

MEMORANDUM

TO: Proposed Rule: Safeguarding Advisory Client Assets
(IA-6240; File No. S7-04-23)

FROM: Janet Jun
Senior Counsel, Division of Investment Management

RE: Meeting with Representatives of the Real Estate Roundtable

DATE: November 3, 2023

On November 3, 2023, staff from the U.S. Securities and Exchange Commission (“SEC”) held a meeting with representatives of the Real Estate Roundtable.

Participants included SEC staff from the Division of Investment Management: Sarah ten Siethoff, Melissa Rovers Harke, Christopher Staley, Holly Miller, Samuel Thomas, Janet Jun, Alexander Haer, Frank Buda, Matthew Williams, Jenson Wayne, Michael Republicano, and Christopher Rice; from the Division of Economic and Risk Analysis: Ross Askanazi and Ulas Alkan; and representatives from the Real Estate Roundtable:

- Clifton E. (Chip) Rodgers, Jr., Senior Vice President, The Real Estate Roundtable
- James Sonne, Head, Government Affairs, PGIM (Prudential)
- David Blass, Partner, Simpson Thacher & Bartlett LLP
- Ellen Kelleher, Real Estate Adviser, Carlyle
- Patricia Bailey, Chief Operating Officer, Real Estate, Principal Financial Group
- Jeffrey Jacobs, Chief Legal Officer, PGIM Real Estate
- Steve Gottheim, General Counsel, American Land Title Association
- Christopher Morton, Senior Vice President of Public Affairs & Chief Advocacy Officer, American Land Title Association
- Derren Berk, Chief Financial Officer, Dune Real Estate Partners LP
- Victoria Rostow, SVP, Regulatory Policy and Deputy General Counsel, Nareit
- Minh Ta, Principal, Global Government Affairs, Carlyle

Among other things, the participants discussed the SEC’s proposal titled “Safeguarding Advisory Client Assets,” set forth in Release No. IA-6240 (Feb. 15, 2023). Attached as Appendix A hereto is a copy of the Real Estate Roundtable’s presentation that was discussed during the meeting.

Appendix A



The Real Estate Roundtable

SEC Proposed Rule 223-1: Real Estate Concerns

A Discussion With the SEC's Division of Investment Management

November 3, 2023

About Real Estate Roundtable

The Real Estate Roundtable brings together leaders of the nation's top publicly held and privately-owned real estate ownership, development, lending and management firms with the leaders of major national real estate trade associations to jointly address key national policy issues relating to real estate and the overall economy.

By identifying, analyzing, and coordinating policy positions, The Roundtable's business and trade association leaders seek to ensure a cohesive industry voice is heard by government officials and the public about real estate and its role in the global economy.

Who We Are

- **67% Owners**
 - 55% Private
 - 44% Public
 - 46% Mixed
 - 14% Office
 - 12% Retail
 - 12% Hotel
 - 11% Housing
 - 4% Industrial
 - 2% Other
- **20% Financial Services**
 - 58% Banks (Commercial & Investment)
 - 26% Insurers
 - 16% Mortgage Bankers
- **3% Asset Managers**
- **10% Real Estate Trade Organizations**

Scale of Real Estate Market

- **\$18-\$22 trillion:** Total value of US commercial real estate¹
 - The value of America's commercial real estate is nearly 39%-47% of the market capitalization of all U.S. publicly traded companies²
- **\$13.3 trillion:** Size of the professionally managed real estate market in 2022¹
- **\$4.0 trillion:** Gross assets owned by REITs³
 - **\$2.5 trillion:** Public REITs assets
 - **\$1.9 trillion:** equity market cap for global REITs
 - **\$1.3 trillion:** equity market cap for US-listed REITs

Sources:

¹ Real Estate Roundtable, Commercial Real Estate By The Numbers: 2023, <https://www.rer.org/wp-content/uploads/CRE-By-The-Numbers.pdf>

² According to Sibilis Research, The total market capitalization of U.S.-based public companies traded on the NYSE, NASDAQ and OTC markets was \$46.2 trillion at the end of June 2023. <https://sibilisresearch.com/data/us-stock-market-value/>

