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Ohio Common Sense Initiative
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RE: Ohio Division of Securities Rule 1301:6-3-09 Registration by Qualification

Dear Sir or Madam,

The Institute for Portfolio Alternatives (the "Institute") appreciates the opportunity to comment on the proposal of the Ohio Division of Securities Division (the "Division") to amend Rule 1301:6-3-09 (the "Proposal"). The Institute represents, among other firms, the sponsors and distributors of federally-regulated, non-listed real estate investment trusts ("REITs") and business development companies ("BDCs"), both of which are subject to the Proposal.[1]

The Institute appreciates the Division's willingness to engage in administrative rulemaking, as requested by the Joint Committee on Agency Rule Review under R.C. 101.352. By submitting the Proposal through this process, the Division is ensuring that it hears from impacted constituents and market participants such as our members.

We respectfully submit the following comments to the Proposal:

- The changes outlined in the Proposal are would have a significant impact on capital formation and investment in Ohio and warrants a thorough analysis of the potential adverse business impact. Therefore, it is critical that the Division submit a Business Impact Analysis ("BIA") that acknowledges the business impact and fully answers the questions, as required by the JCARR's order and the Common Sense Initiative ("CSI").

- The Division should conduct a thorough BIA of the proposed concentration limit in paragraph 5(a) of the Proposal, and amend the concentration limit to provide an accredited investor exemption.

[1] For over 35 years, the Institute has advocated for increased investor access to alternative investment strategies with low correlation to equity markets, as part of a diversified portfolio. Such 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, among others. With nearly $300 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.

- The Division should revise paragraph 5(b) to remove overly broad language and provide predictability to the industry and members of the public with clear notice about the types of advertising statements that would be prohibited.

- The Division should address the business impact of each NASAA Statement of Policy individually in section 4(a).

- The Division should extend the comment period beyond the current 14 calendar day period. The Division did not respond to an extension request of an additional 14 days by the comment deadline when requested by multiple stakeholders.

1. The Proposal Would Have a Significant Adverse Impact on Ohio Business.

More than 31,000 Ohioans have invested in 195 federally-registered non-listed REITs, with the total value of these investments exceeding $1.9 billion. Similarly, more than 6,000 Ohioans have invested in 39 federally-registered non-listed BDCs, with the total value of these investments exceeding $372 million.

A. Non-Listed REITs and BDCs Provide Investment Benefits to Ohioans.

Non-listed REITs and BDCs provide investment benefits to Ohio investors. For example, non-listed REITs provide Ohioans access to geographically diverse investment opportunities across a range of property types – industrial, multifamily and other rental housing, office, retail, self-storage, medical, and real estate debt. Non-listed REITs provide the opportunity for income generation, long-term capital appreciation, inflation protection, portfolio diversification, and access to highly regarded and institutional quality real estate managers. Non-listed REITs also support the acquisition and development of affordable housing, commercial properties for small businesses, and other types of real estate that supports economic growth and employment, including in Ohio.

Non-listed BDCs provide investors with opportunities to invest in high growth businesses, including access to private equity and debt investment opportunities, historically available only to institutional investors. Non-listed BDCs also provide diversification to a broad array of traditional assets, contributing to an investor's diversification goals and enhancing portfolio resilience, and access to highly regarded institutional quality asset managers.

State public employee pension plans and other institutions invest in real estate to achieve diversification and reduce their portfolio risk. The Ohio Public Employees Retirement System Defined Benefit Plan, for example, targets over 23% of its assets to alternative investments, with target allocations of only 1% to publicly traded REITs and 10% to non-public funds investing directly into real estate.[2]

[2] OPERS 2022 Annual Investment Plan at 6 https://www.opers.org/pubs-archive/investments/inv-plan/2022-Annual-Investment-Plan.pdf.

Capital from the non-listed REIT industry has been a significant source of economic activity and employment, supporting thousands of jobs in health care facilities, apartment buildings, shopping centers, office buildings and industrial warehouses. The Proposal would inhibit the flow of capital to these properties.

Non-listed BDCs also play an important role in providing capital to small and mid-sized companies that may not have access to traditional sources of capital. BDCs are required to invest at least 70% of their total assets in small and medium-sized U.S. operating companies, including in Ohio, and must also offer managerial and other support to their portfolio companies. Similarly, the Prosposal would restrict the flow of capital to these types of businesses in Ohio.

B. The Division's Merit Review Has an Adverse Business Impact.

All public non-listed REIT and BDC offerings are registered with the United States Securities and Exchange Commission ("SEC") and must receive a no-objections letter from the Financial Industry Regulatory Authority ("FINRA"). Once the SEC declares a registration statement effective and the FINRA review is complete, then under federal law the offering may be sold anywhere in the United States. Nevertheless, the Division conducts a "merit review" in which it imposes additional conditions on registration. These conditions are the principles of law and policy[3] that the JCARR requested the Division include in the Proposal.

