



PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION

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May 6, 2019

Vanessa Countryman
Acting Director, Office of the Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090
rule-comments@sec.gov

**RE: File Number SR-FINRA-2019-009 - Request for Comment on
Proposed Rule to Adopt Remaining Legacy NASD and Incorporated
NYSE Rules as FINRA Rules**

Dear Ms. Countryman:

I write on behalf of the Public Investors Arbitration Bar Association (“PIABA”), an international bar association comprised of attorneys who represent investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules promulgated by the Financial Industry Regulatory Authority (“FINRA”) relating to investor protection.

PIABA generally supports the adoption of remaining Legacy NASD and Incorporated NYSE Rules as FINRA Rules. Consolidation into the FINRA rulebook provides clarity to FINRA members, as well as to the public, about what rules apply to a FINRA member or associated person.

While no substantive changes are being proposed, PIABA continues to be concerned about one particular rule subject to the current consolidation – NASD Rule 2340 (Customer Account Statements) proposed to be adopted as FINRA Rule 2231.¹

¹ SR-FINRA-2019-009 notes that “FINRA will continue to review the substance of the rules addressed in this proposed rule change and expects to propose substantive changes to some or all of the rules as part of future rulemakings.”

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In 2014, the Commission sought comment on proposed amendments to NASD Rule 2340. Among other things, FINRA proposed to modify the requirements relating to the inclusion of a per share estimated value for unlisted direct participation programs ("DPPs") and unlisted real estate investment trusts ("REITs") securities on a customer account statement.² FINRA's concern in 2014 echoed many of our members' concerns – that the existing rule and industry practice of using the offering price (or "par value," typically \$10 per share) on customer account statements created a situation where, at best there was significant investor confusion, and at worst investors were being actively misled - particularly where costs and fees had reduced investors' capital and the value of the investments. After responding to comment letters, FINRA proposed Amendment No. 1 to the proposed rule change, which included such important improvements as making per share valuation mandatory, not voluntary (and eliminating a "not priced" reporting option).³ PIABA submitted a comment letters to both the original rule change proposal and Amendment No. 1.⁴ The SEC approved FINRA's proposed rule change, as modified by Amendment No. 1.⁵ Current NASD Rule 2340 reflects those amendments.

Current NASD Rule 2340 mandates inclusion of a per share "estimated value" of a DPP or unlisted REIT security, "developed in a manner reasonably designed to ensure that the per share estimated value is reliable, and the disclosures in paragraph (c)(2) as applicable." The rule clarifies that the estimated value will be deemed to satisfy the "manner reasonably designed" requirement if the member uses one of two methodologies: "net investment" valuation or "appraised value." Net investment value under NASD Rule 2340(c)(1)(A) provides:

At any time before 150 days following the second anniversary of breaking escrow, the member may include a per share estimated value reflecting the "net investment" disclosed in the issuer's most recent periodic or current report ("Issuer Report"). "Net investment" shall be based on the "amount available for investment" percentage in the "Estimated Use of Proceeds" section of the offering prospectus or, where "amount available for investment" is not provided, another equivalent disclosure that reflects the estimated percentage deduction from the aggregate dollar amount of securities registered for sale to the public of sales commissions, dealer manager fees, and estimated issuer offering and organization expenses. When the issuer provides a range of amounts available for investment, the member may use the maximum offering percentage unless the member has reason to believe that such percentage is unreliable, in which case the member shall use the minimum offering percentage.

Appraised value under NASD Rule 2340(c)(1)(B) provides:

² Securities and Exchange Commission Release No. 34-71545; File No. SR-FINRA-2014-006 (published in the Federal Register, Vol. 79, No. 33, February 19, 2014).

³ Securities and Exchange Commission Release No. 34-72626; File No. SR-FINRA-2014-006 (published in the Federal Register, Vol. 79, No. 140, July 22, 2014).

⁴ See PIABA comment letters dated March 11, 2014, and June 25, 2014.

⁵ Securities and Exchange Commission Release No. 34-73339, File No. SR-FINRA-2014-006 (published in the Federal Register, Vol. 79, No. 201 (October 17, 2014)).

At any time, the member may include a per share estimated value reflecting an appraised valuation disclosed in the Issuer Report, which, in the case of DPPs subject to the Investment Company Act of 1940 (“1940 Act”), shall be consistent with the valuation requirements of the 1940 Act and the rules thereunder or, in the case of all other DPPs and REITs, shall be:

- (i) based on valuations of the assets and liabilities of the DPP or REIT performed at least annually, by, or with the material assistance or confirmation of, a third-party valuation expert or service; and
- (ii) derived from a methodology that conforms to standard industry practice.

Current NASD Rule 2340(c)(2) also includes mandatory disclosures on the customer account statements:

(A) An account statement that provides a "net investment" per share estimated value for a DPP or REIT security under paragraph (c)(1)(A) shall disclose, if applicable, prominently and in proximity to disclosure of distributions and the per share estimated value the following statements: "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."

(B) Any account statement that provides a per share estimated value for a DPP or REIT security shall disclose that the DPP or REIT securities are not listed on a national securities exchange, are generally illiquid and that, even if a customer is able to sell the securities, the price received may be less than the per share estimated value provided in the account statement.

While the rule change improved industry practice, **PIABA advocates for more clarity and transparency on customer account statements:**

- FINRA should eliminate the “net investment” methodology. The current rule allows use of this methodology, which is far less reliable than the “appraised value” methodology, for two years plus up to another 150 days after breaking escrow. By the time the issuer is required to use the “appraised value” methodology, most of the shares of an offering will likely already have been sold and, early investors will have received account statements for years with less accurate information. Accurate, third party valuations should be required from the beginning of an offering of DPPs or REITs.
- If it does not eliminate the “net investment” methodology outright, then FINRA should reduce the allowable time period for its use, and expand the disclosure requirements to specifically provide the *end date* for which the “net investment” methodology may be used.
- FINRA should mandate identification of the service used to obtain the valuation under the “appraised value” methodology, and require semi-annual valuations.

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- FINRA should mandate that the third-party valuation expert or service must be truly *independent* from the issuer, and that issuers must include in their annual reports share valuations based on such analysis of audited financials including assets, liabilities, and operations of the program or REIT.

Thank you for your consideration.

Respectfully Submitted,

A handwritten signature in blue ink, appearing to read "Christine Lazaro". The signature is fluid and cursive, with the first name "Christine" and last name "Lazaro" clearly distinguishable.

Christine Lazaro
President