

Public Investors Arbitration Bar Association

April 11, 2012

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Via Email Only
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Marcia E. Asquith
Office of Corporate Secretary
FINRA
1735 "K" Street, N.W.
Washington, DC 20006-1506

Re: Regulatory Notice 12-14 – Proposed Amendments to NASD Rule 2340

Dear Ms. Asquith:

On behalf of the Public Investors Arbitration Bar Association ("PIABA"), I thank FINRA for the opportunity to comment on the proposed amendments to NASD Rule 2340. PIABA is a national, not-for-profit bar association comprised of attorneys, including law professors and regulators, both former and current, who devote a significant portion of their practice to representation of public investors in securities arbitrations.

PIABA submitted a comment letter in response to Regulatory Notice 11-44, which described previously proposed amendments to NASD Rule 2340. PIABA stated that the amendments proposed in Regulatory Notice 11-44 were both beneficial and detrimental to investors. PIABA's comment on Regulatory Notice 11-44 set forth a detailed history of the previous amendments to Rule 2340 in late 2000 period and the simultaneous amendments to NASD Rules 2710 and 2810. PIABA will not here reiterate the history of the prior amendments. PIABA believes that it is critical to note that the purpose and intent of the amendments to Rules 2340, 2710, and 2810 were to ensure that investors who own direct participation program units or shares of non-traded REITs are provided with valuation information that is as accurate as possible, so that investors can determine how their investments were performing.

The proposed amendments to Rule 2340 set forth in Regulatory Notice 12-14 are *contrary* to the interests of investors and are *contrary* to the purpose and intent of the year 2000 amendments to Rules 2340, 2710, and 2810.

Direct Participation Programs ("DPPs") and non-traded REITs are illiquid, speculative investments. Non-traded REITs have been offered for sale to investors, including retirees, primarily based on two selling points: (1) that non-traded REITs provide higher dividend payments than other income producing investments, and (2) that investors can escape the volatility of the stock market by

purchasing non-traded REIT shares. These so-called "advantages" of non-traded REIT shares are misleading.

Issuers of non-traded REIT shares have been able to list the offering price of non-traded REIT shares as the "value" of those shares, because FINRA placed its stamp of approval on that practice in Notice to Members 09-09. PIABA believes that this practice is contrary to the express language of NASD Rules 2710 and 2810.

PIABA recognizes that FINRA is not vested with the jurisdiction to regulate issuers of DPP units or non-traded REIT shares. However, FINRA has the ability to compel issuers of DPP units and non-traded REIT shares to provide meaningful and accurate share valuation information. FINRA can accomplish this goal by prohibiting member firms from selling DPP units or non-traded REIT shares of issuers that fail to timely and accurately provide valuations based on third-party appraisals. If broker/dealers were prohibited from selling DPP units or non-traded REIT shares of issuers who refuse to provide share valuations based upon independent appraisals of the assets, liabilities, and operations of the program or REIT, then issuers would be compelled to comply with that requirement to ensure that their shares could be sold to the investing public by broker/dealers.

Proposed subsection (c)(1) of Rule 2340 is a step backward for investors. Under (c)(1), FINRA provides an option to general securities members to provide share values based upon appraised value supplied by issuers or net offering price or to indicate on monthly or quarterly statements that the DPP or non-traded REIT securities are "not priced". The current Rule 2340 requires general securities members to provide a per share estimated value from an independent valuation source if the general securities member can demonstrate that the value provided by the issuer is inaccurate. *See* SEC Release No. 34-43601 at p. 71171 (Nov. 29, 2000). Allowing general securities members to list on customers' account statements that their DPP or non-traded REIT securities are "not priced" defeats the purpose of the amendments to Rule 2340, 2710, and 2810 in 2000 and provides a disclosure loophole to issuers.

In Regulatory Notice 12-14, FINRA states that pending the adoption of amendments to Rule 2340, it will accept exemptive requests from broker/dealers that do not wish to use gross offering price per share on customer account statements as estimated value. FINRA cites to paragraph (e) of the existing rule which grants FINRA authority to exempt firms from the provisions of the rule for good cause shown. FINRA concludes that any firm requesting to remove gross offering per share price from a customer's account statement because that price is not indicative of estimated value will generally be deemed to have shown good cause. This language in Regulatory Notice 12-14 is troubling and is contrary to the interests of investors.

