malinconico

Kristen Malinconico
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