ADISA™
ALTERNATIVE & DIRECT INVESTMENT SECURITIES ASSOCIATION
Education ▲ Networking ▲ Advocacy

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September 23, 2015

Via Electronic Mail
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Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue NW
Washington, D.C. 20210

Re: Proposed Fiduciary Rule (RIN 1210-AB32; 1210-ZA25) Hearings

Dear Sir or Madam:

The Alternative and Direct Investment Securities Association ("ADISA" or the "Association"), submits the following comments in relation to the Department's recent hearings on the re-proposed rule defining who is a "fiduciary" by reason of providing investment advice for a fee or other compensation to retirement savers and retirement accounts (herein, the "Fiduciary Rule"), as well as the related "Best Interest Contract" Exemption ("BICE" or "BIC Exemption"). ADISA appreciates the opportunity to have appeared at the hearings on August 13, 2015, on these important regulatory proposals (referred to collectively herein as the "Proposal").

Background

ADISA (f/k/a REISA, the Real Estate Investment Securities Association), is a national trade association whose members sponsor, manage and distribute alternative investments. These alternative investments include, but are not limited to non-listed real estate investment trusts ("REITS"), real estate partnerships, real estate income and development funds, tenant-in-common interests, oil and gas interests, equipment leasing, non-listed business development companies ("BDCs"), and other securitized real estate investments. The Association has more than 4,000 active members, who are key decision makers who represent investment professionals throughout the nation, including sponsors and managers of real estate and related offerings, broker-dealers, securities licensed registered representatives, registered investment advisers, investment adviser representatives, accountants, attorneys, mortgage brokers, institutional lenders, qualified intermediaries, real estate agents and real estate brokers.

Department Hearings on Re-Proposed Fiduciary Rule and the Proposed "Best Interests Contract" Exemption

During the period August 10 -13, 2015, the Employee Benefits Security Administration (the "Administration") held hearings on the Proposal. ADISA appreciated the opportunity to have appeared and provided testimony at the hearings. The Administration staff who presided over the hearings asked important questions and listened to the various persons who provided testimony. To this end, ADISA would like to follow up on one line of questions posed by the Administration's representatives to our panel (Panel #23), and provide some needed elaboration and clarification.

Specifically, Administration staffer Judy Mares asked the witnesses on panel 23 to "walk us through a typical non-traded REIT in terms of what its structure is, how investors get visibility into the assets, and how the assets are valued and managed and the different oversights of the fees and that process." Ms. Mares also asked a number of follow up questions in response to information elicited by her initial questions. Although the panel members addressed various aspects of her inquiry, ADISA would like to address the related issue of how non-traded alternatives work from a broader perspective. Our goal is to have the Administration understand that non-traded alternatives are eligible for purchase by and are in fact already included in the portfolios of large and small client accounts alike, and are not reserved for and their use not limited to the select, high balance accounts of well-to-do retirement savers.

In brief, and as we set forth in our initial comment letter on the Proposal, alternative investments such as non-listed REITs and non-listed BDCs (as well as other direct participation programs), are important to and represent valuable components of a diversified portfolio for all manner of savers, including retirement savers who invest through an individual retirement account ("IRA").

1. <u>Description of Non-Listed REITs, BDCs and other Direct Participations Programs</u>

a. Non-Listed REITs

Non-listed REITs are investment vehicles that directly invest in real estate on a tax advantaged basis. Investors receive periodic cash distributions constituting a return of capital and a portion of a REIT's taxable income. Non-listed REITs own, manage and lease investment-grade, income-producing commercial real estate in nearly all property sectors, including office, industrial, apartment, retail, health care, self-storage, data center and hotel. They are also subject to various IRS requirements to avoid or minimize corporate tax, including distributing at least 90 percent of taxable income to shareholders annually.

Offers and sales of interests in publicly-offered REITs are registered under the Securities Act of 1933, as amended (the "1933 Act"), regulated by FINRA, and must comply with robust state requirements. In addition, listed and non-listed REITs are subject to the reporting and disclosure requirements of the Securities Exchange Act of 1934, as amended (the "1934 Act"), including the filing of quarterly, annual and current reports, proxy statements and other required items, all of which are publicly available through the SEC's EDGAR database.

b. Non-Listed BDCs

Non-listed BDCs are investment vehicles that invest in the equity or debt of private companies and small public companies. BDCs generally make investments in private or thinly-traded public companies in the form of long-term debt and/or equity capital, with the goal of generating current income or capital growth. Investors typically receive periodic cash distributions that may include dividends. A non-listed BDC may ultimately choose to list, merge or sell its assets.

BDCs are a special category of investment company under the 1940 Act that was added by Congress to facilitate the flow of capital to private companies and small public companies that do not have efficient or cost-effective access to public capital markets or other conventional forms of corporate financing. BDCs are closed-end funds that elect to be regulated as BDCs under the Investment Company Act of 1940 (the "1940 Act"). Publicly-offered BDCs are subject to certain provisions of the 1940 Act as well as the 1933 Act and the 1934 Act as well as corollary state regulations. BDCs may qualify to elect to be taxed as regulated investment companies for federal tax purposes.

c. Other Direct Participation Programs

Direct participation programs, as defined in FINRA Rule 2310, include other publicly registered products which focus on a variety of asset-based and business lending areas, such as oil and gas, equipment leasing and impact lending. These products are regulated by the SEC and FINRA as well as being subject to state securities regulations, including guidelines adopted by the North American Securities Administrators Association.

