November 7, 2011

Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090
Attention: Ms. Elizabeth M. Murphy, Secretary

Re: File No. S7-34-11
Release No. IC-29778
Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments

Ladies and Gentlemen:

The Mortgage Bankers Association ("MBA")[1] appreciates the opportunity to provide its views in response to the request for comments by the Securities and Exchange Commission (the "Commission") in its August 31, 2011 release referenced above (the "Concept Release").[2]

The Concept Release states that the Commission and its staff ("Commission staff" or "staff") are reviewing interpretive issues under the Investment Company Act of 1940 ("Investment Company Act" or "Act") relating to the status under the Act of companies engaged in the business of acquiring mortgages and mortgage-related instruments and that rely on the exclusion from the definition of investment company in Section 3(c)(5)(C) of the Act (together, "mortgage-related pools"). Accordingly, the Commission is requesting data and other information from the public about mortgage-related pools and soliciting views about the application of Section 3(c)(5)(C) of the Investment Company Act to mortgage-related pools, including steps that the Commission might take in this area. The Commission's goals in this effort are to: (1) be consistent with the congressional intent underlying the exclusion from regulation under the Investment Company Act provided by Section 3(c)(5)(C); (2) ensure that the exclusion is administered in a manner that is consistent with the purposes and policies underlying the Act, the public interest, and the protection of investors; (3) provide greater clarity, consistency and regulatory certainty in this area; and (4) facilitate capital formation.[3]

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[1] The Mortgage Bankers Association is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies, including all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, real estate investment trusts, life insurance companies and others in the mortgage lending field.

[2] 76 Fed. Reg. 55300 (August 31, 2011).

[3] Capitalized terms not defined herein have the meanings given in the Concept Release.

We commend the Commission for its thoughtful consideration of the interpretive issues relating to the status of mortgage-related pools under the Act and appreciate the Commission's focus on investor protection and capital formation.

Section 3(c)(5)(C) was enacted to exclude from regulation under the Investment Company Act companies that were primarily engaged in, among other things, purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. Generally speaking, the guidance and interpretation regarding Section 3(c)(5)(C) issued by the Commission to date have been consistent with the intended scope of this exclusion and also have been consistent with promoting the Commission's goals of investor protection. The companies that rely on Section 3(c)(5)(C) are engaged in the mortgage industry and play a significant role in that industry.

We agree with the Commission that there have been significant changes in the real estate finance system in recent years and market participants have reacted to these changes by adapting their business models. We underscore that the basis of the Section 3(c)(5)(C) exclusion relates to the broader public policy interests of encouraging investment in real estate. Indeed, Congress drew a distinction based on particular public policy objectives, presumably because Congress sought to encourage investment in mortgage-related assets.

Importantly, MBA underscores the fact that during the ensuing 71 years since the passage of the Investment Company Act and in connection with the most comprehensive financial reform legislation in decades, the Dodd Frank Wall Street Reform and Consumer Protection Act[4] (the "Dodd-Frank Act"), no action has been taken to amend this exclusion. We focus our comments below on the types of companies that rely on Section 3(c)(5)(C) and the role of these companies in the mortgage market.

I. SUMMARY OF MBA'S VIEWS

We recommend that the Commission refrain from taking further action with respect to the Concept Release. Following an overview of real estate investment trusts (REITs) and their structural characteristics, MBA offers the following observations for the Commission's consideration:

Mortgage REITs Are a Vital Component of the Real Estate Finance System. The real estate finance system is a highly regulated market that under normal circumstances is dynamic and evolves to meet the needs of market participants. As this system has yet to normalize following the upheaval of the financial crisis and financial regulatory reform, MBA believes it is imprudent to consider imposing a new and additional regulatory framework. MBA requests that the Commission remain mindful of the way in which mortgage REITs fit into the real estate finance system, and the symbiosis between mortgage REITs and other participants in the residential and commercial real estate finance market.

Current Statutory and Regulatory Requirements Governing REITs. We examine the Concept Release in light of the existing statutory and regulatory environment and note that the

[4] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

Dodd-Frank Act, the Sarbanes-Oxley Act and other laws already require robust regulation and disclosures for publicly-listed mortgage REITs.

The Statutory Language and Congressional Intent of Section 3(c)(5)(C) is Unambiguous. The statutory language and Congressional intent of Section 3(c)(5)(C) is unambiguous in the distinct treatment of mortgages and other liens on and interests in real estate. We urge the Commission to preserve the regulatory regime in a manner consistent with the statutory framework.

