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July 21, 2015

VIA Email: [e-ORI@dol.gov](mailto:e-ORI@dol.gov) and [e-OED@dol.gov](mailto: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:

Thank you for the opportunity to review the Department’s regulatory package expanding the definition of fiduciary investment advice and preventing conflicts of interest in advice provided to ERISA-covered retirement plans and Individual Retirement Accounts (“IRAs”).

We share the Department’s goal of improving the quality of investment advice provided to plans, plan participants and IRA owners. Retirement investors should receive advice in their best interests. We believe that this goal is best achieved without limiting retirement investors’ access to the full range of investment products and services available to plans and IRAs.

One of the legal obligations of a prudent investment fiduciary is to diversify investments within the investment portfolio, taking into account the role various asset classes play within the portfolio’s investment strategy.<sup>1</sup> Preserving the ability of retirement plan investors and their advisors to construct portfolios from a wide array of asset classes, including a broad range of real estate investments, is vitally important to proper diversification

**About REITs:**

REITs were established by Congress in 1960 to enable all Americans to enjoy the benefits of investment in real estate. There are two main types of REITs, generally referred to as equity REITs and mortgage REITs. Equity REITs invest in “bricks and mortar” real estate by acquiring leasable space in properties, such as apartments, shopping malls, office buildings, and other properties, and collecting rents from their tenants. Mortgage REITs primarily invest in

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<sup>1</sup> See ERISA §404(a)(1)(C) and 29 CFR §2550.404a-1(b).



mortgages and mortgage-backed securities, providing financing for residential and commercial properties. More than 2 million single-family homes are estimated to be currently financed by mortgages owned by mortgage REITs.

REITs in the United States may be public companies whose securities are registered with the Securities and Exchange Commission (SEC) and listed on a stock exchange (so-called Listed REITs); public companies whose securities are registered with the SEC, but which are not listed on a stock exchange (so-called, “Public Non-Listed REITS” or PNLRs); or private companies<sup>2</sup>. At the end of June 2015, 327 REITs were registered with the SEC, and 229 of these REITs were Listed REITs on U.S. stock exchanges, primarily the New York Stock Exchange (NYSE).

Like Listed REITs, PNLRs own, manage and lease investment-grade, income-producing commercial real estate in nearly all property sectors. PNLRs are subject to the same IRS requirements that a Listed REIT must meet, including distributing all of their taxable income to shareholders annually to be subject to just one level of taxation. In addition, PNLRs are required to make regular SEC disclosures, including quarterly and yearly financial reports. All of these PNLR filings are publicly available through the SEC’s EDGAR database. PNLRs are primarily sold by broker-dealers registered with and regulated by the SEC, the Financial Industry Regulatory Association (FINRA), and the relevant state securities regulatory authorities.

### **About NAREIT:**

The National Association of Real Estate Investment Trusts (“NAREIT”) is the worldwide voice for REITs and real estate companies with interests in U.S. real estate and capital markets. NAREIT’s members are REITs and other real estate businesses throughout the world that own, operate and finance commercial and residential real estate.

PNLRs participate at NAREIT through the Public Non-Listed REIT Council (the “PNLR Council”), which consists of 44 NAREIT PNLR corporate members. The mission of the PNLR Council is to advise NAREIT’s Executive Board on matters of interest and importance to PNLRs.

NAREIT’s PNLR Council has carefully reviewed the proposed regulation redefining fiduciary investment advice under ERISA §3(21)(A)(ii) (the “Proposal”),<sup>3</sup> and the new proposed prohibited transaction class exemption, the

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<sup>2</sup> Private REITs are not traded on stock exchanges or registered with the SEC. They are regulated by the SEC, and are sold to accredited investors under Regulation D and to qualified institutional buyers (QIBs) under Rule 144A.

<sup>3</sup> 80 Fed. Reg. 21,928 (Apr. 20, 2015).



Employee Benefits Security Administration

July 21, 2015

Page 3

Best Interest Contract Exemption (the “BIC Exemption”),<sup>4</sup> and has developed the attached comment letter for submission and consideration by the Department.

NAREIT and its PNL Council look forward to working with the Department as it continues its work on this important regulatory project, and we would be pleased to answer any questions the Department may have.

Please feel free to contact me if you would like to discuss our positions in greater detail.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "S.A. Wechsler". The signature is fluid and cursive, with a long horizontal stroke at the end.

Steven A. Wechsler  
President & CEO

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<sup>4</sup> Id at 21,960.