The Division's merit review is a extensive and time-consuming assessment of each offering to determine whether it merits registration in the state. The Division can block the registration of an offering in Ohio if the non-listed REIT or BDC does not comply with a requirement imposed by the Division. In other words, if an issuer does not agree with the Division's requirements, the offering will not be registered in Ohio. In such a case, Ohio investors lose the opportunity to invest in an offering that has previously undergone review by the SEC.

2. The Division Should Submit a Full Business Impact Analysis.

Section 107.53 of the Ohio Revised Code requires the Division to conduct a BIA of any new legislative rule, including the Proposal. Unfortunately, the Division's BIA is virtually nonexistent, with incomplete or nonresponsive answers to questions posed by the CSI. For example, in response to the first question, the Division admitted that the Proposal would have adverse impacts to business.[4] In the rest of the BIA, however, the Division *denied* an adverse impact. For example, in response to Question 15.b., the Division said:

[3] "Principles of law and policy" refer to the Division's statements of policy, public pronouncements, and legal requirements that have a general and uniform operation and establish legal regulations or standards that would not exist in their absence. *See also*, Letter by Larry Wolpert, Executive Director of JCARR, to the Ohio Securities Division, Dec. 13, 2022.

[4] Business Impact Analysis Answer 1 (a-c).

> The Division does not believe the proposed amendments will have an adverse business impact. They proposed amendments . . . simply codify existing practice and industry standards already in place.[5]

As a consequence of its assumption that the Proposal would have no adverse business impact, the Division claims that it need not:

- rely on data to develop the Proposal;[6]
- develop new measures of success;[7]
- take measures to ensure that the Proposal does not duplicate existing Ohio regulation;[8] or
- develop a plan of implementation.[9]

Contrary to the Division's assertion, the Proposal could have an adverse business impact. The Division should be required to resubmit a BIA that takes this impact on business into account and fully addresses the questions, as required by the CSI and the JCARR order. Moreover, the Proposal would not "simply codify existing practice and industry standards already in place." It contains entirely new guidance that has never appeared in any federal law or Ohio regulation.

Importantly, the Division should not assume that there is no impact on business or job creation merely because the Proposal is based upon existing Division policies. The Division adopted those policies without submitting them to the CSI and the JCARR for review. The BIA is required for "draft rules" that "might" have an adverse impact on business, and the Ohio Revised Code defines "draft rule" as "any newly proposed rule."[10] As is evident from this language, agencies must conduct a forward-thinking BIA, one that compares the impact of the the rule to business conditions without it.

If the Division were permitted to assume that there is no adverse business impact without answering the questions asked by the CSI, then the adoption of the Proposal would undermine the CSI and JCARR processes. The Division would benefit from having adopted the principles of law and policy included in the Proposal without following the administrative procedures that the Ohio Revised Code demands. The Proposal would be drafted without any of the improvements that come from a BIA under Section 107.53.

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[5] Business Impact Analysis Answer 15.b.
[6] Business Impact Analysis Answer 11.
[7] Business Impact Analysis, Answer 7.
[8] Business Impact Analysis Answer 13.
[9] Business Impact Analysis Answer 14.
[10] *See* Ohio Revised Code Sections 107.51, 107.52, 107.53.

As an example, the Proposal includes new rules (outside of JCARR and CSI review) concerning a concentration limit and the advertisements of non-listed REIT and BDC offerings. In conducting its BIA, the Division's baseline should be the absence of the concentration limit and advertising requirements. It should measure the impact of the proposed concentration limit and advertising rules to a world in which those rules do not exist.

The Institute respectfully requests that the CSI require the Division to resubmit the BIA, with complete answers. The CSI should require the Division to use as the baseline the *absence* of the principles of law and policy as set forth in the Proposal, and which the Division never should have adopted outside of the CSI and JCARR.

3. The Institute Recommends Amendment of the Proposed Concentration Limit.

Although the Institute and our members need more time to review and comment on all aspects of the Proposal, we do have comments on the concentration limit. We hope that our comments will help the Division develop this part of the Proposal.

The proposed concentration limit contains prefatory language stating that the concentration limit is intended to mitigate the "right to restrict or retain an Ohio purchaser's returns or ability to exit from investment." Without the concentration limit, according to this prefatory language, the offering would be considered "grossly unfair" or "defraud or deceive, or tend to defraud or deceive purchasers." Assuming issuers fully disclose the illiquidity of their shares, which the Division appropriately ensures, these terms are simply inapplicable adjectives.