The Commission's Current Regulatory Regime Is the Appropriate Approach to Administering the Section 3(c)(5)(C) Exclusion. While we believe there is an opportunity to provide additional guidance and greater transparency, the no-action letter process remains the most appropriate means to administer the Section 3(c)(5)(C) exclusion. MBA generally supports the Commission's approach of providing guidance through the issuance of no-action letters and believes that this approach has provided sufficient certainty for market participants and permits thoughtful consideration of novel interpretive questions — without the disruptive and chilling effect that may result from overly broad rulemaking in the area. We offer a number of suggestions regarding measures that might provide additional guidance and transparency for market participants.

The Commission Should Carefully Consider the Potential Costs Associated with Any Change in Approach on Section 3(c)(5)(C). We are concerned that any suggestion that the Commission could change its approach in this area creates the implication that compliance costs for mortgage-related pools could increase, quell both near- and long-term innovation in mortgage and real estate-related interests and adversely affect investors and capital formation generally. We note that the mere publication of the Concept Release has had a chilling effect on capital formation in the mortgage REIT sector.

The Commission Should Announce Future Actions Regarding the Concept Release. We are concerned that prolonged uncertainty regarding Commission actions following this Concept Release will negatively impact mortgage REIT activity. We respectfully request that the Commission provide an indication of how it plans to proceed with the Concept Release once it has reached a determination on this matter.

II. REIT OVERVIEW

REIT Structural Characteristics

A REIT is a vehicle designed to allow investors to pool capital to invest in real estate assets. The mortgage REIT sector is comprised of companies that own direct or indirect interests in mortgages on real estate or other interests in real properties. The REIT structure has certain advantages; in particular, a REIT is generally not taxed on the entity level to the extent that it distributes dividends even if its stock is publicly traded. However, it also has disadvantages, including tax restrictions that limit the REIT to long-term investments in qualifying assets (i.e., its assets must primarily consist of real estate-related assets that are not "dealer property") and certain distribution requirements (i.e., it must distribute at least 90 percent of its taxable income to its shareholders currently).

There are three general types of REITs: equity REITs, mortgage REITs, and hybrid REITs. Mortgage REITs may have different strategies. Certain mortgage REITs have origination platforms or engage in servicing or special servicing businesses and manage the underlying assets. Other mortgage REITs may not originate or service, but instead buy whole loans or mortgage backed securities (MBS). Residential mortgage REITs hold residential mortgage whole loans and residential MBS. Commercial mortgage REITs generally hold first and mezzanine commercial mortgages, commercial MBS, residual interests in commercial MBS and other interests in commercial mortgages. Hybrid REITs constitute some combination of mortgage real estate and equity real estate assets and typically hold loans and MBS and also sometimes have direct ownership interests in real estate properties. As reflected by these brief descriptions, mortgage REITs that engage in originating or servicing mortgage loans undoubtedly qualify for the Section 3(c)(5)(C) exclusion. The business activities of other REITs may more closely resemble spread lending, which facilitates liquidity in the mortgage market, and likewise is also consistent with the policy objective of the exclusion.

In adopting Section 3(c)(5)(C), Congress selected language that creates an asset-based test. While Congress could have included additional factors, such as an income-based test (as it did in Section 3(c)(6)), to define more narrowly the types of companies that would qualify for the exclusion, it did not. Nonetheless, mortgage REITs must structure their business and operations to meet certain federal tax requirements (both asset- and income-based tests), as well as to comply with Section 3(c)(5)(C). These restrictions further serve to reinforce the focus of mortgage REITs on the real estate market.

Tax Treatment of REITs

For federal income tax purposes, a REIT is a corporation that benefits from special tax treatment. This special tax treatment is an exemption from federal income tax at the corporate level to the extent the REIT distributes its income annually. A REIT is subject to normal corporate tax on any income that it retains. In order to qualify as a REIT for tax purposes, substantially all of the entity's assets must be held in real estate-related investments. It also must earn, each year, at least 95 percent of its gross income from passive sources and at least 75 percent of its gross income from real estate-related sources. Real estate mortgages constitute "good" REIT investments under the asset test and produce "good" income for both the 95 percent and 75 percent tests. A REIT is subject to a 100 percent penalty tax on income from sales of "dealer property" (generally meaning the sale or disposition of property held by the taxpayer as inventory or primarily for sale to customers in the ordinary course of its trade or business, excluding certain foreclosure property). In general, therefore, a mortgage REIT is limited to investments in mortgage loans. However, as discussed below, many mortgage REITs have adopted securitization structures in the last 20 years. In these structures, the mortgage REIT originates or acquires mortgages and then finances them by offering MBS that are typically treated as borrowings against the mortgages for federal income tax purposes.

