Research and Due Diligence Association, Inc.
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November 11, 2011

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, N.W.
Washington, D.C. 20006-1506

Re: Regulatory Notice 11-44: Proposed Amendments to NASD Rule 2340

Dear Ms. Asquith,

The Research and Due Diligence Association, Inc. (RADD) is pleased to submit this letter in response to FINRA's request for comments on proposed amendments to NASD Rule 2340 to address values of unlisted direct participation programs and real estate investment trusts in customer account statements. RADD is an association of individuals involved in research and/or due diligence functions who are either employed by independent broker-dealers or by firms retained by broker-dealers to assist in those functions.

RADD is commenting on paragraph (c)(2)(A) of Rule 2340, as proposed to be amended, which states that "[a] member must refrain from providing 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 member's attention[.]" RADD has two concerns relating to this provision: first, it would subject broker-dealers to an ambiguous standard that would be extremely difficult to satisfy, and second, it would have a chilling effect on their ability to conduct due diligence on the program that publishes a valuation or subsequent offerings by the sponsor of the program that publishes a valuation.

Ambiguous Standard

The standard set forth in this clause is ambiguous primarily due to the use of the term "unreliable." Valuations are conducted in a variety of ways – some are conducted entirely by individuals employed by the issuer or an affiliate, and some are conducted with the input from an outside firm. If an outside firm is utilized, its role can vary, from merely providing input to management or the board of the issuer to producing the actual value to be reported by the issuer. In addition, there are a number of valuation methodologies that might be utilized, including those based upon net asset value, discounted cash flow analysis, public company

comparables, or a dividend discount model. The use of each methodology in turn involves making a number of assumptions, such as assumptions relating to current and future capitalization rates, the choice of market comparables, and the choice of an appropriate discount rate.

The "reliability" of a given valuation therefore could be challenged on a number of fronts. For example, would a valuation be unreliable if it were conducted entirely by internal staff due to potential conflicts of interest? Similarly, would it be unreliable to rely upon valuation information provided by a valuation firm retained by the issuer? Would it be unreliable if the issuer utilized a valuation firm with conflicts of interest due to providing other services to the issuer or its affiliates? Would broker-dealers be charged with determining the appropriateness of the methodology chosen, and the reasonableness of each assumption made in the calculation of value? If so, the broker-dealer could be required to conduct a comprehensive evaluation of all aspects of a valuation, including the qualifications of the individuals or firms conducting the valuation, any conflicts of interest that may be present, the appropriateness of the methodology utilized, and the reasonableness of every assumption made in conducting the valuation.

Potentially Chilling Effect upon Due Diligence

RADD is also concerned that the proposal could have a chilling effect upon due diligence. Because offering of direct participation programs and non-traded REITs are typically conducted on a continuous basis, broker-dealers often conduct ongoing or periodic due diligence of these offerings. And because these programs are typically "blind pools," due diligence may include an investigation of prior performance and an evaluation of related disclosure. A review of the information relating to the valuation of a current or prior offering therefore could be appropriate as part of due diligence, as it could be relevant to the performance of a current program or that of a prior program, respectively.

During the course of such due diligence, a broker-dealer will typically review public and non-public information. A review of non-public information is generally called for, since a principal objective of due diligence is to ensure that all material facts pertaining to an issuer are adequately and accurately disclosed in the offering document, a determination that often cannot be made by reviewing only public information. RADD believes that broker-dealers conducting due diligence generally should obtain and review non-public information relating to valuations of current and prior programs, as well as other non-public information concerning the issuer, the sponsor, and the sponsor's prior programs.

RADD is concerned, however, that the proposed amendment could provide disincentive for broker-dealers to request non-public information, or for sponsors to provide it to them. Many pieces of information, both significant and insignificant, could arguably have a bearing on the reliability of a valuation. This includes not only information directly related to the valuation, but the issuer's property-level information, financial models and projections, financial statements

and anything else that could affect the value of a company or its assets. If a broker-dealer is required to consider the potential impact on the reliability of a valuation of all non-public information received in the course of its due diligence, it may be reluctant to request as much non-public information as it otherwise would, and the sponsor may be more reluctant to provide it.

Conclusion

In light of the forgoing, we would urge FINRA to modify (c)(2)(A) of Rule 2340, as proposed to be amended, to either (1) include specific language that would make it clear what would constitute an "unreliable" valuation or (2) choose a more objective standard with a higher threshold for culpability. In light of the inherent complexity in defining what might constitute an "unreliable" valuation, RADD believes that adoption of a more objective standard with a materiality standard and a higher threshold of culpability would be appropriate, so that the requirement is manageable and not unduly burdensome. In this regard, RADD believes that it also would be appropriate for FINRA to provide guidance, either in the rule or in a proposing or adopting release, as to the expected level of inquiry by broker-dealers in evaluating a published valuation. RADD believes that this or a similar approach would be more appropriate, as it would continue to hold broker-dealers accountable with respect to published valuations, but would provide them with a more objective standard of accountability and greater clarity as to their duty of inquiry.

Please contact the undersigned at 410-964-2500 if you have any questions.

Very truly yours,

John F. Kearney
General Counsel