We respectfully recommend that the Division strike this prefatory language for two reasons. First, it is unclear what securities carry a "right to restrict or retain an Ohio purchaser's returns or ability to exit from investment." The prefatory language is written generally and could be read to apply to many types of investments. Moreover, it presumes these offerings are inherently fraudulent or deceptive.[11]

Second, the prefatory language is self-evidently false. Investment in equity securities is not a deposit in a personal savings account. Every corporation restricts or retains returns or an ability to exit from an investment in common stock. Public corporations, for example, retain earnings rather than paying them out to stockholders. Moreover, public company common stock, like many other investments, normally do not carry any right of repurchase and, if they do, that right is never unlimited.

[11] The SEC staff has previously granted certain non-listed REITs no action relief under Rule 13e-4 of the Securities and Exchange Act of 1934, which imposes conditions on an issuer's repurchase of its own equity securities pursuant to a share repurchase plan. In order to obtain no-action relief, non-listed REITs represented that they would limit their repurchases to a fixed percentage of net asset value every quarter. By this representation they demonstrated that they would not repurchase a "substantial percentage of its stock," which is one factor indicating that a tender offer exists.

Third, the concentration limits in the Proposal would deprive retail investors of investment opportunities and restrict investment choice. As the world emerges from the worst of the pandemic, gas prices have been at their all-time high and food prices rose at the fastest pace in 41 years.[12] Inflation and interest rates are on everyone's mind. Economists predict stagflation and recession. With these critical economic headwinds along with geopolitical events from lockdowns in China and Russia's invasion of Ukraine, many investors need portfolio diversification, protection from inflation, and a reliable source of income. Investors have found that non-listed REITs and BDCs can be a balanced solution for diversification. Yet the Proposal would discourage investment in a diversifying asset when macroeconomic events make diversification, consistent with the basic tenets of modern portfolio theory, so important.[13] As a result, a thorough and detailed BIA is appropriate and necessary.

Assuming the Division moves forward with adoption of a concentration limit by rule in Ohio, we recommend that the Division include an exemption from the concentration limit for accredited investors. The "accredited investor" definition in SEC Rule 501 of Regulation D promulgated under the Securities Act of 1933, as amended (the "Securities Act"), is intended to encompass those individuals and entities "whose financial sophistication and ability to sustain the risk of loss of investment or ability to fend for themselves render the protections of the Securities Act's registration process unnecessary."[14] Private offerings with less disclosure than non-listed REITs and BDCs are sold to accredited investors and are not subject to registration in any state, including Ohio.

The federal government does not impose a concentration limit on investors and Ohio is in the minority of states that impose a concentration limit. If the Division moves forward with the imposition of a concentration limit, we believe that the Division should include an exemption for investors that are "accredited" as defined by Rule 501 of Regulation D under the Securities Act. By doing so, the Proposal would give wealthy and sophisticated investors a degree of investment choice when they are advised by their federally regulated broker or investment adviser. These investors may need to follow portfolio diversification strategies like those employed by large institutions. For example, an investment professional might recommend that a client with enough cash to meet reasonably foreseeable needs, diversify her portfolio by investing more than 10% of her net worth in a non-listed REIT or BDC.[15] The REIT or BDC might be one in which she has a long history of successful investing.

Non-listed REITs and BDCs are sold through financial professionals, who must determine that the investment is in the best interest of the investor. The Proposal would arbitrarily override the financial professional's recommendation without regard to the financial sophistication of the investor. No one is in a better position to evaluate what is best for investors than investors themselves, guided by their financial professionals.

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[12] *See* https://www.agriculture.com/news/business/food-prices-rise-at-fastest-pace-in-41-years.

[13] *See, e.g.,* Markowitz, "Portfolio Selection," The Journal of Finance (1952).

[14] *See*, *e.g.*, Rel. No. 33-6683 (Jan. 16, 1987) [52 FR 3015] (Regulation D Revisions; Exemption for Certain Employee Benefit Plans).

[15] The Institute recommends that as part of the business impact and economic analysis, the Division address why 10% as opposed to any other limit such as 15%, 20%, 25% or 30% is justified.