A REIT can own a taxable REIT subsidiary ("TRS"). The TRS does not qualify as a REIT itself but instead is subject to a corporate level tax. A REIT's combined TRS investments cannot exceed 25 percent of its total gross assets. Accordingly, the use of a TRS can allow a REIT to engage in otherwise prohibited transactions without losing its tax status. REITs may conduct REIT-compliant activities either directly or through another type of subsidiary known as a

"qualified REIT subsidiary" ("QRS"). Because the operation of a mortgage lending and investment business often involves a mix of activities and assets, some of which are REIT-compliant and some of which are not, many mortgage REITs create and operate through multi-entity structures that include the principal, often publicly held, REIT, and one or more wholly owned TRSs and QRSs.

We note that in the Concept Release, the staff observes that mortgage REITs bear certain similarities to investment companies and points to a few commonalities. Among the similarities, the staff points to the fact that both mortgage REITs and investment companies benefit from pass-through tax treatment. It is important to distinguish that while both types of entities (REITs and investment companies) may benefit from pass-through tax treatment, in the case of REITs, there is a specific public policy rationale for this approach, that is to encourage broader investor participation in the real estate industry, which underlies the REIT tax treatment. This is a distinct and important difference. We would question the assertion that the pass-through tax treatment of both types of entities would form the basis for imposing the Investment Company Act regulatory scheme on mortgage REITs. Any investor confusion relating to similarities between REITs and investment companies could be mitigated by additional disclosure requirements.

Qualifying Asset Test for REITs

In addition to satisfying the asset and income tests for federal income tax purposes, in order for a mortgage REIT to qualify for the Section 3(c)(5)(C) exclusion, it must meet the qualifying assets test. Generally, and consistent with the plain meaning of the exclusion, the Commission staff has focused on whether at least 55 percent of the issuer's assets consist of mortgages and other liens on and interests in real estate, referred to as qualifying interests. The Commission generally has viewed the following assets as qualifying interests: assets that represent an actual interest in real estate; loans or liens that are fully secured by real estate; assets that can be viewed as the functional equivalent of, and provide the same economic experience as, an actual interest in real estate or a loan or lien fully secured by real estate (such as whole pool agency MBS), and certain commercial real estate B Notes.

In addition to the qualifying interests requirements, the Commission has looked at whether the remaining 45 percent of the issuer's assets consist primarily of real estate type assets: whether at least 25 percent of the issuer's assets consist of real estate type interests (subject to reduction to the extent that the issuer invested more than 55 percent of its assets in qualifying interests) and no more than 20 percent of its assets are invested in miscellaneous investments. This includes loans where 55 percent of the fair market value of the loan is secured by real property at the time the issuer acquired the loan and agency partial pool certificates. This guidance has provided sufficient certainty regarding the availability of the Section 3(c)(5)(C) exclusion.

Among non-bank entities, mortgage REITs stand out as a result of the tax advantages applicable to REITs in the United States ("U.S."). These advantages are particularly meaningful for businesses that depend on net interest income, or "spread," since the imposition of normal corporate double taxation on this income source substantially reduces yields relative to the single level of taxation enjoyed by REIT shareholders. Importantly, the REIT structure is oriented toward long-term holding of mortgage and real estate assets. MBA submits this as a relevant consideration from a public policy perspective.

III. MORTGAGE REITS ARE A VITAL COMPONENT OF THE REAL ESTATE FINANCE SYSTEM

MBA is committed to facilitating a fully-functioning and responsible real estate finance system. Mortgage REITs, which generally rely on the Section 3(c)(5)(C) exclusion, have played an important role in the mortgage market for many years by providing liquidity to the residential mortgage market, as well as to the commercial real estate market.[5] Their role is even more significant now given the turmoil in the primary and secondary mortgage markets.

The Financial Services Regulatory Environment

The U.S. real estate finance system has yet to fully recover from the global financial crisis. More than 90 percent of all new residential mortgage originations in the U.S. are funded or guaranteed by the U.S. government.[6] The prospect that the U.S. government, and thus the U.S. taxpayer, might remain the principal source of liquidity for the U.S. mortgage market over the long term presents significant policy concerns. There is widespread support for substantially reducing the role of the government in the mortgage markets and increasing the participation of private capital. It is also not clear at this time what direction government-sponsored enterprises (GSE) reform will ultimately take.