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**VIA Email:** [e-ORI@dol.gov](mailto:e-ORI@dol.gov) and [e-OED@dol.gov](mailto:e-OED@dol.gov)

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

Ladies and Gentlemen:

The Public Non-Listed REIT Council (PNLR Council) of the National Association of Real Estate Investment Trusts (NAREIT) submits the following comment with respect to the Department’s regulatory package redefining fiduciary investment advice. Specifically, we submit comments on the proposed regulation (the Proposal)<sup>1</sup> redefining the term “fiduciary” with respect to investment advice under ERISA §3(21)(A)(ii), and the proposed prohibited transaction class exemption “Best Interest Contract Exemption” (the BIC Exemption).<sup>2</sup> The PNL Council appreciates the opportunity to comment on these very important regulatory initiatives.

The PNL Council supports the Department’s goal of ensuring that financial advisors put the best interests of retirement plans, plan participants and IRA owners first. We agree that it is prudent and reasonable to update the 40 year-old fiduciary advice definition in the current regulation, given the significant changes that have occurred in retirement savings since 1975.

However, we have a number of specific concerns about the negative effect the Proposal and the BIC Exemption would have on the availability of investments, like Public Non-Listed REITs (PNLRs), used by IRA owners and participants to diversify their retirement portfolios. In addition to our specific comments below, we want to associate ourselves with, and formally endorse, the comment letters filed by the Investment Program Association and the U.S. Chamber of Commerce. These letters raise important concerns on this issue and many others that the Department should consider during its development of any final rule.

### **About PNLRs**

PNLRs are public companies whose securities are registered with the SEC, though not listed on a stock exchange. PNLRs own, manage and lease investment-grade, income-producing commercial real estate in nearly all property sectors. PNLRs are subject to IRS requirements that include distributing all of their taxable income to shareholders annually in order to be subject to just one level of taxation, and must make regular SEC disclosures, including quarterly and yearly

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<sup>1</sup> 80 Fed. Reg. 21,928 (Apr. 20, 2015).

<sup>2</sup> Id at 21,960.

financial reports, which are publicly available through the SEC's EDGAR database. Interests in a PNLR are public offerings, exchanged primarily through broker-dealers registered with and regulated by the SEC, the Financial Industry Regulatory Association ("FINRA"), and the relevant state securities regulatory authorities.

PNLRs help build diversified portfolios for retirement plan investors. Typically paying meaningful dividends due to the IRS REIT distribution requirements, PNLRs also provide the potential for moderate, long-term capital appreciation. As the leases, rents, properties and other underlying investments have tended to be responsive to inflation, PNLRs generally offer the potential for some protection from inflation risks. Further, PNLRs potentially provide an additional source of portfolio diversification because their investment returns reflect the performance of income-producing real estate, which typically has been only moderately correlated with the returns of other assets over long investment horizons.

As with mutual funds or any other pooled investment, there are a variety of fees charged in connection with PNLRs that are reflected in net returns and clearly disclosed in the prospectus, which is publicly available from the SEC. These fees will become even more transparent to PNLR shareholders when [FINRA Regulatory Notice 15-02](#) comes into effect next year.

### **Specific Concerns with the Proposal and BIC Exemption**

The PNLR Council is concerned that as currently written, the Proposal and the BIC Exemption would prevent many IRA owners and plan participants from having access to investments, like PNLRs, that can play an important role in diversifying retirement investment portfolios.<sup>3</sup> We are particularly concerned with the BIC Exemption's definition of "assets" in Sec. VIII(c)<sup>4</sup> of the proposed exemption. In this definition, the Department lists only certain types of investments, and PNLRs are not on the list. Investments not on the list cannot be the subject of advice provided in connection with the exemption. As a result, many advisors would be effectively prohibited from being able to discuss PNLRs at all, no matter how much doing so might be in the best interests of their clients.

This inability to discuss PNLRs would be particularly harmful if the advisor provides an investment analysis and recommendations for a client's total portfolio and the client owns shares in PNLRs outside of his or her retirement accounts. For example, advisors would be effectively unable to advise clients to use such assets inside retirement accounts, preventing them, for example, from taking into account tax efficiency in investing. Placing such limitations on the information, analysis and recommendations of investment advisers in such circumstances would inevitably compromise the ensuing advice and would depart from "best practices" dictating that assessments and recommendations be based on comprehensive information about the investors'

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<sup>3</sup> The Investment Program Association estimates that nearly half of the PNLRs owned by retail investors are held in IRAs, although plan participants may hold PNLRs through a brokerage window.