As stated above, the NASD took the position during the approval process for the amendments to Rules 2340, 2710, and 2810 that broker/dealers would not be excused from providing an estimated value from an independent valuation source if

the member could demonstrate that the estimated value provided by the issuer was inaccurate. Thus, according to FINRA's predecessor, if a member can demonstrate that the offering price is not an accurate estimate of value, the member is required to obtain a more accurate estimated value from an independent valuation source. Pending the adoption of amendments to Rule 2340, FINRA should simply enforce its own interpretation of the requirements of the rule. FINRA's allowing member firms to indicate on investors' account statements that their DPP units or non-traded REIT shares are "not priced", pending adoption of amendments to Rule 2340, is an abdication of FINRA's investor protection responsibilities and is a rejection of the NASD's interpretation of the requirements of Rule 2340.

Allowing issuers to avoid providing an accurate estimated value of DPP and non-traded REIT securities until the second quarterly filing following the effective period of the first registration statement is contrary to the interests of investors. In the body of Regulatory Notice 12-14, FINRA blithely dismisses the utility of appraised values during the offering period with the following statement:

An appraised value during most of the initial offering period would not be as useful to investors because most of the assets in the program will typically consist of cash and short-term, liquid securities.

To the contrary, an appraisal of the assets, liabilities, and operations of an issuer during the offering period, which would provide investors with the most accurate estimated value of shares, is precisely what is best for investors. Such appraisals would demonstrate that what investors were sold at \$10 per share is almost immediately valued at \$9 to \$8.50 per share. Any amendments to Rule 2340 should focus on providing investors with accurate share valuations and not allowing issuers to provide artificially high or misleading valuations during the offering period to boost sales of DPP units and non-traded REIT shares.

The importance of FINRA doing all that it can to prevent investors from being duped into buying DPP units and non-traded REIT shares is evidenced by FINRA's enforcement proceeding against David Lerner & Associates filed in May, 2011, and recent share valuation write-downs by a number of non-traded REITs. Over the last two weeks, Investment News has reported on numerous non-traded REITs writing down estimated share valuations significantly. Those non-traded REITs include the following:

1. Berringer Harvard Opportunity REIT I had a per share offering price of \$10 per share and currently estimates the value of each share at \$4.12;
2. Berringer Harvard REIT I had a per share offering price of \$10 and has a current estimated per share value of \$4.64;
3. Berringer Harvard Short-Term Opportunity Fund had a per share offering price of \$10 per share and has a current estimated per share value of \$.40;

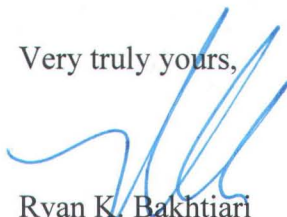
4. Cornerstone Core Properties REIT had a per share offering price of \$8 and has a current estimated per share value of \$2.25;

5. Inland Western Retail Real Estate Trust, Inc., had a per share offering price of \$10 per share and has a current estimated per share value of \$6.95; and

6. KBS Real Estate Investment Trust, Inc., had a per share offering price of \$10 and has a current estimated per share value of \$5.16.¹

Unless FINRA amends Rules 2310 and 5110 (former NASD Rules 2810 and 2710) and strengthens the requirements of Rule 2340, issuers will continue to be able to have member firms sell unsuitable DPP units and non-traded REIT shares to investors, many of whom are seeking safety of principal and income. Rules 2310 and 5110 should be amended to prohibit general securities members from selling DPP units or non-traded REIT shares unless the issuers of such units or shares will provide in each annual report a valuation of the units or shares based upon an independent appraisal of the assets, liabilities, and operations of the program or REIT. Annual independent appraisals and the reporting of appraised values should be required throughout the offering period and after the conclusion of the offering period. In addition, Rule 2340 should require the reporting of those appraised values unless member reasonably believes that the per share estimated value is unreliable. In that event, consistent with the requirements of the current Rule 2340, members should be required to report estimated value based upon an analysis of the audited financial statements of the program or REIT prepared by an independent valuation service.

Very truly yours,



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¹ See Investment News, "Six notable non-traded REITs on the slide" (March 30, 2012).