The level of regulation of all participants in the mortgage origination and securitization process—regardless of corporate form or business model—has stepped up considerably in the wake of the financial crisis, imposing additional costs and liquidity constraints. For example, banks are subject to increasingly stringent regulatory capital requirements with respect to their holdings of securitized assets. Banks are also required to maintain loan loss reserves against mortgage assets in accordance with rigorous regulatory requirements, which have the effect of additional capital requirements. These capital burdens will likely only increase as U.S. bank regulators to the extent that they adopt the heightened capital standards imposed under the Basel II and Basel III accords, reinforced by the formidable minimum standards imposed by certain provisions of the Dodd-Frank Act. The ever-increasing capital requirements in connection with holding mortgage assets long term can act as an incentive for banks to sell mortgage assets upon origination, rather than hold them in portfolio. In addition to requiring increased capital for holding mortgage loans and MBS, proposed Basel III rules would severely reduce the amount of mortgage servicing rights that banks may count towards Tier 1 capital requirements.

Regulations issued pursuant to the Dodd-Frank Act and otherwise impose a considerable number of additional restrictions and requirements on originators, servicers and securitizers. For example, the proposed regulations to implement the Dodd-Frank Act's risk retention requirements also are likely to change the securitization market. Additionally, U.S. banks that transfer assets into securitization vehicles must comply with the FDIC's safe harbor securitization rule[7] if the securitization is to be rated by nationally recognized credit rating agencies and accepted by securitization investors. These restrictions are most burdensome in the

[5] The discussion below generally focuses in more detail on the impact of mortgage REITs on the residential mortgage market.
[6] Congressional Budget Office, *Fannie Mae, Freddie Mac and the Federal Role in the Secondary Mortgage Market* (Dec. 2010).
[7] 12 C.F.R. § 360.6.

area of residential MBS and include such odd constraints as a limitation of residential MBS securitization structures to six tranches and a prohibition on most forms of external credit enhancement.

Importantly, many of the new mortgage market restrictions such as the FAS166/167 accounting rules that generally preclude sale treatment and recognition of gain on sale for U.S. issuers, and the pending Dodd-Frank Act's risk retention requirement on asset-backed securities, which has already been implemented by European regulatory authorities, apply only to securitized loans. Accordingly, a bank may originate and sell whole loans without becoming subject to the risk retention requirement, and still be able to recognize an accounting sale and gain upon a transfer. The regulatory regime, therefore, could incent institutions to originate and sell loans promptly and to leave securitization activities to other market participants. However, the reinstitution of a robust secondary mortgage market for U.S. residential mortgage loans also depends on the availability of balance sheet capacity to hold mortgage assets for an extended period.

Mortgage REITs as Critical Sources of Liquidity

As previously noted, many bank participants in the loan origination, servicing and securitization businesses have become increasingly consolidated in the years since the financial crisis. In addition, the GSEs are under pressure to reduce their portfolios substantially and relatively quickly, which increases the need for additional sources of mortgage liquidity. Given the decreased balance sheet capacity of many traditional funding channels, mortgage REITs have served an increasingly important role by providing much-needed liquidity to primary mortgage market participants. Despite the market challenges mentioned above, during the last few years, mortgage REITs have stepped up their activities and a number of new mortgage REITs have been formed. Notwithstanding the inhospitable public offering market, several mortgage REITs have completed successful initial public offerings (IPOs). These new market entrants provide capital for the full spectrum of mortgage asset types, ranging from single-family residential mortgage loans to commercial mortgage loans, from private-label residential MBS to government-guaranteed MBS and to commercial MBS, and from whole loans to structured finance products.

Especially in a post-financial crisis world, the importance of mortgage REITs to the mortgage markets should not be underestimated. Given the current limitations regarding private funding sources created by constraints in other traditional lending sources, REITs provide an important vehicle for bringing private capital into the mortgage market. Mortgage REITs raised over $30 billion of capital in 88 IPOs and secondary offerings since 2008.[8] In the first part of 2011 alone, they have raised $11 billion, which translates into $71 billion of mortgage demand out of net supply of $203 billion.[9]

As discussed above, mortgage REITs have different business models, but all models serve an important function in the residential and commercial mortgage markets. Many originate and service mortgage loans, which are activities fundamental to "the mortgage banking industry." Others purchase mortgage loans and MBS, and by doing so provide important liquidity in the

[8] Sources: Dealogic and Factset.
[9] Barclays Capital, "SEC Action Threatens REIT demand for MBS," September 20, 2011.

mortgage market. Finally, mortgage REITs securitize mortgage loans—again, an essential activity. In MBA's view, these activities are central to an efficiently functioning mortgage market. Regardless of business model, strategy and organizational structure, the role that mortgage REITs serve is consistent with the legislative intent of Section 3(c)(5)(C) to promote private investment in the mortgage market, while promoting investor protection.