<sup>4</sup> 80 Fed. Reg. 21,987 (Apr. 20, 2015).

assets and accounts.”<sup>5</sup> Such information limits could also conflict with other regulatory requirements applicable to advisers.<sup>6</sup>

It is a decidedly odd result that a regulation intended to prevent conflicts that could cause an advisor to act against your best interest would actually prohibit an advisor from acting in your best interest. Further, the asset definition does not provide any additional conflict protection to IRA owners and participants. We believe the Department should not attempt to restrict the type of investments about which IRA owners or participants may receive advice, or attempt to restrict investments by IRA owners and participants that are otherwise permitted by law.

- **The Definition of Assets Should Be Removed from the BIC Exemption**

A close review of the Department’s rationale for including the definition of assets, as well as the practical effects of the definition in operation, lead us to ask that the Department remove the definition from the BIC Exemption entirely. It serves only to limit investment and advice options for IRA owners and participants, while offering them no additional benefits.

*The Asset Definition Provides No Additional Protection from Advisor Conflicts*

The BIC Exemption’s asset definition provides no additional protection against conflicts beyond those already provided by the Proposal and the BIC Exemption conduct and compensation conditions. Instead, the asset definition simply would limit the types of investments IRA owners and plan participants would be advised to make.

The Proposal would impose a general level-fee requirement on advisors by defining them to be fiduciaries for the purposes of the prohibited transaction rules. Under this general rule, advisors to plan participants and IRAs could have no financial incentive to recommend one investment over another. The BIC Exemption also would prohibit advisors from receiving compensation that would affect their advice. While the BIC Exemption would be a limited exception to the prohibited transaction rules, it generally would not allow the advisor to receive differential compensation.<sup>7</sup> According to Section II(d)(4), the advisor could not receive compensation incenting him or her to act against the best interest of the IRA owner or participant, and may not

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<sup>5</sup> See, e.g., “Questions Advisers Should Ask While Establishing or Reviewing Their Compliance Programs,” SEC, May 2006, available at [https://www.sec.gov/info/cco/adviser\\_compliance\\_questions.htm](https://www.sec.gov/info/cco/adviser_compliance_questions.htm), last accessed July 19, 2015, (SEC registered investment advisers should “maintain *current and complete* information regarding each client’s financial and family circumstances, investment objectives and restrictions, and risk tolerance.” and this information should be the basis for “...provid[ing] clients suitable investment advice.”); [FINRA Rule 2090](#) (Know Your Customer) (requiring a broker to seek to obtain and consider all relevant customer-specific information when making a recommendation); and [FINRA Rule 2111](#) (Suitability) (requiring brokers to exercise “reasonable diligence” to ascertain the customer’s investment profile prior to making a recommendation).

<sup>6</sup> See, e.g., 31 U.S.C. §§ 5311-5330 (Bank Secrecy Act), and associated regulations 31 C.F.R. §§ 1023 et seq., and [FINRA Rule 3310](#) (Anti-Money Laundering Compliance Program).

<sup>7</sup> While the BIC Exemption might permit a rollover to take place despite the fact that the advisor typically receives a higher proportional fee in an IRA than in a plan, the differential compensation in such a rollover is due to the structural differences in cost between a retail IRA and an institutionally-priced plan.

receive differential compensation unless it is in connection with a “neutral factor” that presents no conflict.<sup>8</sup>

Removing the asset definition from the BIC Exemption would not diminish the Department’s efforts to reduce conflicts in any way.

*The Asset Definition would be Contrary to the Intent of the BIC Exemption, ERISA’s History, and the Practical Realities of Retirement Investing*

The structure of the asset definition—its narrow application only to specifically identified assets—would be exactly contrary to the Department’s stated intentions in crafting the exemption. In the Preamble to the BIC Exemption, the Department writes, “Rather than create a set of highly prescriptive transaction-specific exemptions...the proposed exemption would flexibly accommodate a wide range of current business practices...The Department has [taken] a standards-based approach...”<sup>9</sup> In other words, the Department’s intent was to permit flexibility in the execution of principles that protect participants and IRA owners from conflicted advisors.

The Asset Definition, by contrast, would apply rigidly with no flexibility—an asset is either on the list, or not. Given the significance of the asset definition in limiting the scope of the exemption, the change in approach makes a material difference in the application of the exemption.

