

September 24, 2015

*Submitted Electronically – e-ORI@dol.gov and e-OED@dol.gov*

Office of Regulations and Interpretations  
Office of Exemption Determinations  
Employee Benefits Security Administration  
U.S. Department of Labor  
200 Constitution Ave., NW  
Washington, DC 20210

**Re: Definition of the Term “Fiduciary” (RIN 1210-AB32);  
Best Interest Contract Exemption (ZRIN 1210-ZA25)**

Ladies and Gentlemen:

NorthStar Asset Management Group Inc. (“NSAM”) submits the following additional comments regarding the rule proposed by the U.S. Department of Labor (the “Department”), which would redefine who is a “fiduciary” by reason of providing investment advice for a fee or other compensation (the “Proposed Rule”) and the related proposed Best Interest Contract Exemption (the “BIC Exemption”).<sup>1</sup>

As NSAM noted in its letter to the Department dated July 21, 2015, NSAM is a member of the Investment Program Association (“IPA”) and concurred with the IPA’s initial comment letter. NSAM provides asset management and other services to a variety of traded and non-traded public companies, including entities defined as Public Products in the IPA comment letter, such as publicly registered, non-exchange listed real estate investment trusts (“Non-Listed REITs”) and publicly registered, non-exchange listed Business Development Companies (“Non-Listed BDCs”).

As an initial matter, NSAM strongly believes that the Department should take into account all of the comments received and testimony provided in connection with the Proposed Rule and the BIC Exemption and prepare and publish a re-proposed rule for public comment. Based on the large number of comments received and requests to testify before the Department, it is clear that the potential negative impacts of the Proposed Rule greatly exceed the Department’s understanding and expectations. As set forth in the comment letter submitted by

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<sup>1</sup> See Proposed Conflict of Interest Rule, 80 Fed. Reg. 21960 (proposed Apr. 20, 2015 (to be codified at 29 C.F.R. pt. 2550)); and Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21960 (proposed Apr. 20, 2015 (to be codified at 29 C.F.R. pt. 2550)).

the U.S. Chamber of Commerce on July 17, 2015, the Proposed Rule will have broad and far reaching consequences. Such dramatic changes merit careful consideration, with the ultimate goal being to adopt a rule that is effective and beneficial to investors, even if additional time is required to achieve that goal.

If the Department proceeds with the Proposed Rule and BIC Exemption without further public comment, NSAM respectfully asks that the Department: (1) reject the concept of a “legal list” in its entirety or (2) include Non-Listed REITs and Non-Listed BDCs in the definition of “Assets” eligible for the application of the BIC Exemption.

It is our understanding that the Department’s two primary concerns with including Non-Listed REITs and Non-Listed BDCs on the list of eligible Assets are transparency and liquidity. With the implementation of amended FINRA Rule 2340, FINRA’s customer account statement rule, effective April 11, 2016, we believe that the valuation of Non-Listed REITs and Non-Listed BDCs will sufficiently address the Department’s concerns about valuation transparency. With respect to liquidity, while we believe there are many benefits to non-listed products, including avoiding the volatility in the market unrelated to the actual performance of a company’s assets, NSAM is willing to consider enhanced liquidity features if permitted to do so by the regulations adopted by the Securities and Exchange Commission (“SEC”).

As discussed below, the Department’s concerns about Non-Listed REITs and Non-Listed BDCs can be adequately addressed through existing regulations alone, or in combination with the protections provided by the BIC Exemption. If Non-Listed REITs and Non-Listed BDCs are not eligible for the BIC Exemption, and there is no other applicable exemption, the impact would be to significantly restrict the range of investment options available to participants in most retirement plans and accounts.