³ Nareit, <https://www.reit.com/data-research/data/reits-numbers>

Types of Real Estate Investments

Estimates of Commercial Property Value: 2021Q2

Sector	Base Estimates		
	Square Footage (Millions)	Price per Square Foot (\$)	Value (\$ Trillions)
Multifamily	16,383	\$235	\$3.8
Office	11,780	\$270	\$3.2
Retail	14,040	\$207	\$2.9
Health Care	2,705	\$864	\$2.3
Specialty, Sports and Other **	-	-	\$3.4
Hospitality	2,625	\$617	\$1.6
Industrial	21,698	\$106	\$2.4
Data Centers	-	-	\$0.2
Self-Storage	-	-	\$0.4
Towers	-	-	\$0.4
Total	69,231		20.7

Source: Nareit; CoStar

Executive Summary

Real estate should be excluded from the Safeguarding Rule entirely, as there are ample legal protections in place for the class.

- The risk of loss to real estate is only speculative - it has not been shown to be real. Unlike cash and readily marketable/transferrable securities, real estate assets are not freely transferable.
- Title is logged on the books of governmental entities, providing a level of transparency that further guards against misappropriation. These entities—like county clerks—serve as an effective analog to the custodial function in certain respects.
- A “host of gatekeepers” are already incentivized to safeguard real estate, from the lending banks to the lawyers that sit on each side of a real estate transaction.
- Title insurance is commonly obtained to protect such real estate.

Applying the “real asset” exemption to real estate only adds costs that investors have to pay with no meaningful benefit on them and introducing inefficiencies to the real estate transaction process with limited to no upside protection resulting from such requirements.

Proposed Safeguarding Rule

Unless an exemption is available, all assets of advisory clients must be held by a qualified custodian

- Custodian must have “possession or control” of assets requiring that the custodian participate in any change of beneficial ownership, effectuate such transaction, and their involvement is a condition precedent to such change
- Adviser must have a written assurances from custodian providing that the custodian will
 - Indemnify the client for custodian’s negligence, recklessness, or willful misconduct
 - Share annual written internal control report including an opinion from an independent public accountant
 - Provide at least quarterly account statements to the adviser and client
 - Provide client asset documentation to the SEC or an independent public accountants upon request
 - Otherwise abide by standards of care set out in the proposed rule

The Proposal either treats (i) assets of a Special Purpose Vehicle as assets of the fund or (ii) the SPV as a separate advisory client (mandatory if third-party investors in the SPV)

- While the proposing release discussion focusses on audit and account delivery requirements, the proposal appears to require all assets owned by the SPV to either be held by a qualified custodian or eligible for an exemption

Proposed Rule (cont'd)

Rule 223-1(b)(2) provides an exemption for assets unable to be maintained with a qualified custodian.

- The adviser must document the basis for relying on the exemption
- The adviser must have a written agreement with an independent public accountant to perform verification of purchases, sales or other transfers, and the adviser must notify the accounting firm within one business day of any purchase, sale, or transfer of the asset
- The existence and ownership of assets must be verified either through an annual audit or surprise examination
- The adviser must reasonably safeguard assets
- The adviser must segregate the real assets
 - Titling or registering the assets in the client's name or holding assets for the client's benefit
 - No commingling the assets with the adviser or its related person's assets
 - No subjecting the assets to any right, charge, security interest, etc. in favor of the adviser or its related persons

The proposing release creates ambiguity for how and whether the exemption applies to real estate

- SEC proposing release (page 135): “[I]n the real estate context, a deed or similar indicia of ownership that could be used to transfer beneficial ownership of a property would not qualify for the exception, but the physical buildings or land would qualify.”

Real Estate Assets Should Be Excluded from the Rule

We see no policy reason to impose the rule on real estate – real estate cannot readily be stolen

- Title insurance protects real estate buyers against false claims of ownership.
- Lenders and others protect against misappropriation of real estate
- Titles are recorded in the name of the acquiring entity by a government entity
 - The SEC's release indicates that deeds evidencing ownership of real estate can be held at a qualified custodian. The title is not a liquid instrument able to be traded

Conditions to the exemption for real assets are problematic

- Auditor verification of transactions is costly and not negotiated for by fund investors
- “Reasonable” safeguarding requirements is ambiguous as applied to real estate

Different jurisdictions present even more challenges

- Different laws for title exist between not only states but countries
- The rule applies to registered investment advisors regardless of where the asset is located

The proposals' treatment of real estate JVs would upend longstanding market practices