In particular, public non-listed oil & gas/energy partnerships provide individual investors with the opportunity to own interests in partnerships or limited liability companies which own oil and gas reserves or producing or non-producing properties. Investors receive cash distributions from income generated through the sale of oil and gas. These partnerships are designed to mitigate for investors the volatility of traded energy securities markets while providing the potential benefits of energy asset ownership and diversification with securities which have low correlations to financial asset markets. Interests in oil & gas partnerships are registered under the 1933 Act.

2. Characteristics of Non-Listed REITs and BDCs and other Programs

As a general matter, these investment programs and products share the following characteristics:

- They can provide income and inflation protection, as well as capital growth.
- They provide investors with the opportunity to diversify their financial asset holdings and improve their risk/return profile by investing in real assets or portfolios of private debt and equity.
- They provide investors with the opportunity to own exposure to assets which have low correlations with exchange-traded financial products, thereby reducing portfolio risk.
- Due to industry developments and regulatory changes, they provide improved liquidity, transparency and valuation discovery, and offer enhanced governance and professional management.
- They are subject to extensive regulation at the federal and state level.

Most importantly, with these characteristics, they have established themselves as integral components of investment and retirement accounts for millions of investors, including retirement savers and accounts.

3. Importance of Non-Listed "Alternative" Investment Products for all Investors

As noted during the recent hearings, so-called "alternative" investments are only a small part of the universe of available investment products.[1] We acknowledge this to be generally true, but the fact remains that the "alternative" nature of these products (that is, they are an "alternative" to stocks, bonds and cash), is the very reason these investment products are important for long-term investors (and particularly young savers with a long investment horizon).

Younger generations appear to have a strong interest in alternatives: According to one survey, 78 percent of Millennials and 70 percent of Gen Xers endorse using alternatives, compared with only 58 percent of boomers.[2] While we do not know the exact source of this interest in alternatives – it could be due to the volatility of the stock market, their knowledge of different investment types, or perhaps their lack of concern about liquidity because of their longer investment horizons (or some combination of these factors) - we do know that the smaller investor wants more of the investment strategies that have long been within the exclusive domain of the wealthy.

4. Potential harm if personal financial advice is discouraged

The hearings explored in part the issue of whether financial advisors are important to savers that want to invest in non-listed and other alternatives. Most alternative investment products are available primarily or even exclusively through a financial intermediary. If access to financial advice and financial advisers working on the traditional commissioned basis is curtailed by the elements contained in the Proposal, access to non-traded alternatives will be curtailed.

Data collected by Equifax and analyzed by Oliver Wyman[3] indicate that those making less than $100,000 per year turn to financial advisors during times of economic stress in order to address or even ameliorate the effects of listed market downturns. Restricting financial advice would amplify the exposure of low and moderate level retirement accounts to the vagaries of the market because of the attendant lack of needed diversification that would otherwise be accessed available via alternative investments purchased through financial advisors. So-called "robo advisers" simply cannot adequately sell or represent non-traded investment products; it might even be reckless to encourage such an approach.

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[1] Ms. Mares noted that approximately 96% of available investment products, in the Administration's view, do not fall into the alternative category.
[2] Durable Portfolio Construction (Natixis Global Access Management Survey 2014).
[3] From Equifax data, during the Recession and its aftermath, the ratio of advised to non-advised IRA assets in accounts for those making less than $100,000 per year grew by over 20% (Oliver Wyman, 2015).

5. <u>Conclusion</u>

At bottom, the potential benefits of alternative investments, including non-listed REITs and BDCs but also oil & gas partnerships and other direct participation programs, are well known in financial and academic circles. They can and often do provide significant advantages to holders thereof, including diversification, non-correlation and high income. These investments are typically sold to investors by their licensed and regulated financial advisers, who take the time to understand and explain the products and their potential benefits to investors. For retirement savers, especially young workers, the illiquid nature of these products is not a negative factor, as they can afford to wait for down-the-road liquidity and are in a position to capture any available "illiquidity premium" in the meantime. It is particularly important to ensure that long term savers – especially those in tax advantaged retirement accounts – can have access to investments that match up with their long term time horizons.

In closing we again express our thanks for the opportunity to comment on the Proposal and to elaborate on several key points discussed during the recent hearings. ADISA is eager to help in any way and to discuss our comments further at your convenience.

Sincerely,

Thomas Voekler (Kaplan Voekler Cunningham & Frank), ADISA President

<u>Drafting Committee</u>:
John H. Grady (RCS Capital), ADISA Vice President and Legislative & Regulatory Committee Chair
John Harrison (ADISA Executive Director/CEO)