IV. CURRENT STATUTORY AND REGULATORY REQUIREMENTS

The Commission seeks comment as to whether it should take a different direction, and abandon its focus on the plain meaning of the Section 3(c)(5)(C) exclusion, and consider instead the similarities between the activities of mortgage-related pools and those of investment companies. The motivation for doing so would be to enhance investor protections. MBA urges the Commission to refrain from abandoning its current approach by establishing a new test that is likely to be highly subjective. Instead, we urge the Commission to consider the regulatory and oversight framework that already applies to mortgage REITs.

In the Concept Release, the Commission refers to a number of objectives associated with the regulation of investment companies. Investment companies are indeed highly regulated and must comply with restrictions related to leverage and their capital structure, related party transactions, advisory fees, valuation, and custody of assets. These restrictions and requirements are not easily transferable to mortgage REITs.

Mortgage REITs, especially those that are reporting companies that have registered a class of securities and therefore file current and period reports with the Commission, already are subject to a number of substantive investor protection requirements. A mortgage REIT that has a class of securities that is listed or quoted on a national securities exchange or that is otherwise subject to the Securities Exchange Act of 1934 is subject to a comprehensive regulatory system that focuses on ensuring disclosure of material information and strong corporate governance. Mortgage REITs that are public companies are subject to periodic and current reporting requirements, proxy and tender offer rules, and ownership reporting requirements. In addition, such a company is subject to substantive Sarbanes-Oxley Act provisions relating to, among other things, internal controls, director oversight, management accountability and a prohibition on company loans to directors and officers, as well as certain governance and disclosure provisions contemplated by the Dodd-Frank Act. Further, the listing standards of the national securities exchanges also impose substantial corporate governance requirements on the company. Finally, the corporate laws of the state in which the company is incorporated specify standards of responsibility and accountability for the board of directors and management.

Mortgage REITs that are reporting companies must file annual reports which include, among other material information, audited financial statements, management's discussion and analysis of results of operations and financial condition, risk factors, and quantitative and qualitative disclosures about market risk. In addition, management must perform an evaluation of internal control over financial reporting, and the auditors must attest to such evaluation in the audit report, while the company's principal executive officer and principal financial officer must provide certifications with each periodic report affirming the information in the report and the executives' responsibilities with respect to the report, the company's disclosure controls and procedures, and the company's internal control over financial reporting. Annual disclosures are

supplemented by periodic and current reports, which provide financial and other material information concerning the company. A reporting company's periodic and current reports are subject to review by the Commission staff, which must review the company's reports at least once every three years in accordance with the Sarbanes-Oxley Act.

With respect to companies that are subject to the Commission's proxy rules, the annual election of directors and voting on proposals for which shareholder approval is required are conducted in a manner which ensures that shareholders are provided with all material information necessary to make an informed voting decision, including the background, qualification and independence of directors, executive compensation (if applicable), and related party transactions. Likewise, the periodic and current reporting system provides ongoing information regarding the company's assets, capital structure and borrowings which enable investors to make informed investment decisions with respect to mortgage REIT securities.

Beyond the disclosure and internal control requirements of the federal securities laws applicable to public companies, those mortgage REITs with a class or classes of securities listed on a national securities exchange are subject to substantive corporate governance requirements that provide further investor protections for mortgage REIT investors. These protections include listing standards mandating that, subject to certain exceptions, a majority of the board be comprised of independent directors. Moreover, listed mortgage REITs must have, subject to certain exceptions, an audit committee comprised of independent directors meeting a heightened standard of independence. The Dodd-Frank Act also requires that analogous independence standards be applied in the context of compensation committee members, which the Commission currently has under consideration. Depending on the exchange on which a mortgage REIT is listed, additional listing standards also may include specific requirements with respect to, among other things, board committee charters, corporate governance guidelines and codes of conduct.