## **I. The Department Should Reject the Concept of a Legal List.**

As numerous commenters have observed, it would cause harm to retirement plan investors to attempt to define in advance a list of investment products eligible for prohibited transaction exemptions. Attempts to require trustees to select investments from a statutory list of approved investments (“legal lists”) have not been successful. As a result, the drafters of Restatement (Third) of Trusts concluded that “[k]nowledge, practices, and experience in the modern investment world have demonstrated that arbitrary restrictions on trust investments are unwarranted and often counterproductive.”<sup>2</sup>

Indeed, the Department itself has previously recognized that it is not appropriate “to include in the [fiduciary] regulation any list of investments, classes of investment, or investment techniques that might be permissive under the ‘prudence’ rule. No such list could be complete; moreover, the Department does not intend to create or suggest a ‘legal list’ of investments for plan fiduciaries.”<sup>3</sup> Similarly, in the preamble to the proposed BIC Exemption, the Department

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<sup>2</sup> Restatement (Third) of Trusts, Ch. 17, Investment of Trust Funds (Introductory Note, Edward C. Halbach, Jr., Reporter); See, also, Jeffrey N. Gordon, *The Puzzling Persistence of the Constrained Prudent Man Rule*, 62 N.Y.U.L. REV. 52 (1987).

<sup>3</sup> 44 Fed.Reg. 31639 (June 1, 1976).

emphasized that it intended to adopt a “principles-based” or “standards-based” approach that “would flexibly accommodate a wide range of current business practices” while minimizing conflicts of interest.<sup>4</sup>

While we believe the existing regulatory framework adequately protects retirement plan investors, if the BIC Exemption is adopted, its ample disclosure requirements and enhanced investor protections should be sufficient to allow retirement plan investors to invest in any product that their financial advisors deem to be in their best interests. For example, the BIC Exemption explicitly requires disclosure of information relating to fees, compensation and material conflicts of interest. The BIC Exemption also requires a contractual agreement to adhere to impartial conduct standards, and the adoption of policies and procedures designed to mitigate material conflicts of interest. Further, BIC contracts would be subject to judicial enforcement.

There is no reason to preclude certain investment products from investors when they would be subject to such additional robust investor protections and disclosure requirements. Maintaining a “legal list” will restrict investor access to current and future products that have been, or may become, beneficial for ERISA accountholders. Dispensing with the concept of a legal list would provide retirement plan investors with more choice and opportunities for diversification while requiring the additional safeguards provided by the BIC Exemption.

## **II. New and Existing Regulations Provide Robust Transparency Requirements for Non-Listed REITs and Non-Listed BDCs, and the Additional Requirements Proposed by the IPA Should Satisfy the Department’s Concerns.**

### *New FINRA Regulation*

Recent changes to NASD Rule 2340 will sufficiently address the Department’s goal of greater transparency by imposing requirements for Non-Listed REITs and Non-Listed BDCs relating to the reporting of their share values on customer account statements and by requiring the material involvement and confirmation of such reported values by third-party valuation experts.<sup>5</sup> As described in FINRA Regulatory Notice 15-02, amended Rule 2340 (i) requires general securities members to provide estimated per share values on customer account statements based on either a net investment or appraised value methodology, (ii) shortens the time period before a valuation based on an appraisal is required to be disclosed and (iii) provides important additional disclosures to investors, including information about return of capital distributions, the non-listed status of the security, lack of liquidity and the potential that the investment may be sold for less than its estimated value.

NSAM believes that, in addition to providing enhanced disclosure regarding the value of a Non-Listed REIT and Non-Listed BDCs and providing such disclosure earlier, the amended

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<sup>4</sup> Proposed BIC Exemption, at 21961.

<sup>5</sup> See FINRA Regulatory Notice 15-02 (discussing how amended NASD Rule 2340 will provide two different options for calculating estimated per share values of products, such as Non-Listed REITs and Non-Listed BDCs, on customer account statements). Available at: [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Notice\\_Regulatory\\_15-02.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-02.pdf).

Rule 2340 will result in Non-Listed REITs and Non-Listed BDCs adopting additional compensation structures that can meet the needs of a wide variety of investors.

### *Existing SEC, FINRA and State Regulation*

As discussed in our prior comment letter, Non-Listed REITs and Non-Listed BDCs are registered with the SEC and are subject to the SEC's extensive and ongoing disclosure requirements during the course of their public offerings to investors and after such offerings have been completed. These disclosures include regular prospectus supplements and post-effective amendments to the registration statements for ongoing offerings, as well as annual and quarterly reports and current reports regarding material developments. Non-Listed REITs and Non-Listed BDCs are also subject to extensive regulation by state securities regulators, including a "merit review" of their offerings in most states.

