Institute for Portfolio Alternatives

June 18, 2025

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1700 K Street, NW
Washington, D.C. 20006
pubcom@finra.org

***RE: Regulatory Notice 25-06 (the "Notice")***

Dear Ms. Mitchell:

The Institute for Portfolio Alternatives (the "IPA") appreciates the opportunity to comment on the Notice. The IPA represents sponsors and distributors of alternative investments, including net asset value ("NAV") REITs and business development companies ("BDCs"), lifecycle REITs and BDCs (REITs and BDCs that are not continuously offered but do maintain share repurchase programs), interval funds, tender offer funds and regulated distributors of private placement securities.[1]

In the Notice, FINRA requests comment on Rule 2310 and Rule 5110, and "on any of its rules, guidance or processes that may impose barriers to capital raising."[2] The Notice follows two other recent notices regarding capital formation, Regulatory Notice 23-09 and Regulatory Notice 24-17, the latter notice having proposed amendments to Rule 5110, Rule 5121, and Rule 5123.

This letter supplements and does not replace our comment letters to those earlier notices. In particular, as we stated in our March 20, 2025 comment letter to Regulatory Notice 24-17, we recommend that FINRA clarify proposed Supplementary Material .05 to Rule 5110, by (1) establishing a self-operating safe harbor, rather than one subject to

[1] For 40 years, the IPA has advocated for increased investor access to alternative investment strategies with low correlation to equity markets as part of a diversified portfolio and subject to effective investor protections. These strategies include real estate, public and private credit, and other real assets through investment vehicles such as REITs, BDCs, closed end funds, interval funds and private placements. With over $500 billion in capital investments, these portfolio diversifying investments are a critical component of an effectively balanced investment portfolio and serve an essential capital formation function for our national, state, and local economies.

[2] Notice at 3.

FINRA staff discretion, (2) providing that a capitalization transaction occurring before the issuer has material assets will be deemed to occur at or above NAV, and (3) extending the safe harbor to any capitalization transaction meeting the conditions of the Supplementary Material, regardless of when it occurs during the life of the NAV REIT or BDC—not only capitalization transactions made before or at the time of the initial offering.

We also continue to recommend that the Corporate Financing Department improve the efficiency of its filing program and reduce unnecessary costs to members, by streamlining its process for reviewing NAV REIT and BDC filings under Rule 5110 and Rule 2310. For example, we continue to recommend that the Department permit sponsors to provide a statement that the REIT or BDC has a charter provision designed to ensure compliance with the underwriting caps, rather than an itemized list of all potential sources of underwriting compensation.

The IPA's detailed comments on the Notice are as follows:

1. **The IPA Recommends that FINRA Level the Playing Field for NAV REITs and BDCs with Tender Offer Funds and Interval Funds.**

NAV REITs and BDCs compete directly with tender offer funds and interval funds that invest in similar asset classes. When broker-dealers evaluate alternative investments for their clients—whether for portfolio diversification, income generation, or inflation hedging—they are typically considering NAV REITs, BDCs, tender offer funds and interval funds.

Regulation Best Interest ("Reg BI") requires broker-dealers to recommend the product that is in the retail customer's best interest. FINRA's current compensation framework creates an uneven playing field among product types that may inadvertently influence a recommendation.

NAV REITs and BDCs face stricter compensation caps under Rule 2310 compared to the more flexible caps applicable to tender offer and interval funds under Rule 2341. Specifically, NAV REITs and BDCs must file offerings under Rule 5110 and comply with Rule 2310's 10% cap on total compensation. This cap applies to each registered offering, which typically lasts three years under SEC rules. In contrast, tender offer and interval funds are governed by Rule 2341, which limits sales charges and servicing fees based on gross new sales and average annual net assets. As a result, tender offer and interval funds can offer higher broker-dealer compensation over time. This means that so long as they continue to grow, tender offer and interval funds will never hit the compensation cap, while NAV REITs and BDCs are all but certain to hit the cap.

For example, a $20 billion NAV REIT conducting a $100 million offering would face a $10 million compensation cap under Rule 2310. A comparable tender offer fund could offer compensation as high as 6.25% of gross new sales indefinitely, plus annual service fees of 0.25% of average net assets. This disparity disadvantages NAV REITs and BDCs, undermining competitive fairness.

There is no policy justification for this unequal treatment. NAV REITs and BDCs offer similar investment portfolios and robust repurchase programs comparable to tender offer funds' discretionary tender offers. Moreover, NAV REITs and BDCs meet conditions similar to those required for tender offer funds under Rule 2341, including continuous offerings, regular share pricing, and frequent repurchases.

To promote competitive fairness and encourage capital formation, the IPA recommends that FINRA align the compensation caps for NAV REITs and BDCs with those for tender offer funds and interval funds.

## 2. The IPA Recommends a Retrospective Review of Rule 2310.

FINRA has not taken a comprehensive look at Rule 2310 in almost two decades, and we encourage FINRA to review and modernize the rule. For example, Rule 2310(b)(2) imposes a suitability standard on the recommendation of a direct participation program ("DPP") without any recognition of the Securities and Exchange Commission's ("SEC") adoption of Reg BI.