This list-based approach also contradicts ERISA’s legislative and regulatory history. Plans and IRAs are permitted wide latitude under the law to invest in vehicles they deem prudent and appropriate—indeed, other than prohibited transaction restrictions that prevent the plan sponsor or IRA owner from inappropriately using the plan or IRA to benefit themselves, the few prohibitions on investments for plans and IRAs, pertain to certain “collectibles” and special rules for precious metals.<sup>10</sup> Other than these restrictions, virtually any asset class is permissible as a potential investment under ERISA.

The Department historically has rejected investment category limitations, instead focusing on the prudent selection and monitoring of such investments. Rather than telling plans what they could invest in, the Department instead issued guidance and regulations governing the investment decision process. In adopting its regulations governing the prudent investment process, the Department wrote that it, “...does not consider it appropriate to include in the regulation any list of investments, classes of investments, or investment techniques...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>11</sup> The Department should retain this approach in the BIC Exemption and rely on the fiduciary process employed by advisors to IRA owners and participants to determine which investments should be considered for any individual’s account.

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<sup>8</sup> 80 Fed. Reg. 21,984 (Apr. 20, 2015).

<sup>9</sup> Id. at 21,961

<sup>10</sup> See, 26 USC §408(m).

<sup>11</sup> 44 Fed. Reg. 31,639 (June 1, 1979).

Finally, as the Department explained in its rejection of a “legal list” of investments in 1979, no list could ever be complete. If the Department in any final exemption provides an asset definition that includes a specific list, it would be fixed as of that point in time. No new investments would be eligible for the BIC exemption absent a separate regulatory approval granted on a case-by-case basis. This would result in a rule and an exemption that would not adapt to an evolving marketplace, and an ever-growing number of IRA owners and participants would not be exposed to these investment opportunities arising after the adoption of the exemption.

For all of these reasons, we ask the Department to remove the asset definition from any final exemption. It would not provide any additional conflict protection to IRA owners and plan participants, but it would result in additional costs through reduced access to investment advice. In effect, the Department would be substituting its own judgment, on a one-size-fits-all basis, regarding which investment categories are appropriate for individual retirement investors, for the professional, impartial, and individualized decisions of financial advisors. The universe of individual retirement investors encompasses a diverse pool of Americans with a range of retirement needs and investment requirements, whose retirement needs are best served by considered financial advice. A contrary result disserves the statutory purpose of ERISA, to facilitate the retirement savings of all Americans.

- **If the Definition of Assets is Retained, PNLRs Should Be Added to the List**

In the Preamble to the BIC Exemption, the Department explained that the asset definition included those assets it determined were “commonly purchased”<sup>12</sup> by retirement plans and IRAs. The Department did not provide much additional insight into how it concluded which investments were “commonly” utilized, but suggested the listed assets should contribute to a “basic diversified portfolio” with investments that are “relatively transparent and liquid,” but it did not require a “ready market price” for inclusion.<sup>13</sup> We believe that PNLRs meet these criteria, and request that they be added to the asset definition.

#### Commonly Purchased

Large numbers of Americans are now invested in PNLRs, including thousands now held in IRA accounts. More than \$15.6 billion was invested in in PNLRs in 2014,<sup>14</sup> and as indicated previously the Investment Program Association estimates that roughly half of PNLR investments are through IRAs. Investors have invested an additional \$8.7 billion to date in 2015.<sup>15</sup> While we recognize that there may be other retirement plan investments that are more common than PNLRs, these numbers demonstrate that they are a common investment for a large number of IRA owners.

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<sup>12</sup> 80 Fed. Reg. 21,968 (Apr. 20, 2015).

<sup>13</sup> Id.

<sup>14</sup> *The Stanger Report*™ (Winter 2015).

<sup>15</sup> *The Stanger Report*™ (Summer 2015).



### Contribution to a Basic Diversified Portfolio

As the Department notes, diversification is a basic legal obligation of a prudent investment fiduciary, taking into account the role various asset classes play within the portfolio's investment strategy.<sup>16</sup> PNLRs can play an important role in basic diversification as they offer access to a portfolio of real estate assets that typically are not closely correlated with fixed income or equity markets, and that can offer potential inflation protection. The dividends required of PNLRs can also offer assistance in meeting cash flow requirements in various investments.

### Relatively Transparent and Liquid

PNLRs are transparent public companies registered with the SEC and providing annual and quarterly reporting. In public offerings, PNLRs provide a prospectus describing the fees, risks, investment strategies and other material information for advisors and investors to make informed decisions. While they are not traded on an exchange, and thus do not have a daily market price, PNLRs are not illiquid—the terms and conditions under which distributions are made are clearly disclosed, as are any redemption fees or other charges. We note that other investments on the “approved” asset list are not traded on an exchange and have redemption fees or other restrictions applicable to investments—these features apparently do not disqualify an investment from inclusion as an eligible asset.