In addition, broker-dealers offering investments in Non-Listed REITs or Non-Listed BDCs are also subject to additional product-specific disclosure requirements pursuant to FINRA Rule 2310. Prior to investing, Section (b)(3) of the Rule requires "that all material facts are adequately and accurately disclosed [to offerees] and provide a basis for evaluating the program."<sup>6</sup> In determining the adequacy of disclosure, FINRA sets minimum guidelines for broker-dealers, such as: "(i) items of compensation; (ii) physical properties; (iii) tax aspects; (iv) financial stability and experience of the sponsor; (v) the program's conflicts and risk factors; and (vi) appraisals and other pertinent reports."<sup>7</sup> In addition, FINRA Rule 2310 requires that a broker-dealer disclose to all offerees "all pertinent facts relating to the liquidity and marketability of the program or REIT."<sup>8</sup> This requirement results in Non-Listed REITs and Non-Listed BDCs including in their registration statements disclosure regarding the status of liquidity events for all prior public programs sponsored by the same sponsor. Moreover, FINRA Rule 2310 stipulates that a broker-dealer may not sell a publicly registered Non-Listed REIT or Non-Listed BDC security unless the issuer agrees to provide a valuation in its annual report (or other public filing).

### **III. Requiring Non-Listed REITs and Non-Listed BDCs to Provide Investors with Enhanced Liquidity Would Alleviate the Department's Concerns regarding Adding Non-Listed REITs and Non-Listed BDCs to the "Legal List" of Assets.**

As discussed in NSAM's July 21<sup>st</sup> letter, there are benefits associated with the lack of correlation to capital markets associated with Non-Listed REITs and Non-Listed BDCs, and retirement investors with a long-term investment strategy may rationally prefer REIT and BDC exposure not subject to daily market volatility. Moreover, Non-Listed REITs and Non-Listed BDCs typically have provisions that permit redemptions subject to certain limitations prior to the

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<sup>6</sup> See, e.g., Disclosures for Direct Participation Programs, which includes REITs discussed herein, Section (b)(3)(A) of FINRA Rule 2310, available at: [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=8469](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=8469).

<sup>7</sup> See, e.g., Disclosures, Section (b)(3)(B)(i)-(vi) of FINRA Rule 2310.

<sup>8</sup> Section (b)(3)(D) of FINRA Rule 2310.

date the Non-Listed REIT or Non-Listed BDC provides full liquidity to investors upon the consummation of a liquidity event (such as a stock exchange listing, sale or merger with an exchange-listed company or liquidation of assets). In fact, none of the NSAM-sponsored Non-Listed REITs has ever declined an investor's request for redemption. NSAM believes that these liquidity provisions are adequate for retirement plan investors.

#### *Potential Additional Liquidity*

To the extent the Department determines that existing liquidity provisions are inadequate, there are options available other than requiring Non-Listed REITs and Non-Listed BDCs to be listed, and subject to daily market fluctuation, or not offered to retirement plan investors at all. For example, additional provisions to mandate liquidity opportunities upon the occurrence of specific exigent circumstances may be workable.

Another possible approach would be to offer liquidity to investors with respect to a certain percentage of their overall investment on an annual basis even absent exigent circumstances. For example, the ability to redeem up to 10% of an investment at net asset value on an annual basis or other more flexible liquidity features would provide adequate liquidity for long-term, retirement plan investors, and we believe would be feasible for Non-Listed REITs and Non-Listed BDCs. Such a provision would require SEC approval, but subject to such approval, offering additional liquidity in this way would both cure the Department's concerns without restricting choice and diversification options for retirement plan investors.

#### **IV. Conclusion**

NSAM wishes to thank the Department for its consideration and its attention to this issue, which will have far-reaching consequences for the sponsors of Non-Listed REITs and Non-Listed BDCs. Again, this is a very complex issue with vast implications, as evidenced by the large number of issues and concerns raised by over 2,500 separate comments and two days of testimony. Such important and sophisticated issues should be resolved only after thorough evaluation and review. If the Department has any additional question, please do not hesitate to contact me directly.

Sincerely,

A handwritten signature in black ink, appearing to read "D R Gilbert". The signature is fluid and cursive, with the first name "D" being the most prominent.

Daniel R. Gilbert

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