In addition, the corporation laws of a mortgage REIT's state of incorporation (typically Maryland) impose specific duties, responsibilities and liabilities on the company's officers and directors. As fiduciaries, the officers and directors of the company must perform their duties in good faith and in the best interests of the corporation and its shareholders. Directors and officers are also prohibited, under applicable state law, from diverting corporate opportunities that belong to the corporation, and disinterested director or shareholder approval is required for interested director transactions. State corporate laws also provide for the adoption and amendment of a charter and bylaws which governs the company's internal affairs and corporate governance.

Together, all of these statutes, regulations and listing standards ensure that there is timely public disclosure available to investors regarding the company. These regulations also set heightened standards in relation to executive compensation and corporate governance practices and limit the possibility for self-dealing. MBA believes these strong protections applicable to public companies provide sufficient protection to investors in the securities of mortgage REITs, and we encourage the Commission to maintain this approach to mortgage REIT regulation and oversight.

V. THE STATUTORY LANGUAGE AND CONGRESSIONAL INTENT OF SECTION 3(C)(5)(C) IS UNAMBIGUOUS

We believe that it is important to note the Commission's long-standing view, as expressed in the Concept Release, that Section 3(c)(5)(C) was enacted to exclude from the application of the Investment Company Act those companies that were engaged in the business of acquiring mortgages and interests in real estate. While we recognize that mortgage markets have evolved since the enactment of Section 3(c)(5)(C), we do not believe that this evolution, and the Commission's interpretive approach in light of that evolution, should be revisited at this time. In this regard, we are of the view that the Commission's interpretive approach strikes the appropriate balance between excluding those companies that are not properly regulated under the Investment Company Act, while preserving the Commission's ability to apply the provisions of the Investment Company Act in those circumstances where a company's business model specifically warrants the application of that regulatory scheme.

Section 3(c)(5)(C) excludes from the definition of an "investment company" a company that is "primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." MBA believes the Commission has consistently interpreted the key statutory mandates of the federal securities laws adopted over 70 years ago, including Section 3(c)(5)(C), in a manner that adapts the exclusion to changing market dynamics and transaction structures, including the development of issuers such as REITs and financial products such as MBS.

We believe that, given the unique circumstances contemplated by Section 3(c)(5)(C) and the pace of change in the mortgage markets, it is not surprising that the Commission's staff has largely addressed the specific application of the Section 3(c)(5)(C) exclusion through the no-action letter process, which provides an informal means by which individual circumstances may be evaluated in light of the overall purposes behind the statutory provisions and the Commission's particular concerns with respect to types of entities and assets.

VI. THE COMMISSION'S CURRENT REGULATORY REGIME IS THE APPROPRIATE APPROACH TO ADMINISTERING THE SECTION 3(C)(5)(C) EXCLUSION

MBA Generally Believes that the Staff's Interpretive Approach for Determining the Availability of Section 3(c)(5)(C) is Appropriate and Strikes the Correct Balance

We note that the staff has generally required that at least 55 percent of the company's assets consist of mortgages and other liens on and interests in real estate ("qualifying interests"), and that at least 25 percent of the issuer's remaining total assets consist of real estate-type interests, subject to reduction to the extent that qualifying interests exceed 55 percent. For purposes of this test, the staff of the Commission has appropriately developed guidelines through the interpretative process as to what constitutes "qualifying interests." In this regard, "qualifying interests" have included:

> Assets that represent an actual interest in real estate or are loans that are fully secured by real estate, which include, for example, fee interest real estate holdings, fully secured mortgage loans, second mortgages secured by real estate, a deed of trust on real property, installment land contracts and leaseholder interests secured by real property;
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> Participation interests in a mortgage loan that is fully secured by real estate, provided that the holder has the right to foreclose on the mortgage loan underlying the participation in the event of a default on the mortgage;
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> "B-Notes" in commercial real estate first mortgage loans; and
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> Any assets that are functionally equivalent to, and provide the same economic experience as, an interest in real estate or a loan or lien that is fully secured by real estate, including, for example, agency whole pool certificates that are issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae.

While the Commission's staff has sought to interpret Section 3(c)(5)(C) in a manner consistent with the original intent, we note that the staff's interpretation has limited the concept of "qualifying interests" in several important respects. The staff's no-action positions have limited the term "qualifying interests" to exclude securities issued by REITs, limited partnerships and other entities investing in real estate. Moreover, the staff's approach has indicated that those loans where at least 55 percent of the fair market value of the loan was secured by real estate at the time the loan was acquired by the issuer, as well as agency partial pool certificates, would not be considered qualifying interests; however they could still be determined to be real estate-type interests for the purposes of the 25 percent test.