The IPA continues to recommend that FINRA clarify that Rule 2310(b)(2)(C) does not apply to a FINRA member who only executes the purchase of an offered DPP upon the order of another financial intermediary without recommending the purchase to the intermediary's customer.

FINRA Rule 2310(b)(2)(A) prohibits any member or associated person from underwriting or participating in a public offering of a DPP unless the DPP has established suitability standards under paragraph (B). Paragraph (B) elucidates the suitability standards applicable to a member or associated person "recommending" a DPP transaction to a "participant," which the rule separately defines to be one who purchases the DPP.[3]

FINRA Rule 2310(b)(2)(C) states, "[n]otwithstanding the provisions of subparagraphs (A) and (B) hereof, no member shall execute any transaction in direct participation program [sic] in a discretionary account without prior written approval of the transaction by the customer." This provision requires that for discretionary accounts, the member have prior written approval of the transaction by the customer before it can complete the purchase of a DPP interest.

[3] Rule 2310(a)(13).

We believe paragraph (C) should not be read in isolation as pertaining to *any* member, even one who does not recommend that DPP purchase. Rather, the text, purposes, and history of this provision imply that paragraph (C) is related to paragraphs (A) and (B). This reading is indicated by the prefatory language in paragraph (C), "notwithstanding the provisions of subparagraphs (A) and (B) hereof." Paragraph (C) is an exception to paragraphs (A) and (B), which concern only FINRA members who recommend DPP securities. Neither paragraph (A) nor paragraph (B) refers to a broker-dealer who does no more than execute the transaction.[4]

The history of Rule 2310 supports this reading. A predecessor to this rule was Appendix F to Article III, Section 34 of the Rules of Fair Practice, adopted in 1982, which applied only to a member "recommending" a DPP interest.[5]

Nevertheless, we understand that the FINRA staff interprets paragraph (C) to generally prohibit a member's execution of any DPP transaction in a discretionary account. This reading prevents "turnkey" platforms such as those offered by some FINRA members, from acting solely as the broker-dealer of record to execute a DPP transaction on behalf of registered investment advisers. These FINRA members must obtain written documentation with express affirmative instructions from the shareholder to purchase the DPP securities before the platforms could process the DPP trade, even when the investment adviser's customer has already contractually given discretionary trading authority to the investment adviser.

This application of paragraph (C) provides no additional investor protection, since the investment adviser who recommends that DPP security is under a fiduciary standard under federal or state regulation. Under FINRA's interpretation of paragraph (C), registered investment advisers (whom FINRA does not regulate, of course) must disregard the previously expressed intentions of their clients, that the adviser act in a discretionary capacity on their behalf and must obtain new written client authorization before every DPP purchase. This expectation creates confusion for investors who have granted discretionary investment authority to investment advisers and are accustomed to having the investment adviser execute transactions without specific notice or execution of documents.

The IPA recommends that FINRA clarify that Rule 2310(C) applies only to members who recommend DPP securities under paragraph (B), and not to execution-only broker-dealers. If FINRA does not believe that it can issue such an interpretation, then we

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[4] If paragraph (A) refers to an execution-only broker, then its reference to paragraph (B) makes no sense, since paragraph (B) refers only to broker-dealers who recommend DPP securities.

[5] *See, e.g.,* NASD Notice to Members 84-53, https://www.finra.org/rules-guidance/notices/84-53.

recommend that FINRA amend the rule accordingly. This recommendation will reduce unnecessary compliance costs and facilitate capital formation by DPPs.

### 3. The IPA Recommends that FINRA Allow Limited Use of Projected Performance.

FINRA Rule 2210 generally prohibits the presentation of performance projections and targeted returns. Paragraph (d)(1)(B) prohibits the presentation of any "promissory" statement or claim in any communication. Under paragraph (d)(1)(F), communications may not "predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast."

In 2023, FINRA proposed to amend the prohibition on projected performance and targeted returns. The SEC's Division of Trading and Markets, acting on delegated authority, approved the rule change. On July 26, 2024, however, the Commission stayed the action and has taken no action since.

The amendments would have created an exception in Rule 2210 from the prohibition on the communication of projected performance or targeted returns for certain institutional communications and communications to qualified purchasers under the Investment Company Act of 1940 and knowledgeable employees about certain private placements. The amendments would have resembled the requirements of the SEC's marketing rule for investment advisers. The proposal would have ensured that investors are better informed, would have conferred important investor protections, and would have harmonized communications requirements that apply to the broker-dealer and investment adviser businesses of dually registered firms. For that reason, the IPA supported FINRA's 2023 proposal.[6]

At the same time, the IPA respectfully recommends that FINRA adopt a broader exception to the general prohibition. The expected or targeted return from a private investment program is material to an investor, as it essentially represents the "price" of the deal. The projected cash-on-cash return for a business investment, the distribution yield for a real estate program, and the internal rate of return for private equity funds are vital to any understanding of these programs. They help investors evaluate the benefits of the program, the nature of the issuer's projections, and whether the program can accommodate the investor's needs. In fact, they are useful to evaluate the *risk* of a product. A higher-than-average distribution yield, for example, could imply that a higher risk premium has been imbedded into the calculation of projected yield.

