LPL Financial

Stephanie L. Brown
Managing Director
General Counsel

One Beacon Street, 22nd Floor
Boston, MA 02108-3106
stephanie.brown@lpl.com
617 897 4340 *office*
617 556 2811 *fax*

9785 Towne Centre Drive
San Diego, CA 92121-1968
858 909 6340 *office*
858 646 0609 *fax*

VIA ELECTRONIC MAIL

November 12, 2011

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: FINRA Regulatory Notice 11-44 ("Request for Comment")

Dear Ms. Asquith:

We appreciate the opportunity to comment on the proposed amendments to NASD Rule 2340 ("Proposed Rule") addressing values of unlisted direct participation programs ("DPPs") and real estate investment trusts ("REITs") in customer account statements. The Proposed Rule would limit the time period that the offering price may be used as a basis for a per share estimated value to the period provided under Rule 415(a)(5) of the Securities Act of 1933 ("Initial Offering Period"). The Proposed Rule also would require firms to deduct organization and offering expenses from the per share estimated values during the Initial Offering Period. The Proposed Rule would further prohibit a firm from using a per share estimated value, from any source, if it "knows or has reason to know the value is unreliable," based upon publicly available information or nonpublic information that has come to the firm's attention. Finally, the Proposed Rule would allow a firm to omit a per share estimated value on a customer account statement if the most recent annual report of the DPP or REIT does not contain a value that complies with the disclosure requirements of Rule 2340.

As stated below, while we are fully supportive of FINRA's goals of providing greater transparency to DPP and REIT investors, there are several aspects of the Proposed Rule that we believe should be modified to better serve investor interests. We commend FINRA's attempts to provide REIT and DPP investors more frequent appraisals and believe that this will serve as the primary driver to enhanced investor understanding of the products' overall performance. We also believe that improved disclosure surrounding the price displayed on customer account statements during the Initial Offering Period is the appropriate manner in which to address the valuation of the security prior to full appraisals. However, we believe that efforts to regulate DPP and REIT products are better directed at the issuing entities and that attempting to regulate DPP and REIT practices indirectly through retail distribution channels is inefficient and potentially costly.

I. Introduction

LPL Financial LLC ("LPL") is one of the nation's leading diversified financial services companies and is registered with the SEC as both an investment adviser and broker-dealer. LPL currently supports the largest independent registered representative base,[1] (referred to herein as "financial advisors") and the fifth largest overall registered representative base in the United States, providing financial professionals with the front, middle, and back-office support they need to serve the large and growing market for brokerage services and independent investment advice, particularly in the market of investors with $100,000 to $1,000,000 in investable assets. As of September 30, 2011, brokerage and advisory assets totaled $316 billion, of which $96.3 billion was in advisory assets. LPL self-clears its transactions and maintains custody of its brokerage client customer accounts.

In 2010, LPL sold in excess of $800 million in REITs and DPP products. We believe that REITs and other DPP products offer investors' exposure to a non-traditional asset class that can diversify a portfolio through a security less correlated to the overall market.

II. Presenting Per Share Estimated Value, Net of Organization and Offering Expenses

Under the Proposed Rule, FINRA would require that all DPP and REIT per share estimated values that appear on customer account statements, including those that are based on the offering price, reflect the deduction of all organization and offering expenses. FINRA's stated purpose of this requirement is based off of the presumption that "the netting out of the offering expenses is likely to be a closer approximation to the intrinsic value, particularly since the up-front fees and expenses reduce the amount of the investable capital during the ramp-up period when the assets are acquired by the DPP or REIT."[2] While LPL is supportive of the conceptual notion of deducting the sales commission from the public offering price, we believe that the issue is best solved through enhanced disclosure and through requirements for more frequent appraisal as described below, and suggested by FINRA in the Proposed Rule. Notably, the $10 per share public offering price that currently is displayed during the Initial Offering Period is an arbitrary number. It is used primarily because it represents a simplistic and easily calculable number from which investors can effortlessly determine yield and unit interests in the issuance. Because the $10 public offering price is not a reflection of the net asset value of the security – subtracting organizational and offering expenses from this arbitrary number to create a second arbitrary number fails to properly address the issue – *i.e., that the net asset value of the security is not calculable until the assets have been invested.*

Moreover, it should be noted that many REIT and DPP products are designed as longer-term yield producing products where the capital appreciation of the underlying securities is of secondary importance. The proposed change to a new offering price may have the unintended consequence of changing this dynamic and of arbitrarily increasing the yield - thus making the product seem more attractive than it otherwise may appear. In addition, because of the additional manners in which a REIT may be purchased and sold (such as through dividend

[1] Investment Advisor's Top 25 Independent Broker/Dealers, *Investment Advisor*, June 2010.
[2] FINRA Regulatory Notice 11-44, September 2011.