- **The Existing Arrangement or “Grandfather” Clause in the BIC Exemption Is Too Limited and Does Not Apply to Assets Not Covered by the Exemption, Including PNLRs. The Effective Date of the General Rule Should Be Amended to Apply Prospectively to New or Renewed Advice Arrangements, Leaving Existing Arrangements in Place Until Their Normal Expiration.**

The Department suggests that the new fiduciary definition and its associated exemptions would take effect eight months following the publication of the final rule in the Federal Register. Without a transition rule, this would result in tens of millions of existing advice arrangements having to be fundamentally reformed on a single day. Unfortunately, the only transition rule provided by the Department is in Section VII(b)(3) of the BIC Exemption, which would permit only certain eligible existing arrangements to continue, and only up to the point that additional advice would be provided after the effective date. If additional advice would be provided, the existing arrangement would have to be modified. This approach to the effective date is fundamentally flawed.

First, PNLRs and other investments not on the “legal list” of assets set forth in the BIC Exemption would be ineligible for even this limited transition rule. There is no logical rationale for a transition rule that discriminates among various asset categories, all of which were lawful prior to the effective date. Such a rule would result in the anomalous outcome that even within the same account, certain assets would be allowed to remain under the prior arrangement (at least until additional advice is provided) while other assets would immediately force account holders to negotiate a different advice arrangement. This is another example of why the asset limitations

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<sup>16</sup> See ERISA §404(a)(1)(C) and 29 CFR §2550.404a-1(b).

under the BIC Exemption should be removed—they affect the entire structure of the exemption in ways unrelated to the goal of preventing conflicted advice to account holders.

Additional deleterious collateral consequences would follow from this limited transition rule. Permitting existing arrangements to stand only until such point that additional advice is provided would deny IRA owners and participants the benefit of the original bargain they made for advisory services, and create obvious disincentives to advisers to provide further advice. Many IRA owners have paid an up-front fee for advice to be provided in the future. Compelling the dissolution of such arrangements would deny account holders the benefit of the advice they have already paid for, and force the reformation of previously lawful contracts under then prevailing market conditions (favorable or otherwise). We question whether the Department has the legal authority to force two private parties who entered into a valid and legal contract for services to dissolve the contract to the detriment of the IRA owner or participant.

Accordingly, we ask the Department to adopt the following clear and straightforward “grandfather rule” applicable to all account assets acquired prior to the effective date of any final rule. With respect to new advice arrangements entered into on or after the effective date, the new regulatory standards would apply. With respect to existing advice arrangements entered into prior to the effective date—including assets acquired pursuant to such previous arrangements—the previous regulatory standards governing these arrangements would remain in effect, unless or until, they would be terminated or renewed by the parties. To do otherwise would violate common sense principles of due process respecting the rights of private parties to make and keep contracts legally entered into.

We further request that this effective date language be included in the general rule, not in the BIC Exemption. The asset definition in the BIC Exemption is linked to the “grandfather” clause, giving rise to the anomalous result that the same account could include assets that are “grandfathered” and assets that are not, further illustrating the unworkability of the BIC Exemption asset list.

In proposing the grandfather rule above, we acknowledge the difficulties posed in attempting to devise a fair BIC Exemption transition rule applicable to existing account assets acquired pursuant previous lawful arrangements. We respectfully submit that this, too, points to the impracticability of any rule prescribing “legal assets” in this manner and furthers supports our earlier arguments that this asset list should be eliminated altogether.

- **Conclusion**

We believe IRA owners and plan participants would be best served by removing the asset definition in the BIC Exemption. This would ensure they get individualized advice from financial advisors to determine what is in their individual best interests, rather than having the Department make that decision for IRA owners and plan participants. If the Department decides to retain the asset definition, we urge the Department to add PNLRs to that list.

The PNL Council looks forward to working with the Department as it continues its efforts on this important regulatory project. We would be pleased to answer any questions the Department may have regarding PNLs or REITs generally.

We appreciate your consideration of our comments, and please feel free to contact me if you would like to discuss our positions in greater detail.

Respectfully submitted,

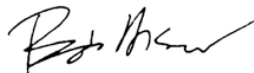
Executive Committee  
NAREIT PNL Council

CHAIR:

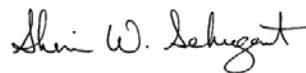


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