In the Concept Release, the Commission notes that mortgage-related pools have also determined that other asset types could constitute qualifying interests, such as bridge loans, certain types of construction and rehabilitation loans, wrap-around mortgages, and distressed debt secured by real estate. In some instances, a convertible mortgage has been deemed to constitute both a fully secured mortgage loan that is a qualifying interest, as well as an option to purchase real estate in the form of a real estate-type interest. The Commission also notes the divergence in treatment of certain commercial MBS, which are treated by some mortgage pools as real estate-type interests, while others treat certain commercial MBS as qualifying interests.

MBA is of the view that the Commission's approach in the administration of Section 3(c)(5)(C) has been principled, and generally strikes an appropriate balance in differentiating those companies that should be regulated as investment companies and those companies that should be treated as non-investment companies given their focus on real estate-related activities. While the Commission could have taken a markedly different approach and adopted prescriptive rules, or perhaps safe harbor rules, for ascertaining how Section 3(c)(5)(C) should be applied, it has proven more effective to address specific asset types and structures as they develop through time, under all circumstances seeking to follow a principled approach when making those judgments. We do not believe that if the Commission had chosen a different course (or if it were to choose a different course today), such as adopting prescriptive rules addressing qualifying interests or real estate-related assets, or if the Commission were to adopt a totally different test, that the approach would be sufficiently flexible. In fact, if prescriptive rules were to be adopted, it is foreseeable

that the Commission would face the conclusion that the standards would be interpreted either too broadly or too narrowly, with the added risk that any adopted rule would prove obsolete immediately after its adoption, as the markets have and will continue to evolve rapidly.

The Staff has Appropriately Limited the Applicability of the Section 3(c)(5)(C) Exclusion to Entities that "Primarily Engage" in the Mortgage Business

We note that the above-referenced asset-based test that the Commission staff has consistently applied in its no-action letters has appropriately focused on the demonstration by a subject company that more than a majority of the entity's assets constitute mortgages and similar qualifying interests. The statutory provision and the staff's administration of the provision recognize that an entity need not focus exclusively on mortgages and similar qualifying interests, and that the presence of some other assets not meeting such categorization would not trigger the application of the Investment Company Act.

If the Commission were to revisit its approach for determining whether an entity is primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate, we are concerned that such a change would harm the market that has been structured in recognition of this long-standing and sensible standard.

The Staff's Approach to "Qualifying Interests" and "Real Estate-Type Interests" Has Drawn an Appropriate Line Between Mortgage and Other Real Estate-Related Assets and Securities that Would Lead to Regulation as an Investment Company

In seeking to consistently apply a standard focused on entities that should properly not fall within the investment company regulatory framework in accordance with the Section 3(c)(5)(C) exclusion, we believe that the staff's focus on the economic or investment experience that derives from the mortgage, interest in real estate or similar interest represents a strong principled approach to distinctions in regulatory treatment. By following this approach, the staff has been able to adapt the exclusion to a changing marketplace where the types of interests and the types of entities that own those interests continue to change.

We do not believe that the Commission could develop, through the rulemaking process or otherwise, a comprehensive list of qualifying interests and real estate-type assets that could adequately reflect all of the variations in ownership and lending practices without constant revision and reconsideration of such a rule. Moreover, should any such specific rule be developed, interpretive issues would inevitably arise and the staff would likely be considering those same issues through the no-action letter process or observing different practices in the marketplace.

The No-Action Letter Process Remains the Most Appropriate Means for Administering the Section 3(c)(5)(C) Exclusion

While the investing techniques and the organizational structures of the companies that rely on the Section 3(c)(5)(C) exclusion may have changed over time in response to market developments, their investment focus has not changed. These companies still engage in the mortgage finance business. Moreover, these companies already are subject to a regulatory framework that

promotes transparency of disclosures, ensures oversight and accountability, and requires fair valuations.

Rule 1(d) of the Rules Regarding Informal and Other Procedures indicates that, while opinions expressed by the Commission's staff do not reflect an official expression of the Commission's views, "they represent the views of persons who are continuously working with the provisions of the statute involved." Further, the rule says that "any statement by the director, associate director, assistant director, chief accountant, chief counsel, or chief financial analyst of a division can be relied upon as representing the views of that division." Thus, persons receiving favorable no-action, interpretive or exemptive relief can have a high degree of confidence that they can proceed as planned without any adverse action by the Commission or the staff of the Commission.