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[6] *See* https://www.sec.gov/comments/sr-finra-2023-016/srfinra2023016-314439-819782.pdf.

The IPA recognizes FINRA's longstanding concern with the use of performance projections in a manner that could mislead investors. We also appreciate that FINRA and other regulators have had to address, by enforcement action and rulemaking, the poor sales practices of some members when conducting private placements. Nevertheless, there is room for sensible accommodation of the need for members and their customers to consider projected returns of private investment programs.

As FINRA is aware, Reg BI imposes an obligation on FINRA members to act in their retail customers' best interest when recommending a securities transaction or investment strategy involving securities. Under Reg BI, the member must exercise reasonable diligence, care and skill and must disclose the material fees and costs associated with a recommended transaction.

Members participating in a nonexempt private placement must file the private placement memorandum and retail communications with FINRA under Rules 5122 and 5123. FINRA's Corporate Financing Department considers whether the member appears to have conducted a reasonable investigation of the issuer. FINRA expects its members to adopt supervisory procedures that are "reasonably designed to ensure that each private placement offering is properly supervised before it is marketed to other members or sold directly to customers."[7] A positive consequence of this regulatory oversight has been FINRA's observation that some broker-dealers have adopted good practices by which they discharge their responsibilities when recommending private placements.[8]

Rule 2210 operates as if these regulatory programs do not exist. A FINRA member who conducts rigorous due diligence, concludes that the investment would be in a customer's best interest, and discloses the costs, fees, and risks to the customer, may not present reasonable issuer projections in any written communication to the customer (outside of FINRA's limited exceptions).

In light of the investor protections provided by Reg BI and FINRA's private placement filing program (as applicable), we recommend that FINRA permit the presentation of projected performance or targeted returns in *any communication related to the recommendation by a member of a private placement.* We also recommend that this exception to the general prohibition be subject to the other requirements in FINRA's proposed amendment:

- The member must adopt and implement written policies and procedures reasonably designed to ensure that the communication is relevant to the likely

[7] Regulatory Notice 23-08, https://www.finra.org/rules-guidance/notices/23-08.

[8] *Id.*

financial situation and investment objectives of the investor receiving the communication and to ensure compliance with all applicable requirements and obligations.

- The member must have a reasonable basis for the criteria used and assumptions made in calculating the projected performance or targeted return and retain written records supporting the basis for such criteria and assumptions.

- The communication must prominently disclose that the projected performance or targeted return is hypothetical in nature and that there is no guarantee that the projected or targeted performance will be achieved.

- The member must provide sufficient information to enable the investor to understand (1) the criteria used and assumptions made in calculating the projected performance or targeted return, including whether the projected performance or targeted return is net of anticipated fees and expenses; and (2) the risks and limitations of using the projected performance or targeted return in making investment decisions, including reasons why the projected performance or targeted return might differ from actual performance.

This rule change would ensure that investors are protected by unwarranted or exaggerated projections of performance or targeted returns. FINRA would retain its existing prohibition of performance projections in situations that present the greatest risk, broadly circulated marketing material that is unrelated to a member's best interest determination. Moreover, registered principals would have to approve communications with projected performance under Rule 2210(b)(1). Retail communications that promote or recommend nonexempt private placements still would have to be filed under Rules 5122 and 5123.

For these reasons, we recommend that FINRA permit the presentation of projected performance or targeted returns in any communication related to the recommendation by a member of a private placement, subject to the conditions of FINRA's 2023 proposal.

### 4. The IPA Recommends that FINRA Reconsider its Filing Fee Increase.

Last November FINRA adopted dramatic increases in its fees associated with the filing of public offerings under Rule 5110.[9] The fee increase will go into effect on July 1, 2025.

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[9] FINRA also adopted fees related to its private placement filing program under Rule 5122 and Rule 5123.

These fee increases appear to be directed to corporate filers for whom Rule 5110 is primarily designed. We are concerned that FINRA may not have given due consideration to the effect of such a dramatic fee increase on noncorporate filers such as NAV REITs and BDCs. For non-WKSI filers, such as NAV REITs and BDCs, the maximum fee will increase from $225,500 to $1,125,000—an almost fivefold increase.

In recent years, NAV REIT and BDC sponsors have turned increasingly to the private markets. The aggregate NAV of privately placed REITs at the end of 2024 reportedly was $18.3 billion—16.5% of the $111.4 billion non-listed REIT market. Similarly, the aggregate NAV of privately placed BDCs at the end of 2024 reportedly was $56.3 billion—37.0% of the $152.1 billion non-listed BDC market.[10]

FINRA's decision to increase its public offering filing fee by as much as five times will encourage further migration to the private markets. We recommend that FINRA readjust its public offering filing fee so that any increase is more gradual, which will support continued capital raising in the public markets.

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Thank you for the opportunity to comment on the Notice. Please send questions about our comments to Jeff Evans, IPA's director of government affairs and policy, at jevans@ipa.com.

Sincerely,

Anya Coverman
President and CEO

[10] Robert A. Stanger & Company, Inc.