The Institute recommends that the Division amend the concentration limit to read as follows:

> (5) Absent good cause shown, registration by qualification will be conditioned upon the restriction of sales to the purchaser in concentrations not to exceed 10% of a purchaser's liquid net worth. This standard shall not be applied to purchasers who qualify as an "accredited investor" as defined in Rule 501 of Regulation D under the Securities Act of 1933, as amended.[16]
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> **The Institute respectfully recommends that the Division first conduct a BIA regarding this aspect of the Proposal. If the Division moves forward, the Institute recommends amendment to include an exemption for accredited investors.**

4. The Institute Recommends Amendment of the Advertising Prohibitions.

We respectfully remind the CSI and the Division that the reason that the JCARR ordered the Division to issue the Proposal under R.C. 101.352 is because the Division had previously imposed principles of law or policy – including requirements concerning advertisements – without following required administrative processes. The Division had not submitted these advertising requirements to the CSI or to JCARR. For that reason, the JCARR ordered the Division to supplant those advertising requirements and other principles of law or policy with lawfully adopted rules.

Paragraph 5(b) proposes a set of advertising prohibitions that is written in new, vague and imprecise terms. Paragraph 5(b) would prohibit statements that "distort the value of performance," "include misleading financial metrics," "downplay . . . risk disclosures," "fail to provide a balanced presentation of risks and benefits," and "present risk in a manner that makes it difficult for prospective purchasers to read or understand." These prohibitions are so broadly written that the industry and members of the public cannot have certainty on how they might be interpreted and applied by the Division. In fact, the Division could claim to rely on the general language in paragraph 5(b) for wide-ranging merit standards that are impossible to predict and, due to the subjective nature of such standards, they are susceptible to inconsistent application among issuers or to creating standards that are overly burdensome. Paragraph 5(b) would give the Division a back door through which it could issue new principles of law or policy that the JCARR hopes to prevent -- without furnishing any notice to the industry or providing an opportunity for comment.

Moreover, Ohio requires approval of marketing materials before their first use, but there is a consistent back-log with no certainty of timing for review. This compounds our concerns with overly broad discretion and lack of certainty for how and when materials are subject to review.

[16] 17 C.F.R. § 230.501(a)(1) to (8).

The Institute respectfully recommends that the Division to remove the overly broad and undefined language in paragraph 5(b).

5. *The Institute recommends that the business impact of each NASAA Statement of Policy listed in section 4(a), and each merit standard in section 4(b), be assessed individually.*

While we appreciate that the Division has incorporated the NASAA Statements of Policy and merit standards into the formal rulemaking process, there should be a review of each policy statement and merit standard individually for a BIA. Additional consideration should also be given to whether each statement has applicability today, given that many are decades old and contain requirements that no longer make sense because they have not been updated with the speed of business or advancing technology. By filtering out policy statements and merit standards that are potentially inapplicable, contradictory or duplicative, the Division and CSI could maintain a review of regulations to eliminate barriers to business growth and job creation.

For example, there are a number of NASAA Statements of Policy that issuers would need to comply with, some of which are duplicative of, and conflict with, topics and issues separately addressed in each of the other Statements of Policy. As a common practice in Ohio, the Division does not apply uniform merit standards accros common issuers for current market practices. This potential for confusion and duplication should be considered carefully before all existing NASAA Statements of Policy and merit standards are incorporated in one single rulemaking. We have previously provided additional comments and concerns regarding the NASAA Statements of Policy and merit standards, but they have not been addressed by the Division. As such, we hereby incorporate by reference into this letter the comments and concerns described in our May 9 letter.[17]

The Institute respectfully requests that the Division review and address the impact on business growth and job creation of each of the NASAA Statements of Policy and merit standard, and avoid adopting Statements of Policy and merit standards that may create confusion or duplication.

6. *The Division Should Extend the Comment Period.*

The Division provided only a 14-calendar day period to review and comment. This amount of time is insufficient to provide complete and meaningful comments on each of the 20 NASAA statements of policy, 17 Merit Standards, and new rule language. By contrast, the SEC typically allows 60 to 90 days for public comment on its rule proposals. The Division also did not respond to an extension request of an additional 14 days by the comment deadline when requested by multiple stakeholders. Given the importance of these issues to the citizens of Ohio and the magnitude of these changes, an extension of the comment period is necessary.

[17] *See* IPA Letter to Ohio Division of Securities, May 9, 2022, available at https://www.ipa.com/wp-content/uploads/2022/05/IPA-Letter-to-Ohio-Division-of-Securities-on-Securities-rule-update-5.9.22-FINAL.pdf.

The Institute respectfully requests that the Division extend the review and comment period to give the public a reasonable opportunity to comment.

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The Institute appreciates the opportunity to comment on the Proposal. We are ready and willing to work with the CSI and the Division on this important rulemaking. Should the CSI or the Division have any questions about our comments, please feel free to contact me or Gina Gombar, Associate General Counsel, at (202) 548-7190.

Sincerely,

Anya Coverman
President and CEO
Institute for Portfolio Alternatives