We note that others may seek to rely on the outcome in a staff no-action position or interpretive response in analyzing their own similar facts. In this regard, the Commission acknowledged in note 4 of Release 33-6253 that "members of the public are entitled to rely on no-action and interpretive letters as representing the views of the Division." That said, it is recognized that a tension exists in ascertaining whether to rely on the staff's views as expressed in prior letters, or whether a company needs to obtain its own no-action letter.

When going forward with the administration of Section 3(c)(5)(C), we believe that it would be important for the staff of the Commission to respond to all requests related to the applicability of the Section 3(c)(5)(C) exclusion, regardless of whether the outcome is positive or negative for the requestor. In our view, this historical approach in the consideration of these no-action letters provides appropriate guidelines for determining what meets the exception's standards, and what does not. Moreover, we believe that this approach to responding to no-action requests can serve to reduce the incidence of overly broad or overly narrow interpretations of the statute that the Commission is concerned with today. We also suggest that it would be helpful for Commission staff to publish a staff bulletin in this area, which could be updated regularly, and would summarize the views taken by the staff on many Section 3(c)(5)(C) matters during the course of the staff's review of filings or otherwise. This would provide greater transparency for market participants and reduce the possibility of confusion regarding the staff's view on an interpretive matter.

We support the staff's approach of providing guidance through the issuance of no-action letters and believe that this approach has provided sufficient certainty for market participants and permits thoughtful consideration of novel interpretive questions without the disruptive and chilling effect that may result from broad rulemaking in the area.

VII. THE COMMISSION SHOULD CAREFULLY CONSIDER THE POTENTIAL COSTS ASSOCIATED WITH ANY CHANGE IN APPROACH ON SECTION 3(C)(5)(C)

Absent more compelling circumstances than those that the Commission has articulated in the Concept Release, we do not believe the costs associated with any change to the approach on Section 3(c)(5)(C) could be justified. We are concerned that the Commission's Concept Release has come at a time when the Commission should be particularly focused on restoring confidence and liquidity to mortgage markets through continued certainty regarding the inapplicability of the

Investment Company Act to mortgage REITs and other similar mortgage-related pools. We are concerned that any suggestion that the Commission could change its approach creates a risk that the costs of compliance for mortgage-related pools could increase, and that could in turn quell both near-term and long-term innovation in mortgage and real estate-related interests and the entities that invest in such interests.

In considering any action related to the Section 3(c)(5)(C), the Commission is charged with balancing investor protection with concerns related to "efficiency, competition and capital formation."[10] Particularly at this time, and at least until the regulatory framework applicable to mortgage products, mortgage origination and securitization, and the secondary mortgage markets have been clarified, it would be extraordinarily difficult to make any assessment of the costs and benefits associated with a new approach to Section 3(c)(5)(C). MBA also notes that the ability to employ leverage is important to maintaining liquidity in the real estate finance system. A change in approach on Section 3(c)(5)(C) could result in mortgage REITs being required to reduce their leverage, which has the potential to alter the business of many such entities. Such a change has the potential to reduce investor interest in mortgage REITs, thereby restricting a critical source of liquidity.

VIII. CONCLUSION

We conclude where we began. The Section 3(c)(5)(C) exclusion was premised on a public policy objective of encouraging investment in the mortgage and real estate market. Although mortgage REITs have long been an important component of the real estate finance system, current market conditions have shed light on the truly pivotal role they play. It is difficult to imagine that there might ever be a greater sense of urgency to use the resources that are already available to us to encourage investment in the mortgage market.

Notably, we are concerned that prolonged uncertainty regarding Commission actions following this Concept Release will negatively impact mortgage REIT activity. We respectfully request that the Commission provide an indication of how it plans to proceed with the Concept Release once it has reached a determination on this matter.

Policy makers are looking for ways to encourage private capital to return to the real estate finance market. We believe the Commission's Concept Release runs counter to this objective because of the regulatory uncertainty and compliance challenges it would impose, as well as the potential constraints on much needed liquidity in current market conditions.

[10] Section 2(c) of the Investment Company Act of 1940.

We therefore respectfully request the SEC to affirmatively withdraw and refrain from taking further action on the Concept Release. Thank you again for the opportunity to provide input on this important matter, and MBA appreciates the Commission's consideration of our views

Sincerely,

David H. Stevens
President and Chief Executive Officer
Mortgage Bankers Association