reinvestment plans, volume discounts and repurchase plans), the creation of a new arbitrary and more complicated "value" may lead to greater investor confusion.[3]

While at first glance the deduction of the organizational and offering expenses may seem akin to the deduction of sales charges from the public offering price afforded other securities – the comparison is not analogous. The Proposed Rule requires deduction of more than sales charges and includes issuer expenses (which may decrease depending on the size of the capital raise), underwriting compensation and due diligence expenses. For instance, the due diligence fees paid to the broker-dealer from a REIT, while charged up-front, are not a distribution expense and instead are paid to provide broker-dealers the resources necessary to *initially* and *continuously* perform due diligence on the product on behalf of investors throughout the offering period of the REIT or DPP. Other products do not deduct these expenses from the public offering price (for instance broker-dealers perform ongoing due diligence of mutual funds – the fees for which may be indirectly derived from the expenses of the mutual fund that are reflected in the expense ratio of the fund). Finally, it should be noted that many investors could invest directly with a REIT issuer or alternatively could make the investment through their brokerage relationship. It would be confusing and inequitable were an investor to receive a statement from the broker-dealer reflecting a different arbitrary number than the statement they received from the issuer who is not bound by FINRA's rules.

We therefore respectfully request that while other elements of the Proposed Rule are promising efforts to increase transparency, that this aspect of the Proposal be reexamined. In its place, LPL would encourage FINRA to support efforts to increase customer awareness of the valuation issue of the Initial Offering Period and the organizational and sales charges imposed by REITs and DPPs. This could be accomplished by enhancing disclosure through both point of sale and customer account statement disclosures. Investors should have full knowledge of the sales charges being paid to their financial advisor and customer account statements should indicate that the price displayed does not represent a net asset value of the security.

III. Close of Initial Offering Period and Appraised Values

As indicated above, while we harbor concerns regarding the proposed change from the $10 fixed price used during the Initial Offering Period, LPL is supportive of changes to the frequency of required appraisals. The Proposed Rule would require that after the Initial Offering Period customer account statements only reflect per share estimated values based off of an appraisal of assets, liabilities and operations of the DPP or REIT that is derived from data no less current than the most recent annual report.

LPL is in agreement that more frequent *independent* appraisals will benefit investors and will provide at least a point in time static valuation of the security. Importantly, while the cost of more frequent appraisals is not insignificant, we believe that the benefits to the investing public of greater transparency outweigh those costs. LPL would continue to recommend that disclosure accompany any such "value" to explain that the REIT valuation is static, may not represent the liquidation value of the security and is not reflective of a true net asset value (*i.e.*, it would not

[3] I.e., investor public offering prices may differ from investor to investor.

reflect the expected return of future dividends that a fixed income security trading on the market may reflect).

IV. Reliability of Estimated Values

While LPL applauds FINRA's efforts at providing additional safeguards to investors regarding the valuation of REITs and DPPs, we believe that FINRA's efforts at directing broker-dealers to revise the price or display a price as unavailable (and the reasons why it is unavailable) on a customer account statement is misdirected. Broker-dealers lack the requisite information necessary to make accurate valuation judgments and would be substituting their own imprecise and uninformed valuation in place of the issuer's judgment. In addition, if the burden to monitor the price is imposed on broker-dealers with imprecise and incomplete information, broker-dealers will be exposed to significant litigation risk. Because it would be easy to second guess with hindsight the valuation decision of the broker-dealer, we believe that broker-dealers may elect to remove the price altogether to mitigate this risk – a result that would lead to even greater customer confusion. We believe that direct rulemaking directed to REIT and DPP issuers by their functional regulator would be more effective and that broker-dealers should be able to rely upon the issuer's annual appraisal values provided adequate disclosure is provided to investors as described above.

V. Conclusion

Thank you for the opportunity to comment on the Proposed Rule. Should the Proposed Rule (or parts thereof) be adopted, LPL would strongly encourage FINRA to clarify how such a rule would apply to REITs and DPPs that have already been issued or that may have recently entered their Initial Offering Period. LPL believes that these grandfathering issues could be substantial and may require systemic changes that may carry significant operational costs and we encourage FINRA to take these concerns into careful consideration. Finally, several industry initiatives had already begun prior to FINRA's proposal. Several of these initiatives address the very concerns raised in the Proposed Rule. LPL would encourage FINRA to permit these industry initiatives to develop and to preempt the progress that is occurring through this rulemaking. If you have any questions regarding this letter, please do not hesitate to contact me at (617) 897-4340.

Sincerely,

Stephanie L. Brown

cc: Kathy VanNoy Pineda
Chief Compliance Officer